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No. MCS/149/2019-21 / R.N.I. No. MAHENG/2012/47041 - Total Pages: 156

THE CHAMBER'S JOURNAL

Vol. VII | No. 4 January 2019

YOUR MONTHLY COMPANION ON TAX & ALLIED SUBJECTS

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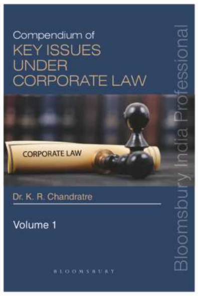
Just released! The most comprehensive book on key issues under corporate law

Compendium of Key Issues under Corporate Law



With the rapid change in statutory environment, Corporate Law has also been evolving at a faster pace from past several decades. The present book is a compendium of key issues under corporate laws covering a wide spectrum of subjects under corporate laws, in two volumes.

This book brings out issues in Corporate Law covering aspects that professionals face in practice. Legislation and case laws from other jurisdictions have been analysed to provide insight into the issues.

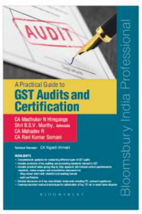
- Topic-wise detailed analysis of various Corporate Law issues.
- A detailed analysis of statutory provisions along with relevant judicial pronouncements and provisions of allied laws (wherever applicable) for each topic has been provided; e.g. SEBI Act and various Regulations issued by the SEBI.
- Provides comparative position of various topics between Companies Act, 2013 and Companies Act, 1956.

Dr. K. R. Chandratre

Pages 2924; Price for set of 2 volumes – INR 5250/-; December 2018

The most updated book for GST Audits

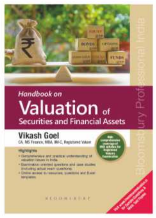
A Practical Guide to GST Audits and Certification



The book has been written with a perspective to enable taxpayers to comply with applicable laws. The vast experience of the four authors in consulting, adjudicating, judging and implementation of indirect taxes would help professionals implement GST provisions and get audit done in an easier way.

CA Madhukar N Hiregange, Shri B.S.V. Murthy, CA Mahadev R and CA Ravi Kumar Somani; INR 995/-

Handbook on Valuation of Securities and Financial Assets

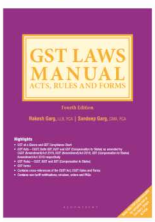


This book is designed keeping in mind the dual needs of a professional who is preparing for the Registered Valuation Examination and a practicing or aspiring valuer. The book would be immensely useful for the chartered accountants, company secretaries, lawyers and management professionals (e.g. MBA-Finance) while undertaking the valuation examination as it gives the provisions of different statutes covered under Valuation examination syllabus in a summarised manner.

Vikash Goel, CA, MS Finance, MBA, IIM-C, Registered Valuer

INR 1,295/-

GST Law Manual – Acts, Rules and Forms (4th edition)

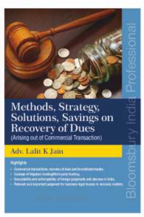


Part A: At a Glance; Part B: Central GST Act, Rules and Notifications; Part C: Integrated GST Act, Rules and Notifications; Part D: GST (Compensation to States) Act, Rules and Notifications; Part E: GST Forms; Part F: Other relevant Legislation

Rakesh Garg and Sandeep Garg

INR 1,495/-; December 2018

Methods, Strategy, Solutions, Savings on Recovery of Dues



This book mainly covers the various methods of recovering the dues arising out of Commercial and Non-Commercial Transactions. The book would be immensely useful for Litigation Lawyers, In-House Legal Departments, Law Students and Finance professionals such as Chartered Accountants & Management Consultants.

Adv. Lalit K Jain

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National Company Law Tribunal and National Company Law Appellate Tribunal – Law, Practice & Procedure (Sixth edition)

This book will equip professionals with necessary knowledge tools to practice in NCLT/NCLAT, acting as their non-verbal guide. Whether it is oppression and mismanagement cases or winding up/liquidation matters, mergers/de-mergers, or class actions or an insolvency case, this book helps find answers to most practical problems.

Prachi Manekar Wazalwar

INR 1,995/-; December 2018

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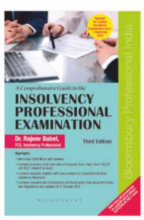

Complete coverage of MCQs on syllabus notified with effect from 1 November 2018:

The Insolvency and Bankruptcy Code, 2016 (with updated text till 31 October 2018); Rules and Regulations under the Bankruptcy Code; Relevant Chapters of the Companies Act, 2013 (with updated text till 31 December 2018); The Partnership Act, 1932; The Limited Liability Partnership Act, 2008

Dr. Rajeev Babel

INR 2,295/-; November 2018

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The Chamber's Journal

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

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

Editorial

Wish you all a very happy, prosperous and peaceful year 2019. The special story for the month of January issue of The Chamber's Journal is on 'Fund Raising for Corporates'. Esteemed professionals have contributed on various issues covered under the above mentioned title. The increase in regulatory interference in the activities of corporates makes it absolutely necessary that we professionals are abreast with all the important developments. It is good governance, when government itself does not get into business and it merely regulates the same. But when there are too many regulators then the businessman is hassled by over regulation.

The present government has shown interest in reforms and has taken major steps in that direction. Of late the steam is depleting. The introduction and passing of The Constitution (One Hundred and Twenty Fourth Amendment) Bill, 2019 at neck breaking speed shows that the entire system has got into election mode. It was noticed during the course of the debate on the floor of the house, that everybody was opposed to the timing of the Bill but none opposed it for its contents or on the ground of a wrong policy. The political class is using the policy of reservation as a tool to garner votes. It is hardly concerned whether reservations are yielding desired social dividends or not. One of the arguments to justify the Bill was to assuage the feeling of alienation by a section of the society. The justification itself is an answer to the question how effective the policy of reservation was. The policy of reservation is no more a tool for social transformation of the backward sections of the society. It is now merely a political tool which yields electoral dividends. The Government may not desist from the so called populist measures which retard the pace of reforms. The General Elections take place every 5 years and assembly elections for different states in the country all through this period. This puts the governments in perpetual election mode and governments are not prepared to take harsh decisions. When the political class know we fall for the doles, they will not be interested in governance. They will divert our attention with doles and they are going to grind their own axe. We have to send a stern message that we are not going to fall for doles. The political class should be made aware that they can impress the electorate by performance or else they have to perish.

I thank all the contributors to this issue for sparing their valuable time. Once again Happy New Year to all.

K. GOPAL
Editor

From the President

experiența este învățătorul tuturor lucrurilor

… is a famous Roman quote by Julius Caesar which means – ***Experience is the teacher of all things!***

My Dear Members,

I wish you all a very Happy and a Prosperous new year. With 2019 swinging in, I pray and hope well-being for all my members, friends and stakeholders. May each day of 2019 be blessed with rays of hope, joy, love, knowledge, progress, health and sunshine. Bidding 2018, an adieu – it brings me pride to happily express that the Chamber was instrumental in spreading knowledge by holding various seminars and conferences along with partnering the government in various issues at various stages! Just as fruitful and impactful, 2018 has been for us – I hope to see our esteemed institution reach newer heights, open new arenas for us to reach and excel.

This year has a series of interesting events lined up, the most notable one being – the General Elections which is considered as the largest show on earth where a hundred and twenty crore Indians will vote for 543 seats, followed by some other global events some of them being – the ICC Cricket World Cup, the FIFA Women's World Cup, the Rugby World Cup, the European Parliament election, final call on Brexit etc. In a nutshell, I foresee 2019 as a revolutionary and an eventful and exciting year.

Learning is a continuous process and is something which can never be stopped. In Mahatma Gandhi's words – "Live as if you were to die tomorrow, learn as if you were to live forever!" for, learning is the only key to experience and experience is one of the main mantras of a successful man. In Oprah Winfrey's words – "Turn your wounds into wisdom!" and that can happen only when we develop the ability to learn from our experiences. It is thus said, failing before succeeding is more important because success might give us pride, while failure gives us experience! History is evident, successful men have conquered positions while experienced men have conquered lands! We, at the Chamber through an experience of nearly nine decades have known that there is no knowledge without learning and no learning without experience and thus, I would like to spread this word and ask my members to follow the moto of – "Carpe Diem!" which means – "Seize the Day!"

While, we talk about experience – it was this experience that helped one single man to draft the Constitution of one the largest Democracies in the world. While, we enter 69th Republic day this January, 26th – I would like to urge and convey to my countrymen to use the fundamental rights righteously and constitutionally and to obey, follow and respect the fundamental duties responsibly to help this great nation, see a new dawn!

Talking about our nation, one of its notable features are its festivals which are full of colours and light! This month, on the 14th will see a grand celebration of *Makarsankranti*. Through the years, this festival has reached the masses and is famous as the kite-flying festival but a lesser known fact about this festival is that it is observed according to solar cycles. Being a festival that celebrates the solar cycle, it almost always falls on the same Gregorian date every year – the 14th January. Also, this is that one rare festival in India, which is known by differing names in different parts of the country. While in North India it is called Maghi, in Assam it is called Magh Bihu and in Tamil Nadu, Pongal.

CTC Events

This month will see a range of events from cultural to educational. **"Surila Yarana"** is a musical evening of togetherness for and by the members of Chamber, their families and student members scheduled on the 11th January, 2019. I have witnessed preparations and rehearsals and hard work put in by Bhavesh Joshi, Vijay Bhatt, Kishore Vanjara, Varsha Galvankar and many others. I expect melodious evening

This month will also see a CTC Box Cricket Tournament on the 12th January. Cricket is like running an organization – it needs team work, motivation, strategy, flexibility, risk assessment. To lighten the mood post tax season, the Chamber is organising the 5th edition of the **CTC Box Cricket Tournament with record 30 boys teams and 6 girls teams playing,**

As much as sports, vocal skills are equally important for the overall personality development of an individual. Debate is the art of dialectic, that puts questioning, reasoning, critical thinking and logic at the heart of the trivium. These are all essential attributes of a great education and to be able to do them well can help ensure that young people perform well academically and indeed, socially. Keeping this in mind, the Chamber is pleased to announce a **Debate Competition with HR College of Commerce & Economics for college students on 18th & 19th January** at the H.R. College premises. We expect atleast 25 to 30 colleges to participate in this event.

The registrations for the **5th International Study Tour to Central and East Europe** have now been closed. This year saw an overwhelming response with approximately 90 members registered and we look forward to see a successful and memorable trip.

This month, the Chamber's iconic event – **The Dastur Essay Competition** has been announced for Law Students and Article trainees, where essays on current topics are invited and then the same are judged by senior professionals. We, at the Chamber believe that young students are the future leaders of our nation. Writing, a dying art today, is an important tool for encouraging the young fresh minds with novel ideas to express themselves on topics of professional interest. I would urge all young minds to participate in this competition.

Both RRCs are receiving overwhelming response from members and we shall close registrations for them. Members are requested to register to avoid disappointment.

Our joint initiatives with various sister organisations on **Workshop on GST Law** will begin from 17th January and will be end with Brainss Trust session on 14th March.

Chamber has also organised its **Lecture Meeting on TDS PROCEDURES COVERING ISSUES ON PROCESSING BY CPC** on 29th January with presentation by TDS department Mumbai, CPC Bengaluru and CPC Ghaziabad. Members are requested to send their queries in advance.

Special Story for January, 2019 on **"Fund Raising for Corporates"** will be useful for members to advise their clients for various funding options. It covers entire gamut of subject of fund raising. I thank Mr. Makarand Joshi, Company Secretary for preparing the design and structure of this special story and also authors who have made timely contribution.

Grazie

(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.

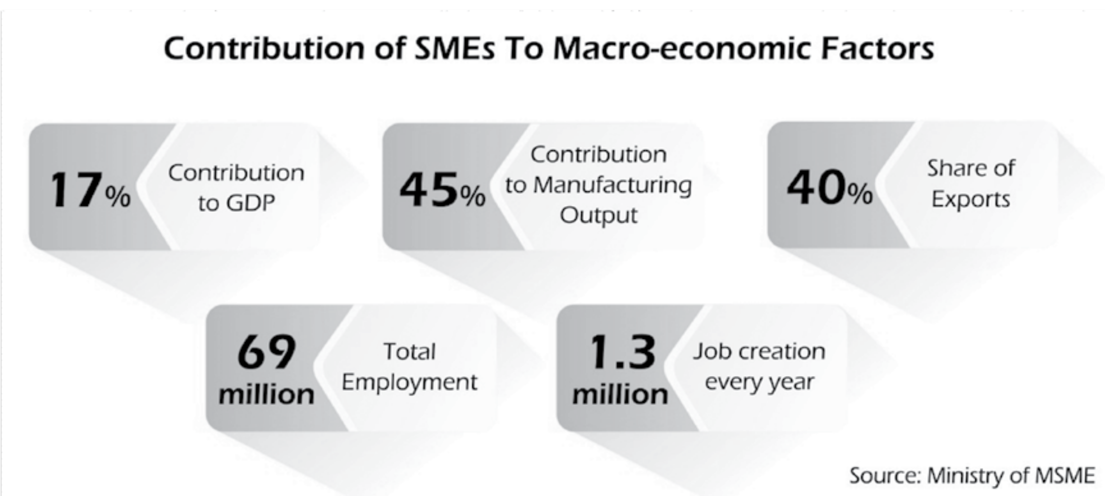
Mahavir Lunawat, Investment Banker

SME Listing and Start-up Listing – New ways to Enhance Value and bring Sustainability

India's emerging business ecosystem is currently at a cusp of transformational growth and expected to grow to USD 5 trillion economy by 2025 i.e., at growth rate of 8 per cent, fastest in Asia. To achieve this aspirational target, economy aims inclusive growth especially in the emerging sector.

As per the estimate there are more than 2.6 crore MSMEs in India. Governments, policymakers and institutions across the globe recognising the role of emerging businesses in the development of economies, have been encouraging them in different ways. This enablement is for the fact that SMEs are significant to the overall economic growth. In India itself, SMEs contribute around 29% of the GDP and up to 40% of the country's exports.

The emerging business sector, broadly christened as MSMEs, is the engine driving the economic growth. This sector in India is growing at an exceptionally fast pace and has truly become the backbone of India's growth story.

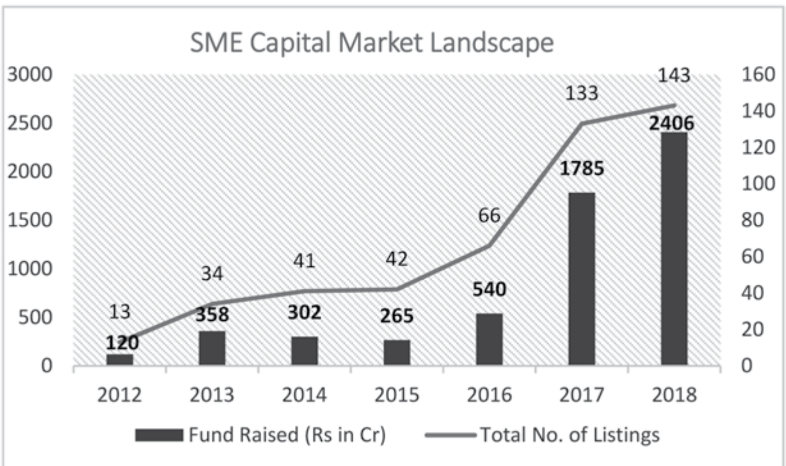


This unorganised sector is the most dominant business in the world today but has been excluded from the mainstream economy. Hence, the need for formal institutions to support the informal sector becomes more crucial.

But one of the biggest challenges faced by this sector is finding the right source of finance. Attracting funds from conventional sources like banks and financial institutions is a bigger challenge. And sourcing funds through private sources like sale of assets, ancestral capital, personal savings, loans from relatives, loans from unregulated markets also turn out to be inadequate. To empower this unorganised sector, and bridge such financing gaps India's Alternate Investment Market was born out of the PM's task force and SEBI recommendations in 2010 whereby BSE SME and NSE EMERGE were then launched in 2012 and 2013 respectively.

SME Listing

Indian SME exchanges since inception have witnessed stellar growth, with around 472 progressive businesses listings, raising funds around ₹ 5,796 crore commanding market-capitalisation of around ₹ 31,000 crore.



Among these, 59 companies have migrated from SME exchange to the mainboard. This reposes the fact that SME listing is the first step to grow bigger and larger. And indeed SME exchanges have been successfully financing the emerging businesses which have the potential to become tomorrow's blue-chip companies.

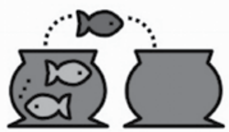
SME Listing Criteria and Eligibility Norms

SEBI Requirements

- Post issue paid up capital shall be maximum ₹ 25 crore
- Minimum application amount / trading lot is ₹ 1 lakh
- Minimum IPO size of 25% of post issue capital with minimum 50 investors
- Mandatory Market making for 3 years, with share inventory of 5% of IPO. Total buy obligation: 25% of IPO

Eligibility Norms of Listing on BSE SME

- The company shall have positive networth
- It should have a track record of at least 3 years
- It should have positive cash accruals (earnings before depreciation and tax) from operations for at least 2 financial years preceding the application



Migration Norms

- Paid-up Capital of at least 25 crore

  Note – should arise only because of merger/acquisition/expansion purpose; not via bonus issue)
- Minimum Market Cap of ₹ 100 crore
- Minimum Revenue of ₹100 crore
- PBT of at least 10 crore for 2 out of 3 preceding years

Eligibility Norms of Listing on NSE Emerge

- The company has a track record of at least 3 years
- Positive cash accruals (EBDT) from operations for at least 2 of the 3 immediately preceding financial years.

Migration Norms

- Post issue paid up capital shall be maximum ₹ 25 crore
- Minimum application amount/trading lot is ₹ 1 lakh
- Minimum IPO size of 25% of post issue capital with minimum 50 Investors
- Mandatory Market making for 3 years, with share inventory of 5% of IPO

SME Listing is a global phenomena

The development of the SME sector has become a world phenomenon. There are more than 40 SME exchanges world over. Some of the major global SME exchanges are AIM (UK), MOTHERS (Japan), GEM (Hong Kong) and CATALIST (Singapore). SME exchanges or trading platforms are globally albeit known by different names, such as 'Alternate Investment Markets' or 'Growth Enterprises Market', 'SME Board' etc. Whatever the name be the objective is to promote progressive entrepreneurial ecosystem.

Global SME Exchanges	Inception Year	IPOs between Jan-Jun 2018	IPOs Since Inception	List M-Cap (USD Mn)
BSE SME & NSE EMERGE	**2012-13**	**88**	**472**	**3,536**
GEM (Hong Kong)	1999	50	377	1,965
MOTHERS (Japan)	1999	27	271	12,178
AIM (UK)	1995	28	3141	3,214
CATALIST (Singapore)	2007	5	207	466

Notably, Indian SME Capital Market is growing at light speed, surpassing many of its global peers. Indian SME bourses have recorded stellar activity in the first six months of 2018. 88 SMEs were listed between January-June 2018 – Highest Globally!

SMEs create value

Since inception in 2012, SME markets have been gradually growing. S&P BSE SME IPO has clocked CAGR of approximately 39% on consolidated basis. Pantomath SMEX – 30 has clocked returns at the rate of 80% CAGR for the last five years. A comparative analysis of market indices shows that SME companies have delivered highest returns. The table below shows a comparative analysis of key indices in India *vis-à-vis* SME indices.

Year	Pantomath SMEX-30*	S&P BSE SME IPO	S&P BSE SENSEX	S&P BSE SmallCap	S&P BSE MidCap	Nifty 50	Nifty SmallCap 50	Nifty MidCap 50
Dec, 2013	100	451	20,716	6,131	6,303	6,168	1,664	2,153
Mar, 2014	118	742	22,386	7,072	7,083	6,704	2,013	2,465
Mar, 2015	237	748	27,957	10,890	10,592	8,491	3,102	3,374
Mar, 2016	210	768	25,342	10,542	10,619	7,738	2,655	3,201
Mar, 2017	471	1,289	29,621	14,434	14,097	9,174	3,823	4,384
Mar, 2018	1261	1,854	32,969	16,994	15,963	10,114	3,995	4,975
CAGR	80.33%	38.95%	11.42%	26.77%	24.13%	12.19%	22.59%	21.52%

Benefits of Listing

Listing on exchange creates sustainable development of business environment. It is a virtuous cycle of formalisation offering several benefits:

Operational Benefits

Opportunity to imbibe Corporate Governance

Listing is a great opportunity to help small and unorganised companies to formalise thereby immunising them to compete with the larger companies. Though the requirements for a company listed on SME Exchange are not as stringent, but it is adequately drawn up so as to incentivise the company for putting in place the internal control systems and corporate governance. Such governance controls in the form of routine compliances become a part of the company's day-to-day existence. Timely disclosure of financial information helps in building investor confidence and leads to improved governance.

Usually small and medium enterprises escape the rightful disclosures and this in turn increases the probability of illegalities. But listing leads to formalisation and becomes a part of organised sector.

A gateway to mainboard

The listed SMEs can migrate to the mainboard on completion of 2 years and/or on meeting other requirements. Hence, SME listing is the first step for entrepreneurs to enter into the larger markets. As on date, 59 SMEs have migrated from the SME exchanges to the mainboard exchange in last 6 years, thereby writing their growth story. For instance, Rudra Global Infra Products Ltd., engaged in manufacturing of superior quality TMT bars and billets was initially listed on SME platform in July 2015 and then migrated to BSE Mainboard Platform in December 2017. Further, the company has created wealth with its market-cap of ₹ 467 crore from the initial market-cap of ₹ 71 crore that is 7 times greater.

Greater brand visibility which rebuilds the Stakeholders' comfort

One of the biggest benefits of listing is that it helps these companies to rebuild their brand and spread awareness. Listing adds to the comfort of stakeholders such as customers/lenders/creditors of the company, which in turn, often, results in increased order book, better negotiated business terms like credit period, margin requirements, less-onerous contractual covenants etc. This becomes extremely crucial for companies from niche backgrounds like robotics, bio-technology and so on for whom finding right credit gets even tougher.

Additionally, listed companies are recognised better and are followed by investors and analysts which leads to enhanced public awareness as their information is available on public forum.

Utilisation of funds raised

Listing provides access to capital with equity infusion which is a direct growth driver. The companies can utilise the growth capital either for further expansion, diversification, acquisition or to meet some debt obligation. For instance, a Gujarat based company, manufacturer of CNC Machines (Computer Numerical Control) - a process used in the manufacturing sector which involves in using computers to control machine tools including lathes, mills, routers and grinders got listed in March 2018, raising equity growth capital of around ₹ 36.61 crore. Within 5 months of listing the company successfully achieved its objective of the issue and has completed phase 1 of 3 phases of expansion. Moreover, the company and inaugurated 3 Tech Centres across India namely in cities like Pune, Kolkata and Ahmedabad. Its current market-cap of ₹ 147.12 crore is three times the listed market-cap of ₹ 40.60 crore. Thus, the funds raised can be further used for business expansion.

ESOPs – Talent retention tool

ESOPs, typically serve as a tool for retaining/incentivising the talent and also act as a wealth creator for employees. The benefits of listing can be attributed to unlocking the value of the company and making ESOPs effective, thus aiding to talent retention.

Financial Benefits

Easy further financing tool

Post listing these companies are well-equipped to exploit other avenues of raising capital such as rights issue, further public offerings, preferential issues, qualified institutions placements (QIP) and other national and international fund raising instruments, such as FCCBs, ADRs and GDRs etc. Moreover, listed shares can be used as collateral to raise further funds in the forms of FPO, Rights Issues, and Preference Shares.

Currency Value

Listed shares, helps them build in the market and act as currency. They can be used as collateral to raise funds. Listed securities act as a viable M&A currency and help avoid the cost and time involved in M&A transactions.

Reduced cost of borrowing

Listing often leads to improvement in credit rating, which in turn enables to negotiate better loan terms from financial institutes. Banks and Financial institutions prefer providing financing solution to listed companies as against unlisted ones.

Tax Benefits

No tax on equity infusion in the company

As per the Finance Act, 2012, a company is liable to tax on equity infusion, if the equity shares are issued to an investor other than a registered venture fund at premium exceeding the fair price. Such a tax is not applicable in case the shares are listed.

Listing provides numerous benefits to SMEs. Post tax returns of a listed company could be expected to be greater than an unlisted company.

No tax on distressed business purchase

As per the Income-tax Act, there lies a tax liability on the investor if the shares of an unlisted company are bought below its book networth. Such a tax incidence is mitigated if the shares are listed.

No tax on buy-back of shares

Unlisted companies are subject to 20% tax on buy back of shares. Such a tax is not applicable if the shares are listed.

Start-up Listing – Innovators Growth Platform

On the other hand, to further boost the development of start-ups the market regulator, SEBI recently relaxed listing norms for new-age ventures in sectors like e-commerce, data analytics and bio-technology to raise funds and get their shares traded on stock exchange - Innovators Growth Platform. This platform is a recreation of Institutional Trading Platform which was a part of SME exchange for listing and trading of specified securities of small and medium enterprises for informed investors. Through ITP, a company was not required to adopt IPO (Initial Public Offer) route. In other words the listing was at much relaxed norms. Promoters and pre-listing shareholders of the company do not have to dilute their shareholding.

As per the new norms, 25% post issue holding by any individual person or a collective holding by persons is to be deleted. Also the minimum application size and minimum trading lot is to be ₹ 2 lakh and in multiples of ₹ 2 lakh thereof instead of ₹ 10 lakh set earlier. Further, there would not be any requirement of minimum reservation of allocation to specific category of investors and minimum number of allottees will be 50. Minimum net offer to public should be in compliance with Minimum Public Shareholding (MPS) norms and minimum offer size shall be ₹ 10 crore. 25% of the pre-issue capital, of the Issuer Company for at least a period of 2 years, should have been held by either Qualified Institutional Buyers, Family Trust with net-worth of more than ₹ 500 crore or Category III Foreign Portfolio Investor; a pooled investment fund with minimum assets under management of USD 150 million and or Accredited Investors (AIs). Accredited Investors (AIs). AIs for the purpose of IGP, include, any individual with annual total gross income of ₹ 50 lakh and minimum liquid net worth of ₹ 5 crore or any corporate body with net worth of ₹ 25 crore. Moreover, not more than 10% of the pre-issue capital may be held by accredited investors.

Such reforms reflect Government's firm stance to revive the emerging businesses sector. Such listing reforms are welcome and believe that this platform will enable the new age entrepreneurs with financial empowerment. This new platform is believed to provide financial aid to future unicorns of India just like the SME platform.

To Conclude

Market situation at present is uncertain and factors which fuel this uncertainty are trade war, depreciating rupee, rising crude oil prices and expanding current account deficit (largest since 2013) markets may be on a topsy-turvy roads. With rise in global geo-political tensions, subdued market conditions, low liquidity investors woes are increasing.

Listing indeed creates value not only for the companies but also for the economy at large. These new forms of financing create sustainable business ecosystem thereby, building a feasible business environment. SMEs are not only large scale employment generators at comparatively lower capital cost than large industries but also help in industrialisation of rural regions, thereby, reducing regional imbalances, assuring more equitable distribution of national income and wealth. SMEs are complementary to large industries as ancillary units and this sector contributes enormously to the socio-economic development of the country.

The growth of SMEs is enabled through policymakers' attention to support by providing easy access to finance, implementation of better regulation and encouraging SME investment. And fostering SMEs and start-ups with financial support will indeed create sustainable business environment in long-run.

Tejas Davda, *Company Secretary & Compliance Officer*

Raising of Capital in Bond Market

In the pre-globalisation era, when the paradigm of State-initiated mixed economic development dominated the minds of development economists and policy makers, developing countries like India favoured a capital market structure having an overwhelmingly large commercial bank sector—mostly publicly owned. The reason for such a preference is rather obvious. Given the approved industrial policy, a relatively large and centrally controlled banking system would apparently serve as a powerful instrument for achieving the targeted pattern of economic development. The shortcomings of such a view are too well-known today. An over-sized, mostly publicly owned and controlled banking system would often amass huge deposits and channel these to prefer investment plans charging administered interest rates (generally set below the rate that would have cleared the market). Such lending decisions would often be taken violating prudent banking principles. Operating in an environment of State-protection and being heavily leveraged, such a banking system would accumulate bad loans, and more importantly, prevent development of other segments of the capital market.

As is well-known, in a situation where the capital market has all the three segments, three different kinds of funding for investment may, in principle, be available to business firms—viz., issuance of equity and/or bond and bank lending. Now, if the banking system is largely publicly owned, overreaching, highly regulated and dominates the other segments, bank lending to business firms may frequently go bad and become unrecoverable. This is because banks, operating under virtual state guarantee, may frequently miscalculate lending risk and misdirect loans to investment demands that are not among the most productive ones.

In contrast, when a well-developed bond market with a sizeable corporate bond segment exists alongside the banking system, it is likely that funds will flow in the right direction in accordance with the productivity of individual investment demands. This will be so essentially for two reasons—viz., (1) a developed and freely operating corporate bond market will judge the intrinsic worth of investment demands better in view of the disciplinary role of free market forces and (2) the corporate bond market will exert a competitive pressure on commercial banks in the matter of lending to private business and thus help improve the efficiency of capital market and the economy as a whole.

Within any country's capital market, it is essential that there exists a well-developed bond market with a sizeable corporate bond segment alongside the banking system, so that the market mechanism ensures that funds flow in accordance with the productivity of individual investments and the market exerts a competitive pressure on commercial banks' lending to private business and helps improve the efficiency of the entire capital market. Further, the debt market must emerge as a stable source of finance to business when the equity markets are volatile. While the corporate bond market is small as compared to the government bond market, the growth seen in this space is worth noting. Historically, corporates have primarily depended on banks for their sources of funding. With banks taking a back seat due to various issues like high cost of funds, Non-Performing Assets (NPAs), stress in the balance sheet, etc., better rated corporates started tapping the bond markets because of the lower cost of funding in these markets. Lower deposit rates, the lack of tax free bonds, tax efficient return from debt funds ensured large flow of funds into their debt schemes. This phenomenon continued over the last few years and as a result we see much more liquid and vibrant credit markets.

Generally a domestic capital market has several segments—viz., commercial banks, the equity market, non-banking financial institutions and the bond market. What should be the nature of composition of the capital market for a given economy is largely a policy matter, although policies alone cannot determine the compositional structure of the market. In most countries the debt market segment of the capital market develops later, as the financial sector becomes mature.

The global scenario for business investments debt capital is generally considered to be more suitable for large-scale, long-term financing of fixed assets and investments, whereas bank loans are thought to be more appropriate for financing short-term investments in working capital, inventories and other current assets. Equity capital is usually costlier than debt, as investors would expect a risk premium and hence a higher return on equity investment over that from a comparable debt investment.

Issuing Bonds: Immediate Cash for Debt with Interest

Rather than exchanging equity for a one-time cash infusion and risk diluting the market value of its existing stock, a corporation may prefer to borrow money from investors by issuing a bond or series of bonds.

The interest rate the corporation pays on the bond will depend in part on the credit quality of its bond and its own creditworthiness as determined by a ratings agency. If the agency believes the company and bond pose a relatively low credit risk, the company can probably attract investors by offering an interest rate at the low end of prevailing market rates. If, on the other hand, the company's financial position is shakier and its bond poses a relatively high credit risk, the firm may need to offer a higher interest rate to sell the bond. This possibly would strain the company's cash flow.

One decision the business faces in issuing debt is how long the bond's term should be. The appeal of a long-term obligation — say, 20 years — is that it provides an immediate cash infusion but gives the company a long time to repay. Among other advantages, inflation works to the company's favour, since the capital it repays is likely to be worth substantially less than the value at the time it was borrowed. A downside, though, is that the rate required to float long-term bonds is typically higher than the rate for short-term ones. To borrow at lower rates, corporations with good credit often prefer a rolling series of short-term bonds, known as commercial paper, which provide a steady stream of operating cash.

Indian Corporate Bond Market

Coming to the corporate bond segment of the debt market, such a market has been in existence since Independence in 1947. Public limited companies have been raising capital by issuing term debt securities since then mostly through private placement. The convenience of structuring of issues to match the needs of issuers with those of investors coupled with savings in terms of time and cost has contributed to rapid growth of the market for private placement. The rationale for investing in the private placement market lies in the convenience and flexibility to the issuers as well as investors.

This route is generally preferred by corporates wishing to issue securities with complex or non-standard features, as deals can be tailor-made to suit the requirements of both issuer and investor. Many companies may prefer private placements if they wish to raise funds quickly to take advantage of interest rate change in volatile market conditions. This market is also preferred by new entrants who do not have track record of performance and hence are unsure about generating adequate public response for their public issues. Again corporates may prefer this route if the general market environment is not conducive for floating public issues.

The investors also have advantages in subscribing to private placements, particularly, when there is no adequate supply of good public issues to match the amount of investible funds available, investors look for bonds at attractive rates in the private placement market. Further, the private placement market provides investors with securities with more or less fixed/predictable cash inflows, which help the investor to match the expected stream of returns with the expected cash outflows. Limited regulatory compliance is another important reason why corporate issuers prefer this route and avoid public issues.

Public Issues

Public financing is the issuance of debt securities to the public. Public financing is done usually (1) because huge financial requirements cannot be met by banks and (2) because public debt financing is cheaper. One of the reasons that public debt financing is cheaper is because the securities are liquid, that is, the securities holder can sell it whenever they need the money.

Listed entities on NSE and BSE raised approximately INR 6 lakh crores in FY18 through issuance of corporate bonds. Debt issuance has proved to be an effective way for young companies who are not willing to part with equity but are in need of financing and hence choose to raise funds by issuing bonds. The rise in mutual funds industry in India, along with a more favourable outlook towards stock market rather than commodity investment such as real estate and gold has been part of the reason why public issuance has flourished in the country. The surge of foreign investments in the country has primarily comprised of investment in the corporate bond market-piggy-riding the domestic sentiment on its back as well. In the year 2017, foreign investment in corporate bonds has risen by a staggering 44%, amounting to ₹ 2.3 trillion, coming dangerously close to the cap of ₹ 2.4 trillion permitted by RBI to foreign investors. This space of around ₹ 44,000 crore is likely to be filled further as there remains a big hole left by masala bonds, which will now be categorised as ECBs.

The Indian debt market is yet to realise its full potential, as it is much less in volume as compared to other economies around it. With the value of domestic corporate bonds outstanding in 2014 to GDP being only 17%, there is room to expand for Indian companies, with its foreign counterparts commanding a much higher rate – China and Brazil registering figures of 46% and 42% respectively. While the banking sector in India remains over-shadowed by a cloud of rising NPAs and poor financial health, it seems likely that the debt market in India will continue to maintain its below moderate growth for at least a couple of more years.

Tough Cash in Tough Economies

If the economy is in a recession and chances for a quick recovery are slim, the prospects for raising capital by issuing stock or bonds may be somewhat grimmer. If stocks are trading below their intrinsic value, a secondary offering of shares may not raise as much capital as the corporation wants. That, on top of saturating the market with shares, may create more problems than the offering solves. Similarly, if a corporation has more debt than potential investors are comfortable with, a bond issue may not float. Or the issuer may have to increase the rate it has offered on earlier bonds to attract investor interest. In that case, repayment may become a substantial burden.

The supply of corporate bonds is expected to more than double to ₹ 55-60 lakh crore in FY2023, from ₹ 27.4 lakh crore at end – FY2018.

As against this, the demand foreseen is ₹ 52-56 lakh crore, leaving a material funding gap of ₹ 3-4 lakh crore. This gap would be significantly wider if 'A'-category borrowers comprising about 2,400 companies with aggregate long-term bank facilities of about ₹ 10 lakh crore — tap the market.

The corporate bond market also faces challenges such as finance sector skew, poor trading volumes and little appetite for debt rated in the 'A' category and below. While the domestic debt market in India amounts to about 67 per cent of GDP, the size of India's corporate bond market is just 16 per cent of GDP — compared with 46 per cent in Malaysia, and 73 per cent in South Korea.

To improve the depth and vibrancy of the corporate bond market, we need facilitations along the following five flanks

Innovation: In capital-starved economies, prudent innovation is a good way to generate growth capital. Credit-enhancement is one such tool. But this needs fast-tracking of the Credit Enhancement Guarantee Fund proposed by GoI, and revisiting risk weights to promote partial credit enhancement products.

Expected Loss (EL) rating scale is another tool, especially in the infrastructure sector, since the conventional Probability of Default scale doesn't factor in post-default recovery prospects. Uniform and transparent benchmarks are also essential.

The dormant credit default swaps (CDS) segment also needs a kick-start. This would need legislative changes, because of the restriction on the netting of mark-to-market positions against the same counterparty for capital and exposure norms. Also, with domestic players not keen, permitting foreign writers of CDS contracts can be explored. The introduction of bond exchange-traded funds (ETFs) can also help by adding secondary market liquidity.

Liquidity: The process of structurally improving liquidity can begin with tripartite repos. Bourses have platforms ready. But some infrastructure and operational issues need ironing out. It would help if banks, primary dealers and brokers are incentivised to be market-makers. Acceptance of corporate bonds by RBI would persuade banks and primary dealers to invest.

Fine-tuning regulations: The electronic bidding platform should be made more flexible to accommodate simultaneous issuances from one issuer, and the issuance time of about four days must be shortened. The current limitation of 12 International Securities Identification Numbers (ISINs) a year is restrictive. 24 ISINs a year could be phased in for starters, which can be reduced over time as the market stabilises. Also, allowing new ISINs when issuances under a specific one crosses say, ₹ 1,000 crore, to ensure sufficient stock for secondary market activity would be salutary.

While the Insolvency and Bankruptcy Code (IBC) has started off well, more steps are needed. These include a standard operating procedure for the National Company Law Tribunal process that provides clarity to investors, enhancing infrastructure and capacity of the resolution ecosystem as the volume of cases rises, and the passage of the Financial Resolution and Deposit Insurance Bill. The Bill is critical as over 70 per cent of the issuances are from the financial sector not covered under IBC.

Investor awareness: Over the last two years, savings has increased, with householders looking beyond gold and real estate. In the first half of 2018, debt issues raised over ₹ 27,000 crore, compared with less than ₹ 4,000 crore in same period of 2017. Depth, liquidity and vibrancy are the robust pillars of financial growth. The Indian economy would be served well over the long term if its corporate bond market, too, has those underpinnings.

Conclusions

If India does develop a corporate bond market, it would take a lot of pressure off banks, which are reeling under bad debts. It would also make it possible to raise capital for private sector infra-projects, which are currently starved of funding. Retail investors will also get a chance to invest in such projects via debt funds. There would be big risks and commensurately huge rewards.

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CA Srinivasan V.

Importance of balance between Debt and Capital

Capital – Background

Business entity concept recognises that business is a standalone entity, different from the owners, irrespective of its legal status. This is the fundamental business concept based on which the Double Entry System of book keeping evolved in medieval Europe. So, whatever money is received into the business, it is recognised as a "liability" – that it has to be paid back.

The vertical form of balance sheet goes one step further by seggregating the items in the balance sheet into Sources and Applications of funds.

Business has the option to obtain its "sources" from several avenues and each of such avenue has material implications for the business which needs to be thoroughly understood by the owner.

It is for lack of understanding the complete implication of various sources and matching it with application, that businesses have failed more number of times than due to other issues like market, technology or labour.

This article will deal with how to balance capital and its derivatives like equity, preference, and other forms and debt, including long term, short term, vendor credit, and how to ensure that the Source to Application matching is done to ensure that such Application is able to service the obligations of the Source and ensure successful enterprise.

Capital and its forms

Capital is raised from the owner and takes the highest risk among various forms of sources. In olden days, capital was only in the form of "Equity" meaning that the funds carry highest form of risk within the category of various forms of capital, the business has no obligation to pay any returns on the equity nor return the equity. These are funds infused to be the fundamental source of funds and are supposed to be with the entity as long as the entity is up and running.

There is another form of capital known as "preference" capital and true to its name, it gets a preferential treatment over equity when it comes to payment of dividend or return of capital. There can be further nuances of the terms of preference in the coupon rate of dividend and return of capital.

However, it should be noted that the "preference" will be applied only when there is sufficient profit (surplus) emerges after paying off all business obligations including interest on debt. In that way the preference is only counted with respect to equity shareholders.

There is yet another category known as "convertible" preference capital, which may either be optionally convertible (at the option of the holder) or compulsorily convertible. Indian Companies Act deals with the terms of issue of such shares and it is not the intention of this article to deal with them here.

It can be said conclusively that all forms of capital other than equity are resorted to with a view to enhance the value for the equity shareholders only. The conversion terms are directly proportional to the certainty of the assumptions relating to the future growth in business and profits – more certain the assumptions, the terms tend to be more clear and fixed upfront, essentially the option for shareholder gets limited.

All payments to holders of instruments of capital are termed as "appropriation" and is typically described as "below the line" adjustments. They are NOT a charge on the profits of the entity but more of "appropriation" of a portion of the cumulative profits of the business.

Debt and its forms

Debt represents an obligation to return the funds at a certain specific date and normally are attached with a coupon rate of interest. The interest is a charge on the profits of the business and is an admissible expenditure for taxation.

Debt can be long term or short term and depending upon its term; other conditions associated with the debt also varies. Typically, the cost of long term tends to be lower than that of short term debt. This is because the short term is subject to more volatility of markets which gets ironed out over the long term and hence long term debt is more benign.

Vendor credit is also a debt since most of the vendor terms contain a clear term of credit free of interest. If not paid within the term, the business will have to pay interest on the delay.

In terms of cost of debt, typically vendor credit is the costliest of debt, followed by short term debt and finally long term debt.

Playing the balancing game between various forms of "sources"

Noted author Dr. Anil Lamba, who has authored a book "Romancing the Balance Sheet" has coined two important financial rules for successful management of companies, which will also help in deciding the right balance between Capital and Debt.

Rule No. 1 – Never invest your money without ensuring that the assets you acquire can generate a return which is at least equal to the cost of your capital.

Rule No. 2 – Invest your money in such a way that the assets will generate an inflow of funds before the liabilities will demand an outflow.

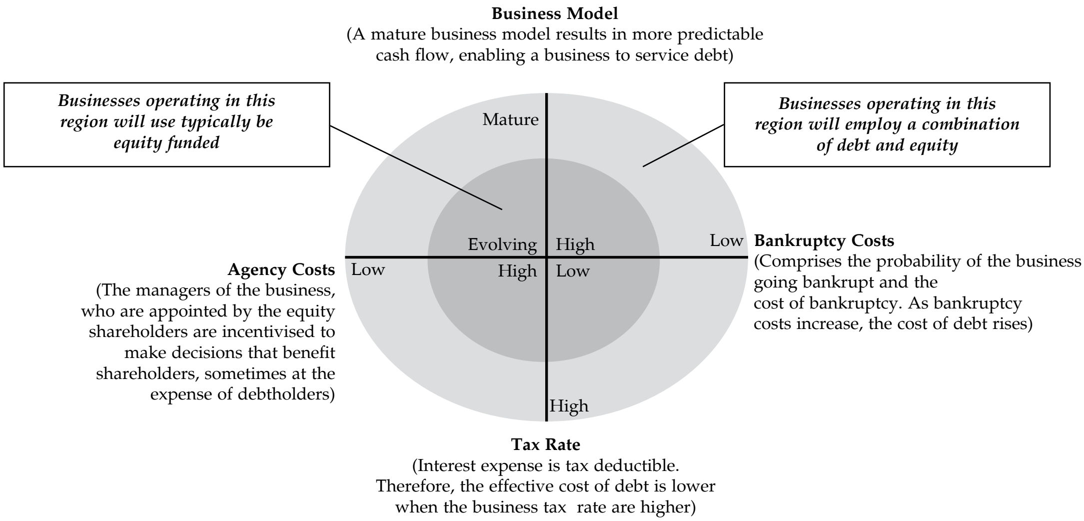
So, fundamentally, the "Application" of the funds would determine the choice and proportion of the "Source".

For example, long term assets like land, buildings, plant & machinery must be financed with long term source and preferably with a higher proportion of equity capital and lower proportion of debt in the initial days of formation of the company. As the company expands and makes profits, the proportion of equity capital could be gradually reduced.

Financing choice is also closely linked to the lifecycle of a business. In its initial stages when there is higher uncertainty of the timing and quantum of returns, a business will rely more on promoter's funds, venture capital and private equity funds. During this phase the debt options available to the business are likely to be limited to working capital loans, bill discounting etc. As the business matures and its cash flows become more predictable, it may fund its growth using debt.

The chart below sets forth the factors that determine the choice of a firm's capital structure

Factors Determining Capital Structure



Owners should have an intimate understanding of the cashflow signature associated with the "application" to ensure that the demands of source can be met on time. Typically, fixed assets have a long gestation period and generates significant amount of cashflow after elapse of sufficient time to capture market, brand affinity etc.

Any investment in intangible asset like goodwill, development of intellectual property is preferably financed with equity or preference capital since the underlying risk of exploitation of the asset resulting in cashflow is high.

However, goodwill resulting from the acquisition of another running business (typically called M&A or Merger and Acquisition) could be done through a mixture of equity and debt if the business being acquired is producing enough cashflows and can help in servicing the interest and repayment obligations of the debt.

There are certain sectors like infrastructure which have essentially a very long term cashflow signature, requiring significant upfront expenditure can access very long term special purpose debt.

Industry and lenders typically use a "Debt:Equity" ratio to determine the appropriate mix of capital vs. debt.

Short term needs like working capital should be met essentially from short term debt – foremost of them being supplier credit followed by bank finance for working capital in the form of cash credit facilities or invoice discounting facilities etc.

Modern developments in bill discounting has given rise to newer platforms like TREdS, Kredx and Loans 4 SME which are using technology to bring entities with surplus cash to the needs of the small and medium enterprises and the process of bill discounting has been significantly simplified.

Summary

- In summary, every entity should apply the two financial rules mentioned above to see if the "Application" of the "Source" is capable of producing adequate cashflows to service the obligations of the lenders of "Source" - Rate of return
- Whether the cashflow signature emanating from the application provides a delta or a surplus over the cashflow signature required to service the obligations of the Source – timing match
- So, it is not just the quantum, but also the matching of the timing of cashflows that is critical in arriving at the right mix of capital and Debt.

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CA Pankaj Majithia & CS Hina Sadrani

Changes in Registration of charges related provisions

Background

As we are aware, an organisation can have two types of borrowings: unsecured borrowings and secured borrowings. In case of companies covered under the Companies Act, 2013, unsecured loans have proved to be a very small source of finance because of extended definition of 'Deposits'. Companies can accept unsecured loans from its Directors and their relatives and members, subject to applicable conditions. Further, accepting funds from a handful of persons is not going to help big projects and corporates have to resort to secured finance from Banks, Financial Institutions etc., resulting in creation and registration of charges. Creation of charge safeguards the interest of the lender in the event of failure of repayment of debt, as the amount can be recovered from the sale of assets under charge. The registration mechanism will also help in avoiding multiple financing by various banks/institutions on the security of some property as the details of various charges/lien will be reflected on the public domain.

Definition of charge

1. The word charge has no connotation like expenses etc., but the topic under the discussion is restricted to legal charge connected with the security creation notings with some authorities.

   Section 2(16) of the Companies Act, 2013 defines charge as follows:

   "Charge" means an interest or lien created on the property or assets of a company or any of its undertakings or both as security and includes a mortgage;

2. Thus, a charge, is a right created by a person, the borrower, on its assets and properties, present and future both, in favour of the lender, who has agreed to extend financial assistance. Such interest in the property can be present or future, or vested or contingent.

3. As distinguished from the Transfer of Property Act, 1882, the Companies Act, 2013 treats the charge at par with the mortgage and hence 'mortgage' has been included in the definition of term 'charge'. Section 100 of the Transfer of Property Act, 1882 defines a "charge" as follows:

4. "Where immovable property of one person is by *act of parties or operation of law* made security for the payment of money to another, and the transaction does not

amount to a mortgage, the latter person is said to have a charge on the property and all the provisions hereinbefore contained which apply to simple mortgage shall, so far as may be, apply to such charge."

5. It is apparent that as per the Transfer of Property Act, 1882, charge and mortgage are taken to be as mutually exclusive. Section 58 of the Transfer of Property Act, 1882 defines mortgage, which includes *inter alia*, "A mortgage is the transfer of an interest in specific Immovable Property for the purpose of securing payment….". The essence of mortgage is a transfer of an interest in the property whereas in case of charge, there is no transfer of interest in property, but a mere obligation on property to secure a debt. Title retention is also considered as charge. The charge can be created in following ways:
    1. By act / consent of parties
    2. By operation of law
    3. By terms of a decree

    Section 77 applies only to a charge created by a Company and not to a charge arising by operation of law, such as vendor's lien for unpaid purchase money.

    Similarly, registration of charge crated by liquidator is not necessary.

Charge registration under Companies Acts, 1956 & 2013

Both the Companies Acts have prescribed forms for filing particulars of charges with Registrar of Companies. Form 8 and Form 13 were required to be filed under the Companies Act, 1956 and Form CHG-1 is required to be filed under the Companies Act, 2013 for creation and modification of charges. Under the old Companies Act, Forms 17 and 13 were required to be filed for satisfaction of charges, which are not replaced by Form CHG-4. With the introduction of e-filing, it was possible to track the record of a particular charge and hence Form 13 was discontinued with introduction of e-filing by assigning Charge Identification Number to charges being created. For modification i.e., changes in particulars already filed, companies are required to file Form CHG-1 with Charge Identification Number and all forms with same Charge ID are tagged together in MCA database. The "View Index of Charges" facility available on MCA webpage provides the direct access to the status of particular charge.

Impact of Charge Registration

Once a charge is registered, it acts as a public notice, that the lender has an interest in the property. Registration of charge identifies the asset which is subject to charge and generates the constructive notice for all concerned persons. Inspection of charge documents allows the prospective lender to know whether the property / asset being offered is free from any encumbrances and the type of charge on the asset – like first exclusive charge, *pari passu* charge etc. The public will be aware that the general public will be entitled to the asset, after the registered charge holder. Non-registration of charge, required to be registered compulsorily can attract a penalty of ₹ 500 for every day of continuing default, on the defaulting company and officer in default.

Charges are created for the time being, till the time the Company is enjoying the credit facilities secured by the charge. Once, borrowings are cleared, the charge can be vacated / satisfied with the help of the 'No Dues Certificate' from the lender.

Who can file the Charge – Latest Change

Particulars of charge can be filed by the Company itself or by the lenders. This facility is provided under the Companies Act, 2013 and was not available under the old Act. Perhaps this is the reason why most banks insist registration of charge before actual disbursement. Please note that it is the duty of the company to get the charge registered. For lenders, it is their right, and not the duty to register the charge.

The old Companies Act provided the list of charges to be registered. The New Act provides for registration of all charges. This is to facilitate the registration of new variety of charges, including hybrid charges and other financing inventions. Here, it is quite possible that any charge created under the regime of old Act did not require any registration and modification thereof after the Companies Act, 2013 became applicable, requires registration. Law is silent about how to deal with such situation.

Whether the charge requires registration with ROC or not, depends on the following questions:

1. Do the rights constitute a charge?
2. Were the rights created by the Company?

In case a charge is not registered, it will suffer from the following disadvantages as compared to a registered charge only, in the event of liquidation:

Void against liquidator: It means that the liquidator, in the event of winding up of a company, can ignore the unregistered charge, and thus treating the concerned creditor as an unsecured creditor. Further, a charge created by an order of the Court does not require registration under section 77 of the Companies Act, 2013 and hence is not hit by this section. Further, improperly stamped charge instrument cannot avail the defence of Section 77.

Please note that with implementation of IBC, 2016, this section has been amended to cover within its ambit, liquidator appointed under IBC, 2016. The new Section 77(3) reads as follows:

"Notwithstanding anything contained in any other law for the time being in force, no charge created by a company shall be taken into account by the liquidator appointed under this Act or the Insolvency and Bankruptcy Code, 2016…."

Void against any creditor of the company: It means that if any subsequent charge is created on the same asset, and the previous charge is not registered, the earlier charge will be void against other creditors, and the latter charge will enjoy priority.

The main difference between the legal status of a charge holder and unsecured creditor arises in the event of liquidation of a company. In the event of liquidation, the secured creditors are paid in full, however, the unsecured creditor are paid after the cost of liquidation has been incurred, the charges on assets have been met, and therefore, the chances of unsecured creditors being paid in full are slim.

Please note that these provisions are contained under section 77 of the Companies Act, 2013 (earlier under 1956 Act also) and hence applicable to the companies defined under the Companies Act only. In the absence of similar provisions under the LLP Act, 2008, this protection is not available to the lenders of LLP. This is the main reason for LLPs having limited access to Bank Finance as Banks are not very keen to extend credit facilities to LLPs. Section 67(1) of the LLP Act, 2008 confers powers on the Central Government to notify sections of Companies Act which shall also apply to LLPs. Professional bodies like ICAI, ICSI should bring this matter to the notice of MCA for notifying section 77 and other sections of the Companies Act, 2013 regulating charges for LLPs also. If done so, the finance to LLP would also be secured to the same extent as is the case for registered companies. This is more particularly required when "Banning of Unregulated Deposit Schemes and Protection of Depositors' Interests Bill, 2016" is in the process of implementation and the Deposits Rules, which are as of now, applicable to companies only, will be applicable to LLPs also, making the tie around the necks of LLPs tighter so far as finance is concerned. No business can run without finance and hence an appeal to all professionals, to do the needful.

Types of Registration of Charges

It is normally understood by Registered charge as the charge registered with Registrar of Companies (herein after referred to as the R.O.C). The given statement is true, but not in its entirety.

The charge registration spectrum has now broadened viz. :

Charge Registration with ROC (which is commonly understood)

a) The charge can be either fixed charge or a floating charge, depending upon the type of assets being charged. If the charge is created on specific property, it is a fixed charge. Floating charge implies the property by description and not by specification. It is a charge on unspecified property or an undertaking of a person. The Act does not distinguish between the two. In case of fixed charge, the asset can be transferred or dealt with subject to an existing charge. In case of floating charge, the borrower can deal with the assets in the normal course of business.

b) Registration of financial transactions with Central Registry of Security Asset Reconstruction and Security Interest (hereinafter referred to as CERSAI) under SARFAESI Act 2002

CERSAI's initial mandate was to maintain a Central Registry of equitable mortgages. Initially transactions relating to securitisation and reconstruction of financial assets and those relating to mortgage by deposit of title deeds to secure any loan or advance granted by banks and financial institutions, as defined under the SARFAESI Act were to be registered in the Central Regisry.

Recent Changes

- Now, with the amendment of Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest (Central Registry) Rules, 2011 w. e. f. 22nd January, 2016, with the insertion of sub-rule Rule 2A, B, C, D in Rule 4 makes it mandatory for creditors to register with CERSAI the other type of charges. This amendment now requires the registration with CERSAI , *inter alia*, of mortgage, hypothecation, charge on the intangible assets and security interest in any under construction, residential or commercial building or part thereof by an agreement or instrument other than by mortgage. This allows prospective lenders to check the registry to ensure that the property against which they are extending a loan to a borrower is not encumbered by a pre-existing security interest created by another lender. Even if it is, with details of the previous loan available to them, they can examine if the value of the collateral is sufficient for them to extend another loan, given the existing liability on the property. Availability of such records would prevent frauds involving multiple lending against the security of same property as well as the fraudulent sale of property without disclosing the security interest over such property. Even the Securitisation & Reconstruction transactions require Registration with CERSAI.

c) Registration of charge of debenture trustees

Secured Debentures necessarily should be registered with Registrar of Companies in Form CHG-9. Apart from this requirement, the debenture trustees for listed debentures should be registered with SEBI and should obtain a registration certificate in accordance with SEBI (Debenture Trustees) Regulations, 1993. Under this regulation, the powers of trustees, procedure of registration, responsibilities and other major factors are included, which are mentioned in contents of deed.

d) Registration of mortgage in the case of simple/registered mortgage of property with sub-registrar of assurance

The owner has to transfer his title deed to the lender thereby creating a charge on the property. The owner orally confirms the intent of creating the charge. If the borrower repays the loan on time, the title deed is handed over back to him at the time of final settlement. This requirement necessarily follows from the Transfer of Property Act, 1882 and State stamp and registration laws.

e) **Registration of lien with R.T.O in the case of vehicle loan**

In the case of vehicle loan, the asset is not immediately transferred to the lender. If the borrower is unable to pay the debt on time, the lender can acquire the movable asset and sell the same to recover the amount of debt. The lien is registered in the book or in the chip if the card is given. When the loan is settled the same lien is required to be given. This also will act as a deterrent for third party transfer during pendency of vehicle loan.

f) **Registration of lien with co-operative society in case of housing loan/mortgage loan against property/reverse mortgage**

Earlier, there was scope for fraudulent practices like availing loans from multiple banks on same property or disposing of the property which is already mortgaged. Nowadays, the banks have made it a practice to send their officer to meet the secretary/chairman of the society & get the lender lien recorded in the society register so that during pendancy of such lien no third party transfer can take place & before disbursal they insist on society NOC for marking such lien.

- **Recent Changes:** E-filing of notice of intimation in case of mortgage by way of deposit of title deed came into effect on April 1, 2013. Notices of intimation of mortgage of property specified in Section 89B of the Registration Act, 1908. Thus, these amendments allow the lender in the case of same property being mortgaged more than once, to take suitable action, and thus safeguard their interest.

Therefore, these amendments have been carried out in order to safeguard the interests of banks and society.

g) **Registration of shipping loan with Lloyds Registry/Shipping authority**

Mortgage of ship: On presentation of mortgage instrument to the registrar of the ship's port of registry, together with the prescribed fee, the registrar, if he is satisfied that the instrument is properly executed and that it does not notice trust, express, implied, or constructive, proceed to record the transaction in the register with the date and acceptance, he shall also endorse on the mortgage instrument, the fact of recording and the date of acceptance.

Priority of Mortgage: When several mortgages on the same ship is recorded in the register book, their respective priorities shall be indicated in the appropriate column in alphabetical order.

Discharge of Mortgage: When the mortgage debt is fully discharged, the registrar shall, after satisfying, that the receipt endorsed on the mortgage instrument is in order and that it is properly witnessed, make the entry reference in the discharge book.

Registration of Mortgages executed and discharged by Companies: Where a mortgage is executed or discharged by a company, the registrar shall not register the mortgage, or enter the discharge unless it has also been registered with ROC under the Companies Act, 2013 or as the case may be, the Memorandum of Satisfaction has been entered in the register of charges under the Act.

A shipowner gives a lender (or mortgagee) an interest in a ship as security for a loan. Ship mortgages differ from other types of mortgage in three ways. First, some privileged claims could have a higher ranking over that of mortgagee against the ship. Second, ships naturally move between jurisdictions. And third, a ship is always at risk of partial or total damages at sea. Therefore, the lender might not be able to recover the entire amount of his debt.

As per Rules 25, 26, 27 and 28 of Merchant Shipping (Registration of Indian Ships)

Rules, 1960, every instrument of mortgage of a registered ship shall be in one of the appropriate forms and shall be filed with the registrar of the ship's port of registry. When several mortgages on the same ship are recorded in the register book, their respective priorities shall be indicated in the appropriate column by capital letters A, B, C etc., in alphabetical order. When the mortgage debt is fully discharged, the registrar shall, after satisfying himself that the receipt endorsed on the mortgage instrument is in order and that it is properly witnessed, make the entry relating to the discharge in the register book. Where a mortgage of a ship is executed or discharged by a company, the registrar shall not register the mortgage or enter the discharge unless it has also been registered with the Registrar of Companies or, as the case may be, a memorandum of satisfaction has been entered in the register of charges under the Companies Act.

h) Registration of Aircraft Loan with Aviation Authority

The aircraft register in India is maintained by the DGCA. This register contains details in relation to the aircraft such as the following:

- the type of aircraft;
- the year of manufacture;
- the full name and address of the owner or lessor; and
- the full name and address of the operator or lessee.

This register is open for inspection by members of the public, both at the DGCA headquarters and on the DGCA website.

There is no separate register of aircraft mortgages in India. However, the Civil Aviation requirements require the owner of an aircraft to file a notarised and apostilled copy of the mortgage documents evidencing the creation of the charge with the DGCA, which will endorse the name of the mortgagor on the certificate of registration.

As per law, if the mortgagor is an Indian company or a company with a registered place of business in India, the mortgagor must, within a prescribed period, register any charge (which includes a mortgage) created with the relevant Registrar of Companies (ROC) in the prescribed form.

- **Negative Lien**

Negative lien or non-disposal undertaking is not charge as they do not give a power to the creditor to cause a sale of property. Since negative lien is not a charge on any assets, it does not require any registration. It is an undertaking from the borrower or its group company to the lenders who decides not to opt for any kind of mortgage as security, that they will neither dispose of property offered as security nor lease it out. It is very popular for granting financial assistance to subsidiaries and special purpose vehicles of large corporates. Negative lien is generally created on the Equity Shares of the borrowers which are held by the parent company, whereby parent company provides assurance of not to dispose of the shares during the tenor of the loan. As explained earlier, it is a type of security / comfort to the lender but no security interest is created in any asset. It is typically suitable for companies forming part of large corporate groups, having good moral values and good standing in market with brand names.

- **Charge on uncalled capital**

Capital uncalled is not the property of the Company, but it is the mere power. Hence, there must be express authority to charge the uncalled capital of the Company

Registration of Charge *vis-a-vis* Insolvency and Bankruptcy Code

Considering the new law – Insolvency and Bankruptcy Code, registration of charge is more important. Financial Creditors are given preferred payments when the creditors opt for IBC. One interesting case – *Sree Metaliks Ltd. vs. SREI Equipment Finance Limited* is discussed in nutshell:

In this case, the Resolution Plan submitted to NCLT had divided creditors into two classes: one class had creditors who had the first *pari passu* charge on assets and the second class included creditors who had a second or subsequent ranking *pari passu* charge on assets. NCLT, while approving the plan, held that such a distinction is allowed under the IBC as it has a rational basis for distinction based on the priority of charges and therefore, is not discriminatory.

Recent changes under the Companies Act, 2013 with respect to charges filing forms etc.

Under the Companies Act, 2013, the following forms are prescribed with respect to charges:

Form CHG-1 – Application for registration of creation, modification of charge

Form CHG-2 – Certificate of Registration of charge

Form CHG-3 – Certificate of Modification of charge

Form CHG-4 – Intimation for Satisfaction of charge

Form CHG-5 – Certificate of Registration of satisfaction of charge

Form CHG-6 – Notice of appointment or cessation of receiver or manager

Form CHG-7 – Register of charges kept at Companies registered office

Form CHG-8 – Application to Central Government for extension of time for filing particulars of registration of creation / modification / satisfaction of charge.

Form CHG-9 – Application for registration of creation or modification of charge for debentures or rectification of particulars filed in respect of creation or modification of charge for debentures.

Changes introduced with respect to furnishing information in charge forms

In order to curb frauds and to safeguard the interest of lenders, following information requirements have been added in the charge form, particularly with respect to immovable properties:

1. Borrower's customer/account number
2. Date of Disbursement
3. Evaluated Price of Asset as on Security interest creation date (these details are to be provided as per valuation report obtained by the Bank)
4. Nature of Property
5. PLOT ID Number
6. Survey No. / Gat No. etc., Street Number & Name, Sector /Block Number, Locality, Landmark, Village/Town Name
7. Latitude and Longitude (to be given from google map)
8. Area of plot
9. Details of surrounding properties
10. Description of the document by which the company acquired the title:
    a. Document type
    b. Document Number
    c. Sub-registrar
    d. Taluka, District, State etc.

All the fields should be captured as appearing in the revenue record, flat number, house number, Municipal Office/Municipal Corporation/ Grampanchayat are to be specified and also the area of the immovable property as well as boundaries.

Recent changes in timelines for filing particulars of charges

1. Prior to the Companies (Amendment) Ordinance, 2018, the time limit available

for filing particulars for creation or modification of charge was 300 days from the date thereof. However, the Ordinance has curtailed that period from 300 days to 30 days. This form can be filed within 60 days with the permission of ROC.

2. Form CHG-4, form for satisfaction of charge was required to be filed with ROC within 30 days prior to the Companies (Amendment) Act, 2017. Now, w. e. f. 5th July, 2018, Form CHG-4 is allowed to be filed within a period of 300 days from the date of satisfaction thereof.

References

1. http://vinodkothari.com/wp-content/uploads/2018/11/No-more-laxity-in-reporting-of-charges.pdf

2. Department Circular No. 8(39) – 125/59-PR, dated 24th November, 1959

3. http://164.100.158.181/interim_orders/kolkata/7-11-2017/2.pdf

Some Interesting Case Laws

- **In the case of Official Liquidator vs. Suryakant Natvarlal Surati on March 29th, 1984**
  It was made clear in the judgment that in the case of winding up of the company, an unregistered charge will be treated in the following manner:

  Unregistered Charge vs. Registered Charge

  In the event of winding up of a company, a registered charge holder will have a superior right over the unregistered charge holder, even if the unregistered charge is created before the registered charge.

  Against a registered charge, unregistered charge is as good as an unsecured creditor.

  Unregistered Charge vs. Other Unsecured Creditors

  In the event of winding up of a company, an unregistered charge holder will have a superior right over the asset of the company as compared to an unsecured creditor.

- Thus, the hierarchy of charge on asset will be:

  a) Registered Charge Holder

  b) Unregistered Charge Holder

  c) Unsecured Creditor

- **IDBI Trusteeship Services vs. M/s. Chattar Industries Ltd.**
  In the event of non-registration of a charge, the charge holder is treated as an unsecured creditor and no superior right is entitled to him in the case of liquidation of the company.

  The same has also been noted in *Kerala Finance Corporation vs. C.K.S. Pannikar, 1978 Tax LR 1850* case in which, the unsecured charge holder was treated as Unsecured Creditor.

- **NOTE: Now the cases of non-registration of charges are not a common feature as the entire process is online, and the lenders are extremely particular about the charge registration to enjoy security and privilege in the event of recovery of their dues.**

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The man who is pure, and who dares, does all things.

— *Swami Vivekananda*

 

Makarand Joshi & Kumudini Bhalerao, *Company Secretaries*

DVR – Is it possible in India?

1. Economy of India

India is a growing economy. It requires lot of young businesses to be successful to keep this growth path steady. It is necessary to create level playing field to grow further. The major growth factor will depend on how the new businesses take off. How the young entrepreneurs are motivated to grow…

Promoters who are confident about business need strong support on funding side. They need such ecosystem which will fund the business and keep their control intact.

Recently all must have read the news that SEBI is thinking on bringing DVRs back in India. This article tries to create awareness of Differential Voting Rights (DVR) provisions, rules and regulations in case of Companies in India.

2. Examples of DVR in India and abroad

In case of "capital" profit share and voting are essential characteristics. It is by default assumed to be in proportion to the amount paid up on shares. But, every time it need not be the same. Examples can be seen from the DVR in India and abroad.

Tata Motors was the first Indian company to tap DVR. In 2008, it issued shares with differential voting rights. Subsequently, couple of other companies such as Future Enterprises and Gujarat NRE Coke too issued dual class shares.

Globally companies like Facebook, Google, News Corp have dual voting shares that enable the founders to retain control in spite of lot of fund raising in their Companies.

3. Recent News of SEBI on DVR

The Securities and Exchange Board of India is reviewing norms on dual-class shares. The regulator has set up a sub-committee to look into the issue of differential voting rights (DVR). The panel is likely to submit its report next month.

"Such rules have worked globally. The framework would work for companies where valuations are not ready but there is faith in promoters. However, some rebalancing from corporate governance side would be required,"[1]

The Sebi panel is looking at various models followed globally on different classes of share including the sunset provision. A sunset clause is available for a period of time or up

1 A statement made by Mr. Ajay Tyagi, Chairman SEBI, published in Economic Times.

to a particular event post which the DVR gets converted into shares with voting rights.

"In India, the DVR market needs to evolve. It should be allowed only in well-governed companies where founders can hold superior voting rights with adequate checks and balances[2] "

4. Provisions regulating DVR in India

a. The Companies Act, 2013

b. The Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015 (LODR)

LODR restricts the issue of such equity shares which carries superior rights:-

The listed entity shall not issue shares in any manner which may confer on any person, superior rights as to voting or dividend *vis-à-vis* the rights on equity shares that are already listed.[3]

The Companies Act travelled as follows w.r.t. DVRs

Particulars	Private Limited	Public Limited or subsidiary of Public Limited
The Companies Act, 1913	DVR allowed	DVR allowed
The Companies Act, 1956	DVR Allowed [Section 90]	Prohibited from the enactment of the Companies Act, 1956-18th Jan 1956 till 13th Dec. 2000 and DVR Allowed thereafter subject to certain conditions and restrictions (Section 86 and rules)[4,5]
The Companies Act, 2013	DVR allowed [sections 43 and 47 can be said to be not applicable if Memorandum or Articles of Association provides so.][6]	DVR Allowed subject to certain conditions and restrictions (Section 43 and rules[7])

It is worthwhile to note that Limited Liability Partnership (LLP) also can be considered as a parallel option to DVR. The LLP Act, 2008 does not provide that the contribution and profit sharing ratio needs to be same. In case of contribution voting rights and dividend are not the essential characteristics as "capital is case of a Company. Hence, it can be considered as another option for DVR.

5. Analysis of Rule 4 of the Companies (Share Capital and Debentures) Rules, 2014

(I) As per Rule 4 (1) of the Companies (Share Capital and Debentures) Rules, 2014 following are conditions to issue of DVR

2 S. Ramesh, MD & CEO of Kotak Investment

3 Regulation 41(3) of LODR

4 The Companies (Issue of share capital with Differential Voting rights), Rules 2001 were notified on 9th March 2001

5 The Companies (Amendment) Act, 2000 w.e.f. 13th December 2000

6 Notification on exemption to private limited companies 5th June 2015. [F. No. 1/1/2014-CL-V]

7 Rule 4 of the Companies (Share Capital and Debentures) Rules, 2014

(a) the Articles of Association of the company authorises the issue of shares with differential rights;

(b) the issue of shares is authorised by an ordinary resolution passed at a general meeting of the shareholders:

Provided that where the equity shares of a company are listed on a recognised stock exchange, the issue of such shares shall be approved by the shareholders through postal ballot;

(c) the shares with differential rights shall not exceed twenty-six per cent of the total post-issue paid up equity share capital including equity shares with differential rights issued at any point of time;

(d) the company having consistent track record of distributable profits for the last three years;

(e) the company has not defaulted in filing financial statements and annual returns for three financial years immediately preceding the financial year in which it is decided to issue such shares;

(f) the company has no subsisting default in the payment of a declared dividend to its shareholders or repayment of its matured deposits or redemption of its preference shares or debentures that have become due for redemption or payment of interest on such deposits or debentures or payment of dividend;

(g) the company has not defaulted in payment of the dividend on preference shares or repayment of any term loan from a public financial institution or State level financial institution or scheduled Bank that has become repayable or interest payable thereon or dues with respect to statutory payments relating to its employees to any authority or default in crediting the amount in Investor Education and Protection Fund to the Central Government;

Provided that a company may issue equity shares with differential rights upon expiry of five years from the end of the financial year in which such default was made good.

(h) the company has not been penalised by Court or Tribunal during the last three years of any offence under the Reserve Bank of India Act, 1934 , the Securities and Exchange Board of India Act, 1992, the Securities Contracts Regulation Act, 1956, the Foreign Exchange Management Act, 1999 or any other special Act, under which such companies being regulated by sectoral regulators.

The detail disclosures are provided in Rule 4 of the Companies (Share Capital and Debentures) Rules, 2014 in explanatory statement to be sent to shareholders for passing ordinary resolution and disclosures in report of Board of Directors too.

(II) The critical points for issue of DVR are as follows:

(a) the shares with differential rights shall not exceed twenty-six per cent of the total post-issue paid up equity share capital including equity shares with differential rights issued at any point of time;

The above clause provides that DVR cannot exceed 26% of the total post-issue paid up equity share capital including DVR.

Does it mean that the voting rights cannot go beyond 26% or it simply means that the number of shares cannot exceed 26%?

Since, DVR is a differential right w.r.t dividend, voting or other rights, it is quite possible that by holding 1 DVR the voting rights can be of 10 Equity shares etc. Hence the restriction is only on the number of DVRs including equity shares.

(b) The Company having consistent track record of distributable profits for the last three "years"

The erstwhile Rules had a requirement of having distributable profits as per section 205 of the Companies Act, 1956 for the three preceding financial years. The Rule 4(1)(b) of the current rules mentions "years" instead of "financial years".

According to section 3(66) of the General Clauses Act,1897 'year' shall mean a year reckoned according to British calendar. This is Gregorian calendar consisting of 365 days and 366 days in leap year. It begins on January 1 and ends on December 31.

But if we apply the rule of contextual interpretation, it requires that the court should examine every word of statute in its context, while keeping in mind the preamble of the statute, other provisions thereof, pari material statute, if any and the mischief intended to be remedied. Context often provides a key to the meaning of the word and the sense it carries. The Court would normally adopt an interpretation which is in line with the purpose of such regulation[8].

Section 123 of the Companies Act, 2013 has provisions for declaration of dividend. The section refers to financial year. Hence, it can be concluded that the "year" referred to in Rule 4(1)(b) can be read as "financial year".

The Company needs to check the track record of distributable profits as per this rule for the financial years.

(g) the company has not defaulted in payment of the dividend on preference shares or repayment of any term loan from a public financial institution or State level financial institution or scheduled Bank that has become repayable or interest payable thereon or **dues with respect to statutory payments relating to its employees** to any authority or default in crediting the amount in Investor Education and Protection Fund to the Central Government.

The attention is needed on payment of dividend to preference shareholders and dues with respect to statutory payments relating to employees.

Following is the list of Acts which can fall into "statutory payments relating to employees":

- The Employees Provident Fund Act – 1947
- The Apprentices Act – 1961
- The Maternity Benefit Act – 1961
- The Workmen's Compensation Act – 1923
- The Payment of Gratuity Act – 1972
- The Payment of Wages Act – 1936
- The Industrial Disputes Act -1947
- The Payment of Bonus Act – 1965
- The Employees State Insurance Act – 1948:
- Professional Tax Act
- POSH (Prevention of Sexual Harassment Act)

(Note:- This is just illustrative list and not exhaustive.)

(h) the company has not been penalised by Court or Tribunal during the last three years of any offence under the Reserve Bank of India Act, 1934, the Securities and Exchange Board of India Act, 1992, the Securities Contracts Regulation Act, 1956, the Foreign Exchange Management Act, 1999 **or any other special Act,** under which such companies being regulated by sectoral regulators.

8 Union of India V Alok Kumar (2010 AIR SCW 3804)

What is "Penalty"?
Directorate of Enforcement vs. MCTM Corporation Pvt. Ltd. AIR (SC) 1996) in which Hon'able Supreme Court have explained the meaning of word "Penalty".

"The officers of the Enforcement Directorate and other administrative authorities are expressly empowered by the Act to "adjudicate' only. Indeed they, have to act "judicially" and follow the rules of natural justice to the extent applicable but, they are not "Judges' of the "Criminal Courts" trying an "accused' for commission of an offence, as understood in the general context. They perform quasi-judicial functions and do not act as "Courts" but only as "administrators' and "adjudicators'.

In the proceedings before them, they do not try "an accused" for commission of "any crime" (not merely an offence) but determine the liability of the contravenor for the breach of his "obligations" imposed under the Act.

They impose "penalty' for the breach of the "civil obligations' laid down under the Act and not impose any "sentence" for the commission of an offence.

The expression "penalty' is a word of wide significance. Sometimes, it means recovery of an amount as a penal measure even in civil proceedings. An exaction which is not compensatory in character is also termed as a "penalty'. When penalty is imposed by an adjudicating officer, it is done so in "adjudicator proceedings' and not by way of fine as a result of "prosecution" of an "accused' for commission of an "offence" in a criminal Court.

Therefore, merely because "penalty' clause exists in Section 23(1)(a) of FERA Act 1947 the nature of the proceedings under that Section is not changed from "adjudicator' to "criminal' prosecution. An order made by an adjudicating authority under the Act is not that of conviction but of determination of the breach of the civil obligation by the offender.

It is thus the breach of a "civil obligation" which attracts "penalty".

The failure to pay the penalty by itself attracts 'prosecution' Under Section 23F of FER 1947 and on conviction by the 'court' for the said offence imprisonment may follow".

Even the Companies (Amendment) Ordinance 2018 amended certain sections replacing "Fine" with "Penalty" for in-house adjudication process.

6. Critical Points need to be considered while using DVR

Some important points which we need to check while considering DVR:

1. Article of Association must have a provision to issue DVR.
2. No default in payment of dividend to preference shares
3. No default in filing financial statements and annual returns for three financial years immediately preceding the financial year in which it is decided to issue such shares.
4. No default in payment of statutory dues with respect to statutory payments relating to its employees
5. No penalty for the last three years for any offence under the Reserve Bank of India Act, 1934, the Securities and Exchange Board of India Act, 1992, the Securities Contracts Regulation Act, 1956, the Foreign Exchange Management Act, 1999 or any other special Act
6. The explanatory statement has all disclosures prescribed under Rule 4
7. The Director's Report has all disclosures prescribed under Rule 4

This article focusses on DVR by promoters, but it can be used by any investor too.

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Bhavik Gala, *Company Secretary*

Private Placement of Securities and Preferential Allotment

Introduction

In today's scenario, every Company needs funds at some point of time to make its business successful As the Company keeps on growing, the demand for the funds also increases. It can raise funds either through debt or equity. The Company raises its funds by various methods.

Primarily, issues of securities by Public Limited Companies can be classified as a public, rights or preferential issues (also known as private placements). While public and rights issues involve a detailed procedure and more time consuming, private placements or preferential issues are relatively simpler. The raising of funds through the issue of securities by way of private placement is one of the preferred methods by the companies.

Background & laws governing issue of securities including Private Placement

In India, a Company planning to issue securities shall abide by relevant provisions of

(a) Securities Contracts (Regulation) Act, 1956 ('SCRA'),

(b) Securities Contracts (Regulation) Rules, 1957 ('SCRR'),

(c) Companies Act, 2013 (hereinafter referred to as the Act) and The Companies (Prospectus and Allotment of Securities) Rules, 2014

(d) Securities and Exchange Board of India (SEBI) Act, 1992 and the rules and regulations made there under.

Chapter III of the Act deals with "Prospectus and allotment of securities", the chapter is divided into two parts, Part I deals with Public Offer and **Part II deals with Private Placement**.

Section 23 of the Act provides that a Company whether public or private may issue securities.

A public company may issue securities:

(a) to public through prospectus ("public offer") by complying with the provisions of Part I of Chapter III of the Act; or

(b) through private placement by complying with the provisions of Part II of Chapter III of the Act; or

(c) through a rights issue or a bonus issue in accordance with the provisions of this Act and in case of a listed company or a company which intends to get its securities listed also with the provisions of the SEBI

Act, 1992 and the rules and regulations made thereunder.

For a private company, the section provides that a private company may issue securities (a) by way of rights issue or bonus issue in accordance with the provisions of this Act; or (b) through private placement by complying with the provisions of Part II, Chapter III of the Act.

Due to lacuna under the erstwhile provisions of Companies Act, 1956 relating to Private Placement the said law was misused by the Companies and their promoters which resulted in the compromising the interest of the shareholders.

A classic example of the misuse is of Sahara, where two companies: Sahara India Real Estate Corporation Limited and Sahara Housing Investment Corporation Limited of Sahara group, under the veil of private placement, issued optionally fully-convertible debentures ("OFCDs") amounting to about ₹ 24,000 crore to more than 2 crore investors. They made the private placements in the multiples of 49 (in line with the provisions of Companies Act, 1956) and in essence made a public issue through a private placement. The Court upheld the proceedings of the SEBI and Sahara Group was ordered to refund the amount to investors along with interest.

Hence, specific provisions relating to 'Private Placement' have been introduced under Companies Act 2013. The provisions relating to private placement have become more structured and time oriented with as compared to the law which was under the Companies Act, 1956, SEBI Act and SCRA.

Provisions of Companies Act, 2013 relating to Private Placement

Section 42 under Chapter III Part II of the Act, deals with the offer and allotment of securities through 'Private Placement'.

The entire Section 42 of the Act has been amended pursuant to Companies Amendment Act, 2017. On August 07, 2018, the Central Government has issued a notification bringing into force the provisions of Section 10 of the Companies (Amendment) Act, 2017 amending Section 42 of the Companies Act, 2013 (Act) relating to private placement norms for issue of securities. Further, consequential amendments required to the Companies (Prospectus and Allotment of Securities) Rules, 2014, as amended (PAS Rules) pursuant to Companies (Prospectus and Allotment of Securities) Second Amendment Rules, 2018 have also been notified.

As per explanation provided under Section 42 of Act, **"Private Placement"** means 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 this section.

Law prior to amendment

Before the amendment, Section 42 of the Act, 2013 read with Rule 14 of the Companies (Prospective and Allotment of Securities) Rules, 2014, prescribed the following requirements:

1. Obtaining approval from the shareholders of the Company by way of special resolution to approve the proposed offer;
2. Identifying prospective investors and sending Private Placement Offer Letter in Form PAS-4;
3. Accompanying offer letter by an application form serially numbered and addressed specifically;
4. Barring any offer under private placement unless past allotments under private placement are completed;
5. Subscribing securities only by way of banking channels such as cheque or demand draft and not by cash;
6. Capping the minimum value of such offer or invitation per person with an investment size of at least ₹ 20,000/- of face value of the securities;
7. Opening a separate bank account in a scheduled bank for parking the amount received on application;

8. Allotting securities within 60 days of receipt of application money and in case the company fails to do so, then repayment of the application money within 15 days from the completion of the 60th day otherwise the companies are liable to pay interest at the rate of 12 percent p.a. from the expiry of the 60th day.
9. Barring use of any public advertisements, media marketing or distribution channels for identifying prospective investors and instead maintaining a record of offers in PAS-5 having pre-identified investors to whom the offer is to be made;
10. Filing of e-Form PAS-3 i.e., return of allotment with the Registrar containing the details of the security holders with relevant information within 30 days of circulation of Private Placement Offer Letter.

Law as it stands post amendment

While the procedural requirements of making private placement of securities is majorly same to that of the provisions of the Act, as stated above, there are few significant changes into it as brought in by the Companies Amendment Act, 2017. The changes are:

1. **Authority with the Board to identify investors:** While the Act, 2013, did not provide any clarity on the authority in order to identify the prospective investors, the same was implied that the authority lies with the Board as the Board is empowered to approve a proposal of issuance of securities. The same is now specifically stated and may be said to be only a clarificatory change.
2. **No Renunciation rights:** Where the Act, 2013 was silent on the right of renunciation in the hands of the investor, the Act, 2017, explicitly provides a clarity on the fact that the private placement offer letter and the application shall not carry any renunciation rights. Private placement being an issuance of securities to a specific pre-identified person only, this was implied that the offer would not carry the right of renunciation unlike rights shares which are offered to the existing shareholders.
3. **Discontinuation of filing Form GNL-2:** Under the Act, 2013, the Company was required to file complete information about the offer with the Registrar and with SEBI (if listed) within 30 days of circulation of the offer letter. However, the requirement of the same has been done away with under the Act, 2017. This will surely reduce the compliance burden of the companies. Consequential change in the rules is also expected w.r.t the same in due course.
4. **Subsequent offers at the same time:** In comparison to the Act, 2013, the Act, 2017, commends for more than 1 private placement offer at a time. The same is very pertinent especially in case on non-convertible debentures where the Company is required to make private placement based on negotiated terms and conditions with each investor. In such a case, such amendment is an enabling amendment.
5. **Reduced timeline for filing PAS-3 and separate penalty:** The Act, 2017 provides for filing the return of allotment within 15 days from the date of allotment compared to 30 days of that in Act, 2013, thereby, making it stringent for companies.
6. **Two-fold penalty:** The Act, 2017 provides for dual situations attracting penal provisions:
   a. In case the Company defaults in filing return, then its promoters and directors shall be liable to a penalty up to ₹ 25 lakh for such delay.
   b. In case, the company makes an offer or accepts monies in contravention of the provisions of the section 42, then its promoters and directors shall be liable for a penalty. The law makers have not prescribed any minimum

amount of penalty but have kept it open-ended by extending it to the amount raised through the private placement, however, capping it to ₹ 2 crore. The said penalty shall be lower of the two as compared to that of Act, 2013, where higher of the two was to be levied. Further, the company shall also be required to refund the money raised to the subscribers with interest within 30 days of penalty imposed.

7. **No utilisation of money received from private placement unless PAS-3 filed:** A very important or significant change which is rather a strange change brought in the Act, 2017, is that the company making the offer or invitation for subscription of securities through private placement is not allowed to utilise the money raised through private placement unless the return of allotment is filed with ROC. This creates an impractical situation for companies whose fund generation is primarily based on private placement of securities considering filing itself is a post facto event.

The amendments in Section 42 seems to have answered much of the recommendations/ expectations of the stakeholders. However, stalling the utilization of the funds received through private placement in an era where divestment of funds is a mouse-click away, mandatory holding back the funds merely for the sake of filing the form seems to be a retrograde change. Further, mere technical glitches w.r.t filing of forms by way of MCA server turning down etc. may become a hassle for companies.

A Private Placement offer can be given to maximum to 200 persons in a Financial Year.

Any offer or invitation made to qualified institutional buyers, or to employees of the company under a scheme of employees stock option as per provisions of clause (b) of sub-section (1) of section 62 shall not be considered while calculating the limit of two hundred persons.

Every offer of securities other than public, rights or bonus offer amounts to a Private placement and governed by Section 42 of Act.

If offer given to more than 200 persons in a F.Y. shall be deemed to be public offer or any private placement offer not complying with the requirements of the section of the Act shall be **deemed Public Offer**.

The provisions relating to Section 42 of the Act relating to Private Placement will be applicable to Private and Public Companies both.

The issue of securities such as equity shares and convertible securities are governed both by provisions of private placement under Section 42 of the Act and preferential allotment under Section 62 of the Act. It is to be noted every preferential issue is private placement but not vice-versa.

Brief Procedure for issue of securities under Private Placement

Phase 1: Prior to issuance of Private Placement Offer-cum-Application Letter (PPOAL)

1. Passing of Board resolution under Section 179(3)(c) of the Act for issue of securities;
2. Delegating the power in relation to identifying persons, making of offer addressed to such identified persons, distributing of offer letter, allotment of securities to a Committee of Board or Committee of Management or officers of the Company;
3. Filing of resolution passed under point No. 1 and 2 with the Registrar pursuant to Section 117(3)(g) of Act in e-Form MGT 14;

   Private companies are exempted from the requirement to file eform MGT-14 under Section 117(3)(g) for resolutions passed under Section 179 *vide* Notification dated 5th June, 2015. However, such private companies will also be required to file MGT-14 for board resolution passed for issue of securities under private placement.

4. Seeking approval of shareholders by way of special resolution for issue of securities by way of private placement;
   - Separate approval of shareholders shall not be required in case of issuance of non-convertible debentures if the proposed amount to be raised is within the borrowing limits approved by the shareholders under Section 180 (1) (c) of the Act, 2013.
   - Explanatory statement to specify the matters provided in proviso to Rule 14 (1) reproduced hereunder:
     - Particulars of the offer including date of passing of Board resolution;
     - Kinds of securities offered and the price at which security is being offered;
     - Basis or justification for the price (including premium, if any) at which the offer or invitation is being made;
     - Name and address of valuer who performed valuation;
     - Amount which the company intends to raise by way of such securities;
     - Material terms of raising such securities, proposed time schedule, purposes or objects, contribution being made by the promoters or directors either as part of the offer or separately in furtherance of objects, principal terms of assets charged as securities.
5. Filing of resolution passed under 4 above with the Registrar pursuant to Section 117 (3) (a) of Act, 2013 in e-Form MGT 14;
6. Identification of persons to whom offer is required to be made by the Board or Committee/ officers delegated with the power by the Board;
7. Ensuring the number of persons to whom the offer to be made does not exceed 200 (reckoned individually for each kind of security that is equity share, preference share or debenture) in a financial year.
   - Limit is not applicable in case of NBFCs, HFCs if they are complying with regulations made by the Reserve Bank of India or the National Housing Bank in respect of offer or invitation to be issued on private placement basis.
8. Recording the names and addresses of the person in the record of private placement maintained in Form PAS-5;
9. Opening of separate bank account for receipt of application money;

Phase 2: Issuance of PPOAL

10. Sending of PPOAL in Form PAS 4 to the identified persons within 30 days of recording the name of such person. PPOAL shall not carry right of renunciation;

    No fresh offer or invitation under this section shall be made unless the allotments with respect to any offer or invitation made earlier have been completed or that offer or invitation has been withdrawn or abandoned by the company.

Phase 3: Post issuance of PPOAL

11. Every identified person willing to subscribe to the private placement issue shall apply in the private placement and application issued to such person along with subscription money paid either by cheque or demand draft or other banking channel and not by cash;
12. Payment shall be made for subscription to securities from the bank account of the person subscribing to such securities in the separate bank account of the Company;

This shall not apply in case of issue of shares for consideration other than cash.

13. Company shall keep record of the bank account from where such payment is received;

Phase 4: Allotment of securities

14. Allotment shall be made by the Board or Committee/ officers delegated with the power;

15. Return of allotment shall be filed in e-Form PAS-3 with the Registrar within **15 days of allotment;**

16. Company shall utilise the amount only after filing the return of allotment;

17. Company shall issue share certificates/ debenture certificates within a period of two months from the date of allotment;

18. Entry shall be made in the register of members/ debenture holders within 7 days of after the Board of Directors or its duly constituted committee approves the allotment of securities.

Compliance and exemptions for Issuance of Non-convertible Debentures (NCDs) under Private Placement Route

It is to be noted that compliance for issuance of Non-convertible Debentures under Private Placement shall be same as mentioned above under Section 42 of the Act.

But there is partial exemption provided with respect to calculation of limits of 200 persons with respect to issuance of NCDs by :

- Non-Banking Financial Companies (NBFCs) registered with Reserve Bank of India (RBI)
- Housing Finance Companies (HFCs) registered with National Housing Bank (NHB)

if they are complying with regulations made by RBI or NHB in respect of offer or invitation to be issued on private placement basis.

At present the regulations prescribed for NCDs are as under:-

- Guidelines on Private Placement of NCDs (maturity more than 1 year) by NBFCs.
- Housing Finance Companies issuance of Non-Convertible Debentures on private placement basis (NHB) Directions, 2014

Electronic Book Mechanism for Issuance of Securities

SEBI *vide* its Circular dated April 21, 2016 introduced electronic bidding platform (EBP) mechanism with respect to issuance of Debt and Non-Convertible Redeemable Preference Shares (NCRPS) which are intended to be listed by any issuer.

Following are the limits prescribed in relation to applicability of compliance under EBP mechanism

1. In case of single issue of ₹ 200 crore more (including green shoe option)
2. In case of Shelf issue-multiple tranches, cumulatively amounts to ₹ 200 crore more in a Financial Year.
3. In case of subsequent issues, then aggregate of all previous issues if it equals to ₹ 200 crore or more in a financial year.

Following are the compliances to be followed under EBP platform:

1. To provide Private Placement Memorandum (PPM) which is Private Placement Offer Letter and term sheet on EBP.
2. The said PPM to be provided at least two working days prior to start of issue opening date.
3. Disclose the details of size of issue, bid opening and closing date and minimum bid lot

4. Eligibility to participate-
    - QIBs which are excluded from the limit of 200 under Section 42 of the Act and entitled to participate in all issuances on the particular exchange.
    - Non-QIBs.
5. EBM-bid open to all QIBs, any QIB may register and participate. In case of non-QIBs, only those who have been selected by issuer can participate.
6. The PPOAL shall be circulated as per Sec 42 of the Act to pre - identified investors
7. EBM-Uploading of PPOAL is deemed circulation to all QIBs
8. Accessible only to QIBs and those non-QIBS as intimated by issuer to EBP

Compliance requirements under SEBI ICDR Regulations with respect to issuance of shares or convertible securities by listed entities

When a listed issuer issues shares or convertible securities, to a select group of persons in terms of provisions of Chapter V of SEBI (ICDR) Regulations, it is called a preferential allotment. The issuer is required to comply with various provisions which *inter alia* include pricing, disclosures in the notice, lock in etc., in addition to the requirements specified in Companies Act, 2013.

It covers allotment of fully convertible debentures, partly convertible debentures or any other financial instruments that could be converted into equity shares at a later date.

Following are the compliances to be followed by listed companies under Chapter V of SEBI ICDR Regulations with respect to Preferential Allotment

1. Conditions for preferential issue

- All equity shares allotted by way of preferential issue shall be made fully paid up at the time of the allotment;
- A special resolution is required to be passed by its shareholders.
- All the equity shares if any, held by the proposed allottees in the issuer are in dematerialised form.
- An issuer cannot make preferential issue of securities to any person who has sold any equity shares of the issuer during the six months proceeding the relevant date.
- A listed company shall not make any preferential issue of specified securities unless it is in compliance with the conditions for continuous listing.
- A listed company shall not make any preferential allotment of specified securities unless it has obtained the Permanent Account Number of the proposed allottees.

2. Ineligibility to issue shares or convertible securities on preferential basis

1. Preferential issue of specified securities shall not be made to any person who has sold or transferred any equity shares of the issuer during the six months preceding the relevant date.
2. Where any person belonging to promoter(s) or the promoter group has previously subscribed to warrants of an issuer but has failed to exercise the warrants, the promoter(s) and promoter group shall be ineligible for issue of specified securities of such issuer on preferential basis for a period of one year from:
    a) the date of expiry of the tenure of the warrants due to non-exercise of the option to convert; or
    b) the date of cancellation of the warrants, as the case may be.
3. An issuer shall not be eligible to make a preferential issue if any of its promoters or directors is a fugitive economic offender.

3. Pricing of equity shares

A. Pricing of frequently traded shares

If the equity shares of the issuer have been listed on a recognised stock exchange for a period of twenty six weeks or more as on the relevant date, the price of the equity shares to be allotted pursuant to the preferential issue shall be not less than higher of the following:

a. the average of the weekly high and low of the volume weighted average price of the related equity shares quoted on the recognised stock exchange during the twenty six weeks preceding the relevant date; or

b. the average of the weekly high and low of the volume weighted average prices of the related equity shares quoted on a recognised stock exchange during the two weeks preceding the relevant date.

Relevant Date means

a) in case of preferential issue of equity shares, the date thirty days prior to the date on which the meeting of shareholders is held to consider the proposed preferential issue:

Provided that in case of a preferential issue of specified securities pursuant to any resolution of stressed assets under a framework specified by the Reserve Bank of India or a resolution plan approved by the National Company Law Tribunal under the Insolvency and Bankruptcy Code 2016, the date of approval of the corporate debt restructuring package or resolution plan shall be the relevant date.

b) in case of a preferential issue of convertible securities, either the relevant date referred to in clause (a) of this regulation or a date thirty days prior to the date on which the holders of the convertible securities become entitled to apply for the equity shares.

A preferential issue of specified securities to qualified institutional buyers, not exceeding five in number, shall be made at a price not less than the average of the weekly high and low of the volume weighted average prices of the related equity shares quoted on a recognised stock exchange during the two weeks preceding the relevant date.

B. Pricing of Infrequently traded shares

Where the shares of an issuer are not frequently traded, the price determined by the issuer shall take into account the valuation parameters including book value, comparable trading multiples, and such other parameters as are customary for valuation of shares of such companies:

Provided that the issuer shall submit a certificate stating that the issuer is in compliance of this regulation, obtained from an independent valuer to the stock exchange where the equity shares of the issuer are listed.

4. Lock-in of specified securities – Promoters

The specified securities allotted on preferential basis to promoter or promoter group and the equity shares allotted pursuant to exercise of options attached to warrants issued on preferential basis to promoter or promoter group, shall be locked-in for a period of three years from date of trading approval granted for the specified securities or equity shares allotted pursuant to exercise of the option attached to warrant, as the case may be BY LISTED COMPANIES Sec. 62(1) of Companies Act, 2013 & SEBI (ICDR) Regulations, 2018

Provided that not more than twenty per cent of the total capital of the issuer shall be locked-in for three years from the date of trading approval.

Provided further that equity shares allotted in excess of the twenty per cent shall be locked-in for one year from the date of trading approval pursuant to exercise of options or otherwise, as the case may be.

5. **Lock-in of specified securities – Other than Promoters**

The specified securities allotted on preferential basis to persons other than promoter and promoter group and the equity shares allotted pursuant to exercise of options attached to warrants issued on preferential basis to such persons shall be locked in for a period of one year from the date of trading approval.

6. **Disclosures to Shareholders**

The issuer shall, in addition to the disclosures required under the Companies Act, 2013 or any other applicable law, disclose the following in the explanatory statement to the notice for the general meeting proposed for passing the special resolution:

a) objects of the preferential issue;

b) maximum number of specified securities to be issued;

c) intent of the promoters, directors or key managerial personnel of the issuer to subscribe to the offer;

d) shareholding pattern of the issuer before and after the preferential issue;

e) time frame within which the preferential issue shall be completed;

f) identity of the natural persons who are the ultimate beneficial owners of the shares proposed to be allotted and/or who ultimately control the proposed allottees, the percentage of post preferential issue capital that may be held by them and change in control, if any, in the issuer consequent to the preferential issue:

Provided that if there is any listed company, mutual fund, scheduled commercial bank, insurance company registered with the Insurance Regulatory and Development Authority of India in the chain of ownership of the proposed allottee, no further disclosure will be necessary.

Explanation: For the purpose of identification of the ultimate beneficial owners of the allottees, where the allottees are institutions/ entities, the identification of such ultimate beneficial owners, shall be in accordance with the guidelines prescribed by the Board, if any.

g) undertaking that the issuer shall re-compute the price of the specified securities in terms of the provision of these regulations where it is required to do so;

h) undertaking that if the amount payable on account of the re-computation of price is not paid within the time stipulated in these regulations, the specified securities shall continue to be locked- in till the time such amount is paid by the allottees.

i) disclosures specified in Schedule VI, if the issuer or any of its promoters or directors is a wilful defaulter.

7. **Tenure of Convertible Securities**

The tenure of the convertible securities of the issuer does not exceed beyond 18 months from the date of their allotment.

8. **Payment of consideration**

Full consideration of specified securities other than warrants issued under this Chapter shall be paid by the allottees at the time of allotment of such specified securities

With respect to payment of consideration for issue of warrants, an amount equivalent to at least twenty five per cent of the consideration shall be paid against each warrant on the date of allotment of warrants. The balance seventy five per cent of the consideration shall be paid at the time of allotment of equity shares pursuant to exercise of option against each such warrant by the warrant holder.

9. **Allotment**

Allotment pursuant to the special resolution shall be completed within a period of fifteen days from the date of passing of such resolution:

Provided that where any application for exemption from the applicability of the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 or any approval or permission by any regulatory authority or the Central Government for allotment is pending, the period of fifteen days shall be counted from the date of the order on such application or the date of approval or permission, as the case may be.

Conclusion

On going through the new provisions in the Companies Act, 2013, we can conclude that appropriate measures have been put in place to curb the malpractices and it revamps several concepts and introduces various provisions for better clarity and effectiveness. The major introductions for fund raising and capital structuring under the Act is that it clearly provides for the ways in which public company or a private company may issue securities. However, due to stringent requirements for raising of funds through private placements, there has been a significant increase in the compliance burden for private companies looking to raise funds through private placement. Since, no specific exemption has been provided for private companies or small companies, it has lead to reduced flexibility for private companies.

Also, though the revamping of the entire section 42 of the Act with respect to private placement seem to have answered much of the recommendations/expectations of the stakeholders, at the same time it seems inappropriate approach of the law maker, particularly stalling the utilisation of the proceeds until efiling of Form PAS 3. In this era of business, where money is transferred within seconds, such a mandate to hold the funds till filing of Form is very regressive. Additionally, it is well-known that the stakeholders are facing recurring technical issues with filing forms from time to time in the MCA website which in turn may add up to the time the funds are to be kept idle. Apart from the proviso enabling the companies to make parallel offer at any time, most of the previous requirements have been retained as it is which almost makes the whole activity of rewriting pointless.

Apart from the proviso enabling the companies to make parallel offer at any point of time, most of the previous requirements has been retained as it is which almost makes the whole activity of reintroducing the Section again makes the effort meaningless.

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CA Bhavesh Vora

Raising of Public Deposits – From RBI's perspective

Introduction

The history of deposits began with the first prototype banks which were the merchants of the world, who made grain loans to farmers and traders who carried goods between cities. This was around 2000 BC in Assyria, India and Sumeria. Later, in ancient medieval ages, lenders based in temples made loans, while accepting deposits and performing the change of money. The Mauryan dynasty which flourished between 321 to 185 BC, already had established instruments similar to letters of credit. In India, the formal deposit acceptance was established by large scale money lenders and banks established under the British rule era. Therefore, the concept of deposit acceptance is as old as money itself.

Regulations on 'Deposits' have had a trend of focusing extensively on individuals in the earlier periods, while in later period regulations have also focused on legal entities, in addition to individuals.

Various regulations regarding 'Deposits' under numerous enactments, both under the State and Central jurisdictions of the Government have been prescribed to check misutilization of deposits and to put proper monitoring mechanism and thereby enhance public trust. The efforts undertaken by the regulator have yielded good results whereby confidence in the system is restored and strengthened.

What is Deposit?

The word 'Deposit' is defined under section 45I(bb) of the Reserve Bank of India Act, 1934 ["RBI Act"] to include any receipt of money by way of deposit or loan or in any other form, but excludes (a) amounts raised as capital, (b) amounts received from a bank / specified institutions, (c) amounts received in ordinary course of business as security deposit, dealership deposit, earnest money, advance against orders for non-financial goods, properties and services (d) amounts received from registered money lenders.

The Companies Act, 2013 has defined deposit to include any receipt of money by way of deposit or loan or in any other form by a company, but does not include such categories of amount as prescribed in consultation with the Reserve Bank of India. The Companies (Acceptance of Deposits) Rules, 2014 lays down the regulations on the same.

Additionally, the definition of deposit varies from State-to-state based on the respective regulations. For example, the Maharashtra Protection of Interests of Depositors (In Financial Establishments) Act, 1999 defines 'Deposit' to include any receipt of money or acceptance of any valuable commodity by any Financial Establishment to be returned after a specified period or otherwise, either in cash or in kind or in the form of a specified service with or without any benefit in the form of interest, bonus, profit or in any other form, subject to prescribed exceptions.

Prohibition on acceptance of Deposits

Section 45S of the RBI Act prohibits certain cases in which an individual / firm / unincorporated body ["UIB"] from acceptance of deposits.

Prohibition has been laid down if the individual / UIB is involved, wholly or partly, in the business of financing, investment in / trading of shares and securities, hire purchase / is a financial lessor, insurance business, managing chits / kuries, accepting monies under a scheme or sale of units / instruments etc.

A deposit from members of same HUF as well as from relatives is permissible.

The RBI Act, therefore, has regulatory powers to check illegal deposit acceptance in India. This however, is in a manner, handicapped approach since the monitoring of such transactions entered into by individuals / unregulated entities is difficult to have oversight on.

Deposits vs. Public Deposits

The distinction for public deposits, as compared to deposits, is presence of additional exclusions to the definition of deposits prescribed under the RBI Act.

The Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 2016 defines public deposits as deposits majorly excluding amounts received from:

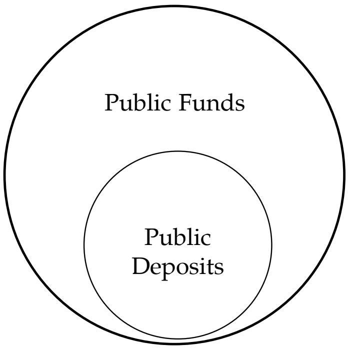
- Central / State Government (Including amounts guaranteed by them)
- Specified Institutions
- Director when he / she held such post and prescribed declaration was obtained
- Shareholder (For Private Companies) when prescribed declaration was obtained
- A Company
- Issue of securities as per Company Law
- Bonds / Debentures secured against asset / compulsorily convertible to equity
- Non-Convertible bonds / debentures having maturity of more than one year, subject to additional regulations
- Loan from promoters, subject to conditions
- Mutual Funds
- Hybrid / Subordinate Debt with minimum maturity of 60 months
- Perpetual Debt Instruments issued to NBFC-ND-SI
- Commercial Papers subject to their regulations

Public Funds

Reserve Bank of India has recently revised the definition of 'Public Funds'. Such definition is used by the regulator to regulate the entities based on the public's exposure in it.

Public Funds have been defined under the Non-Banking Financial Company - Systemically Important Non-Deposit Taking Company and Deposit taking Company (Reserve Bank) Directions, 2016 to include funds raised directly or indirectly through public deposits, inter-corporate deposits, bank finance and all funds received from outside sources such as funds raised by, issue of Commercial Papers, debentures etc. but excludes funds raised by issue of instruments compulsorily convertible into equity shares within a period not exceeding 5 years from the date of issue.

It may, therefore, be said that Public Deposits is a sub-set of public funds.



Raising of Funds

Taking NBFC sector as an example, Commercial Papers form 50% of short-term borrowings of large NBFCs, while bank finance and loans from Directors / Shareholders dominate the short term funding markets for smaller NBFCs.

This trend throws light on the fact that while large entities can issue complex financial instruments to raise relatively cheaper funds. However, entities having smaller operations find it difficult to obtain appropriate credit ratings to tap such funding markets.

Currently, the repo market is also holding massive untapped potential. Investment Companies and Financial Institutions having unencumbered securities seldom opt for this form of borrowing. The transactions as a Repo Seller are governed by the Repurchase Transactions (Repo) (Reserve Bank) Directions, 2018. RBI, in 2017, had also permitted entities to enter into tri-party repo transactions with the involvement of tri-party agents.

Other Money Market Instruments such as Certificates of Deposits, NCDs with maturity up to one year, etc. are governed by the RBI's specific Directions on Money Market Instruments. While the regulations prescribe only basic requirements of reporting, major parameters of interest rates have been left on to the market demand and supply.

Borrowings from unincorporated bodies, especially in closely held entities, to fund short term liquidity requirements pose a major concern for regulatory oversight. This is because if the borrowing entity undertakes any of the prescribed activities, including investments in securities, such borrowing transaction may be considered as a violation of Section 45S of RBI Act.

RBI currently is not actively monitoring the transactions entered into by unregulated entities.

NBFCs raising Public Deposits

NBFCs permitted to raise public deposits are required to comply with the following regulations:

- Invest minimum 10% of 'public deposits' outstanding at the last working day of second preceding quarter, into unencumbered approved securities, and remaining 5% term deposits / bonds of specified FIs.
- Minimum Credit Rating, rated at least once a year
- Prohibition on accepting demand deposits
- Ceiling of Deposits at 1.5 times the Net Owned Funds
- Ceiling on rate of interest at 12.5% per annum
- Prohibition of brokerage on public deposits
- Content of media used for soliciting public deposits

Auditors of such deposit accepting NBFCs have also been laid with additional reporting responsibilities in terms of Non-Banking Financial Companies Auditor's Report (Reserve Bank) Directions, 2016.

It shall, however, be noted that Residuary Non-Banking Financial Companies do not have any ceiling on quantum of deposits.

Why RBI is so restrictive on raising public deposits?

The Reserve Bank of India's overarching concern while supervising any financial entity is protection of depositors' interest. Depositors place deposit with any entity on trust unlike an investor who invests in the shares of a company with the intention of sharing the risk as well as return with the promoters. Protection of depositors' interest thus holds high emphasis.

Disruptive Innovations

We are in the middle of a multi-wave trend where digital is first focused on optimising current products and services. The second wave, where enhanced data capture and analysis drives more targeted customer offerings and improved services is underway. Mobile banking will increasingly disrupt distribution models (e.g. instant videoconferences with product experts) and the payments industry (e.g. peer to peer lending platforms, mobile payments). Advanced systems on IT platforms will enable all aspects of sales, service, delivery and settlement, to be conducted online. Technology is making it easier for customers to switch financial institutions, making relationships much less sticky. This will drive the third wave, where Financial Institutions develop sophisticated profiles on each of their customers. The pace of innovation will continue to increase, and leading financial institutions will leverage this innovation. All of this will accelerate the evolution of leading banks / non-banks into customer-centric information and risk management businesses.

At the same time, disruptive innovation is creating deposit acceptance opportunities between two individuals / entities on electronic platforms without any audit trail, thereby expanding the borrowing / lending activities in all directions.

Unregulated Deposit Bill

The Banning of Unregulated Deposit Schemes Bill, 2018 is aimed at tackling the menace of illicit deposit taking activities and Ponzi schemes in the country. Companies / institutions running such schemes exploit existing regulatory gaps and lack of strict administrative measures to dupe poor and gullible people of their hard-earned savings.

The proposed Bill aims to provide a comprehensive legislation to tackle illicit deposit schemes by completely prohibiting such activities. Nine regulators including the RBI, SEBI, the Ministry of Corporate Affairs, and the State Governments regulate financial activities. According to the Bill, all deposit-taking schemes are required to be registered with the relevant regulator, failing which the "Deposit Takers" will be considered "unregulated" and hence be banned.

"Deposit" is defined in such a manner that deposit takers are restricted from camouflaging public deposits as receipts, and at the same time not to curb or hinder acceptance of money by an establishment in the ordinary course of its business.

Concluding Remarks

The regulators have come a long way in restricting the unregulated deposits and in educating the public to ensure they do not become victims of unscrupulous businessmen / agents / entities.

It shall be interesting to observe the shift in regulatory environment, given the dominant emergence of e-wallets and fintech models.

The regulator is merely a seatbelt and not the driver and therefore stakeholders hold moral responsibility to ensure that the public interest remains protected and they come together to enhance trust in the system and to provide enough cushion for any systemic risks.

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CA Pratik Singhi

Various aspects of Valuation under Companies Act and Income Tax

Introduction

A lot has changed in India, in a little over couple of decades as far as valuation of shares/securities is concerned. Till recently, we were in the era of what is now referred to as the 'CCI valuation formula', proposed by the erstwhile CCI (The Controller of Capital Issues), which was abolished when The Securities Exchange Board of India (hereinafter referred to as 'SEBI') was formed in 1992. In comparison to then, the coverage of instances when a formal independent valuation exercise is to be carried out by a competent professional, and the depth that a valuation exercise needs to go to has increased manifold. From lack of any framework, to a developed and well-organized valuation framework in the making, we have come a long way.

In this article, we will focus on aggregating all requirements on the issue of valuations, primarily financial valuation, as required *qua* the provisions of the Companies Act, 2013 (hereinafter referred to as 'CA13') and the Income-tax Act, 1961 (hereinafter referred to as 'ITA61'). Discussion around CA13 necessitates also discussing the concept of registered valuer (hereinafter referred to as 'RV') as implied by sec 247 of CA13, and the other rules and regulations that the RVs have to adhere to.

To keep this article focused on specific subject matter, the following have not been covered:

- Valuation of listed shares/securities
- Valuation of non-financial assets such as jewellery, immovable property, art works, etc.
- Determination of fair market value (hereinafter 'FMV') in case of conversion of stock-in-trade to capital asset

Income-tax Act, 1961

ITA61 requires a fair value of the underlying asset/liability to be assessed in many cases. The major sections of ITA61 that require a valuation to be carried out, are tabulated here-below:

Section	Purpose
9(1)(i)	Deemed income in case of indirect transfer of shares
17(2)(vi)	Shares issued under ESOP
28(via)	Inventory converted into capitalised asset

Section	Purpose
43CA	Transfer of assets other than capital assets, in certain cases
50C	Transfer of immovable assets
50CA	Transfer of unquoted shares
50D	Deemed full value of consideration in certain cases
56(2)(viib)	Fresh issue of shares
56(2)(x)	Receipt of asset without consideration or at consideration less than FMV
115TD(2)	Accreted income

Income-tax Rules applicable for Valuation

Depending on the section of ITA61 that triggers the need for valuation, there are guidelines given in the Income Tax Rules (hereinafter referred to as 'IT Rules'). Depending on the Rule, the assessee may arrive at the FMVC on the basis of the specific method provided for in the Rule, or alternatively may get the valuation conducted externally by a competent professional. In most cases (relevant to non-physical assets) the relevant valuation professional required by the Rule is either a SEBI-registered merchant banker (hereinafter 'MB') or an Accountant, which typically refers to a chartered accountant.

The relevant Rule as per IT Rules applicable in various cases, as also the prescribed professional, is tabulated as herebelow:

Purpose	IT Rule	Who can conduct valuation	Sec of ITA61
Shares issued under ESOP	3(8)	MB	17(2)(vi)
Determination of value of assets and apportionment of income in certain cases.	11UB	MB/Accountant	9(1)(i)
Fresh issue of shares	11UA(2)	MB	56(2)(viib)
Receipt of asset without consideration or for consideration less than FMV	11UA(1)	MB/Accountant	56(2)(x)
Transfer of unquoted shares	11UAA	MB/Accountant	50CA
Accreted income	17CB	MB/Accountant	115TD(2)
Vesting of options	40D	MB	115WC(1)(ba)

Note: the term 'Accountant' has *different* meaning for different Rules.

Valuation Methodology

In most cases, albeit not all, the respective sections in ITA61 does not specify the methodology to be used for carrying out the valuation. However, the relevant provisions of the IT Rules do indicate the choice of methodology that an assessee must/may adopt for that respective valuation. While the IT Rules allow the assessee to choose a method, in a couple of cases, the Rules dictate the use of DCF as the valuation methodology in case the other suggested option (broadly, can be referred to as a variant of the book value approach) is not adopted. As also, it specifies that if in case the DCF methodology is adopted, the valuation can necessarily be conducted only by a SEBI-registered merchant banker (Rules 11UA2 and 3(8)).

Section 56 read with Rule 11UA

Sec 56(2)(x) deals with charging an implied gain due to difference in fair value of an asset and the transaction value of an asset transferred, and sec 56(2)(viib) provides for charging difference of the issue price of a share over its fair value in case of a fresh issue of unquoted shares by a company (except when the new shares are issued to a duly registered venture capital fund, or when such shares are issued by a company duly registered as a 'startup' under the Startup India Scheme). The computation of such implied gains, which are chargeable to tax are to be derived from workings as per Rule 11UA of the IT Rules, which deals with the valuation of various assets for the purpose of sections 56(2)(viib) or 56(2)(x) of ITA61.

Additionally, Sec 56(2)(viia) deals with implied profits if any on shares received by an assessee by way of a transfer of shares against no or inadequate consideration. Also, while it was never the intent of the authorities, the terminology used in the wording of sec 56(2)(viia) lent itself to being misinterpreted to be applied even in case of fresh issue of shares by way of bonus, rights or preferential issues – yet another area causing trouble to assessees. Vide its circular no 10/2018 dated 31 December 2018, the CBDT had clarified that sec 56(2)(viia) shall be applicable only in case the receipt of shares is by way of transfer of shares and not in case of issuance of fresh shares. However, this circular was repealed vide another circular no 02/2019 dated 04 January 2019, stating that the matter is under judicial examination and that the matter needs to be examined afresh so that a comprehensive circular on the matter can be issued.

Rule 11UA is possibly the most important rule from a practicing valuer's perspective. This rule is primarily divided into two sub-rules:

- Rule 11UA1 determines the FMV of an existing property, other than immovable property, and including jewellery and artistic work
- Rule 11UA2 determines the fair market value of unquoted shares for the purpose of sec 56(2)(viib) of the IT Act, which relates to fresh issue of unquoted shares by a company at a price higher than its face value.

Rule 11UA1

In case of valuation required under Rule 11UA1, in case of unquoted shares/securities, the assessee can adopt any method (note: no specific method prescribed in the Rules) to arrive at the fair value and have an Accountant or an MB endorse it.

Alternatively, as provided for in Rule 11UA1(c)(b), the FMV of unquoted equity shares, on the valuation date, is to be determined by the assessee as hereunder:

FMV = (A+B+C+D–L) × (PV)/ (PE)

where, broadly:

A = book value of all the assets (subject to certain prescribed adjustments and separate calculations, and excluding B, C, and D below)

B = price which the jewellery and artistic work would fetch if sold in the open market on the basis of the valuation report obtained from an RV;

C = FMV of shares and securities as determined in the manner provided for;

D = FMV of immovable property;

L = book value of external liabilities shown in the balance sheet, subject to certain prescribed adjustments;

PV = paid up value of such equity shares;

PE = total amount of paid up equity share capital as per the balance sheet.

Rule 11UA2

Rule 11UA2 is triggered in case of a fresh issue of shares (as contemplated in sec 56(2)(viib) of ITA61), where the issue price is higher than the face value of the shares, and where the fair value of these shares has to be computed as provided in Rule 11UA2. Per Rule 11UA2(a), the assessee can have the fair value computed as per DCF method (note: this specific method – DCF – is specified in the Rules) by a merchant banker (note: effective 24th May 2018, 'Accountant' is disabled from conducing valuation under this clause).

Alternatively, as provided for in Rule 11UA2(b), the FMV of unquoted equity shares, on the valuation date, is to be determined by the assessee as hereunder:

FMV = (A–L) × (PV)/ (PE)

where, broadly:

A = book value of all the assets, subject to certain prescribed adjustments

L = book value of external liabilities shown in the balance sheet, subject to certain prescribed adjustments

PV = paid up value of such equity shares;

PE = total amount of paid up equity share capital as per the balance sheet.

Detailed note on the calculation methodology can be read on the website www.incometaxindia.gov.in; specific link provided here: http://bit.ly/FMVunquoted.

Rule 11UAA

Rule 11UAA prescribes that for the purposes of sec 50CA, the FMV of the share of a company other than a quoted share, shall be determined as provided in Rule 11UA(1)(c)(b)/(c). It further provides that the reference to valuation date in the Rule 11U and Rule 11UA shall mean the date on which such shares are transferred.

Angel Tax

Sec 56(2)(viib) has unwittingly been a bane to small companies (especially startups), and investors, as it seeks to tax the amount invested into the company by issue of shares over its book value, as income from other sources. This has led to what is now commonly referred to as 'Angel Tax' issue, which has become a thorn in the flesh of many funded/to-be-funded startups.

For the purposes of this section, FMV of the shares is considered as higher of what is determined in accordance with such method as may be prescribed; or as may be substantiated by the company to the *satisfaction of the Assessing Officer* (hereinafter 'AO'), based on myriad factors. This provides a lot of discretion to the AO to arrive at what s/he thinks is the FMV of the underlying shares.

The primary reason why sec 56(2)(viib) also evokes such fear in the hearts of the startups and investors is because the law hands such significant discretionary powers to the AO. The valuation in such cases is typically arrived at on the basis of a Valuation Report given by a qualified valuation professional, which in turn is based on the inputs of company's management and is acceptable to sophisticated investors. However, in spite thereof, it needs to be to AO's satisfaction. This discretion to the AO for subjective interpretation has led to much litigation, whereby the AO can lower the value as the FMV and tax the entire premium as income in the hands of the companies.

On the one hand, with the 'Startup India' programme, the Government has taken several proactive steps to protect and nurture the startup ecosystem in India. After several startups complain over receiving 'Angel tax' notices, the Government has finally swung into action. It has said that the *bona fide* investments in startups will not be taxed for exceeding FMV. The official twitter handle of @DIPPGoI tweeted this on 19th December 2018: 'DIPP, in consultation with the Department of Revenue, has put in place a mechanism since April 2018 to grant exemption from the provisions of Section 56(2)(viib) of the Income-tax Act to genuine investors in recognised startups. The Department has again taken up this matter of issue of notices with the Department of Revenue so that there is no harassment of Angel Investors or Startups.'

We would all like to believe this is as a light at the end of the tunnel.

Companies Act, 2013

Intriguingly, CA13, refers to the phrase 'fair value' or 'value' innumerable times. But, nowhere in the Act is the term defined! The statute, if it can be so called, where the term fair value is now defined is the Indian Valuation Standard that simply defines fair value 'the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the valuation date.'

The major sections of CA13 that require a valuation exercise to be carried out are tabulated herebelow:

Section of CA13	Purpose
62(1)C	Further issue of shares (except rights issue and ESOPs)
192(2)	Assets involved in arrangement of non cash transactions with Directors
230(2)	Valuation of shares, property and assets of company under a CDR scheme
230(3)	Valuation report along with notice of creditors/ shareholders meeting – under scheme of compromise/ arrangement.
232(2)	Report of the expert with regard to valuation, if any, to be circulated for meeting of creditors/members
232(3)	Valuation report to be made by the tribunal for exit opportunity to the shareholders of transferor company – under the scheme of compromise/arrangement in case the transferor company is listed and the transferee-company is an unlisted company.
236(2)	Valuation of equity shares held by minority shareholders.
260(2)	Valuation report in respect of shares and assets to arrive at the reserve price for company Administrator
281(1)	Valuing assets for submission of report by liquidator in case of winding up
305(2)	Valuing assets for submission of report by liquidator in case of voluntary winding up
319(3)b	Valuing interest of any dissenting member who did not vote in favour of the special resolution
325(1)b	Valuation of annuities and future and contingent liabilities in winding up of insolvent company

CA13 had introduced the concept of a 'registered valuer' under a separate chapter to cover all kinds of valuation requirements. The Ministry of Corporate Affairs (hereinafter 'MCA') had notified the provisions governing valuation by registered valuers [sec 247 of the Act and the Companies (Registered Valuers and Valuation) Rules, 2017 (hereinafter referred to as 'CVR17')], to come into effect from 18th October 2017. As per the notified sec 247(1) of CA13, whenever a valuation is required to be made in respect of any asset (which includes liability) under the provisions of CA13, it shall be conducted only by an RV[1], on such terms and conditions as may be prescribed and appointed by the audit committee or in its absence by the Board of Directors of that company.

This notification finally lends the much-needed ample clarity, seriousness, and credibility to an exercise that was hitherto considered routine and a necessary evil. The clear motive

1 As per its notification dated 26th September 2018, MCA has extended the last date for obtaining registration certificate for persons who are rendering valuation services without a certificate of registration under the CVR17 up to January 31, 2019. Accordingly, all valuations required to be done under CA13, on or after 1st February 2019, can be done only by an RV.

is to set expected standards and regulate the practice bringing in transparency and better governance in a valuation exercise, which ought to be conducted only by a qualified valuation professional.

Who can be a Valuer?

While the Insolvency and Bankruptcy Board of India (hereinafter 'IBBI') has prescribed a detailed list of requirements to be an RV, it would suffice to say that any post-graduate, or a professional (CA, or CMA or CS) with 3 years' experience, or a graduate with 5 years' experience, can apply, through an appropriate RVO, to become an RV. The choice of RVO shall depend on, *inter-alia*, the class of asset that the RV would like to become an RV for. Of course, the incumbent can make this application only duly completing the mandatory 50 hours' training and clearing the relevant RV exam thereafter. Such as application has to be made within 3 years of passing such exam. Detailed requirements can be obtained here: https://ibbi.gov.in/Regulations-RV.pdf.

Companies (Registered Valuers and Valuation) Rules, 2017

In most instances, CA13 does not specify the valuation method or methodology to follow. However, since the valuation is necessarily to be carried out by an RV, s/he is obligated to follow the CVR17. These Rules, in turn, necessarily mandate that an RV shall 'make valuations as per the Valuation Standards notified from time to time by the Central Government'. Kindly also refer Rule 16.

As of now, CVR17 govern the valuation requirements only under the Companies Act, 2013 and under the Insolvency and Bankruptcy Code, 2016 (hereinafter 'IBC16'). This means that the conduct of valuations under other laws including under Income tax, FEMA, SEBI etc.) shall not be affected by virtue of CVR17.

Inter-alia, CVR17 lay down the following:

- Compliance with valuation standards (Rule 16)
- Minimum requirements in a valuation report (Rule 18)
- Model professional code of conduct for valuers (Schedule I)

A slightly detailed list of the above-mentioned requirements, and discussion thereon, is provided in Annexure A.

As also, as of now, only the valuations to be conducted under the CA13 and IBC16 are mandated to be carried out by an RV. It is common opinion amongst valuation practitioners that its only a matter of time before all the valuation exercises to be conducted, mandated under any statute, will be compulsory needed to be carried out by an RV. By when exactly this may happen, is anybody's guess.

Indian Valuation Standards, 2018, issued by ICAI

Recognising the clear need to have a uniform and consistent valuation policies and practices across the country, the Institute of Chartered Accountants of India (hereinafter 'ICAI') issued the Indian Valuation Standards 2018 ('IVS18'),

IVS18 broadly includes the framework for the preparation of valuation report, valuation bases, approaches and methods, scope of work, analyses and evaluations, documentation and reporting, intangible assets and financial instruments, among several other aspects.

Inter-alia, IVS18 lays down the following:

- Qualitative characteristics of a valuation report (as listed in the Framework for Preparation of valuation report under IVS, not specifically in a valuation standard)
- Factors influencing valuation bases (IVS102 para 12)
- Premise of value (IVS102 para 38)

- Selection of appropriate valuation methodology (IVS103 para 12)
- Guidance on three main valuation approaches/method (IVS103)
- Adjustments to be made (IVS103 paras 28 and 35)
- Analysis of asset to be valued (IVS201 para 29)

A slightly detailed list of the above-mentioned requirements is provided in Annexure B.

ICAI mandates the compliance with IVS18 for all CAs conducting valuations under various provisions of the CA13. Additionally, those RVs who are registered as an RV though the ICAI Registered Valuers Organisation (hereinafter 'ICAI RVO'), are also obligated to mandatorily adhere to IVS18; while it is only recommendatory in case of those RVs that are IBBI-accredited through any of the other nine RVOs. Every valuation report issued on or after 1st July 2018 by an RV who has to comply with IVS18, has to be in compliance with IVS18.

Conclusion

Thus, recognising the importance of valuation, the Rules introduced by MCA, together with IVS18 issued by ICAI, will provide a benchmark to the professionals to ensure uniformity in approach and quality of valuation output.

ANNEXURE A: Summary of Relevant Rules in CVR17

Compliance with Valuation Standards (Rule 16)

CVR17 requires that an RV shall make valuations as per the Valuation Standards notified from time to time by the Central Government. (note: the CVR17 were made before the IVS18 were notified). Until such time as the Valuation Standards are notified by the Central Government, a valuer needs to make valuations as per –

- an internationally accepted valuation methodology; or
- valuation standards adopted by any valuation professional organisation; or
- valuation standards specified by RBI, or SEBI, or any other statutory regulatory body

Minimum Requirements in a Valuation Report (Rule 18)

Until recently there was no guidance or a standard format of report/ disclosure of a valuation report. Now, with CVR17 coming into play, an RV is necessarily required to state the following in the valuation report:

- background information of the asset being valued;
- purpose of valuation and appointing authority;
- identity of the valuer and any other experts involved in the valuation;
- disclosure of valuer interest/conflict, if any;
- date of appointment, valuation date and date of report;
- sources of information;
- procedures adopted in carrying out the valuation;
- valuation methodology;

- major factors that influenced the valuation;
- conclusion; and
- caveats, limitations and disclaimers

This requirement of CVR17 has taken away all the discrepancies and inadequacies that were not uncommon in most of the valuation reports that were hitherto being generated by valuers.

Code of Conduct for Valuers (Schedule I)

Schedule I of CVR17 also lays down the detailed code of conduct for RVs. Broadly, they cover the following specific areas in detail:

- Integrity and fairness
- Professional competence and due care
- Independence and disclosure of interest
- Confidentiality
- Information management
- Gifts and hospitality
- Remuneration and costs.
- Occupation, employability and restrictions.

Annexure B: Summary of Relevant Compliance Requirements per IVS18

IVS18, *inter-alia*, defines the approaches and methods for valuing an asset and provides guidance on use of various valuation approaches and methods. IVS18 is applied in selecting the appropriate valuation approaches and methodologies in determining the value of an asset. An RV decides the approach to valuation based upon the purpose of the valuation in accordance with applicable Valuation Standards and can choose from the Asset, Income and Market approaches to valuation.

Qualitative Characteristics of a Valuation Report (paras 11-20 of Framework for Preparation of Valuation Report under IVS)

Qualitative characteristics are the attributes that make the information provided in valuation report useful to the intended users. The qualitative characteristics expected in a valuation report are:

- Understandability
- Relevance
    - o materiality
- Reliability
    - o faithful representation
    - o substance over form

- o neutrality
- o prudence
- o completeness
- o balance between cost and benefit
- o balance between qualitative characteristics.

Factors Influencing Valuation Bases (IVS102, para 12)
The valuation exercise and selection of valuation bases depend on but not limited to, the following:

- – nature of the asset to be valued;
- – scope and purpose of the valuation engagement;
- – valuation date/ measurement date;
- – intended purpose of the valuation;
- – applicable standard of value;
- – applicable premise of value;
- – assumptions and limiting conditions; and
- – applicable governmental regulations

Premise of Value (IVS102, para 38)
Premise of value refers to the conditions and circumstances how an asset is deployed. In a given set of circumstances, a single premise of value may be adopted while in some situations multiple premises of value may require to be adopted. Some common premises of value are as follows:

- – highest and best use;
- – going concern value;
- – as is where is value;
- – orderly liquidation; or
- – forced transaction.

Selection of Appropriate Methodology (IVS103 para 10)
The appropriateness of a valuation approach for determining the value of an asset would depend on valuation bases and premises. Additionally, some of the key factors that a valuer shall consider while determining the appropriateness of a specific valuation approach and method are:

- – nature of asset to be valued;
- – availability of adequate inputs or information and its reliability;
- – strengths and weakness of each valuation approach and method; and
- – valuation approach/method considered by market participants.

Valuation Approaches/Methods to be Considered (IVS103)
IVS103 of the IVS18 provides guidance for following three main valuation approaches:

- Market approach to valuation (IVS103, para 14)
  - Market price method
  - Comparable Companies Multiple (CCM) Method and
  - Comparable Transaction Multiple (CTM) Method
- Income approach to valuation (IVS103, para 49)
  - Discounted Cash Flow (DCF) Method
  - Relief from Royalty (RFR) Method
  - Multi-Period Excess Earnings Method (MEEM)
  - With and Without Method (WWM) and
  - Option pricing models such as Black-Scholes-Merton or Binomial model
- Cost approach to valuation (IVS103, para 95)
  - Replacement cost method
  - Reproduction cost method

Adjustments to be made (IVS103, paras 28 and 35)
Para 28 of IVS103 also lists down some of the differences between the asset to be valued and market comparable that the valuer may consider while making adjustments to the market multiple or transaction multiple, as may be applicable:

- size of the asset;
- geographic location;
- profitability;
- stage of life-cycle of the asset;
- diversification;
- historical and expected growth; or
- management profile.
- conditions if any governing the comparable transaction such as deferred payment of consideration contingent on achievement of certain milestones.

Further, paras 36-48 of IVS103 also lists provides guidance about premium and discounts as may be relevant in specific cases.

Analysis of Asset to be Valued (IVS201 para 29)
Para 29 of IVS201 lists down the kind of information to be obtained for any valuation. It says that if the valuer relies on the information available in public domain, s/he should assess the credibility/reliability of such information taking into account, inter-alia, the purpose of valuation, and materiality *vis-à-vis* the valuation conclusion. Additionally, the type, availability, and significance of such information may vary with the asset to be valued. Such information shall, *inter-alia*, include:

- non-financial information such as
  - o nature, background, and history of the business;
  - o facilities;
  - o organizational structure;
  - o management team (which may include officers, directors, and key employees);
  - o classes of equity ownership interests and rights attached thereto;
  - o products or services, or both;
  - o capital markets providing relevant information; e.g., relevant public stock market
  - o information and relevant merger and acquisition information;
  - o prior transactions involving the subject business, or involving interests in, the securities of, or intangible assets in the subject business;
  - o economic environment;
  - o geographical markets;
  - o industry markets;
  - o key customers and suppliers;
  - o competition;
  - o business risks;
  - o future outlook for the business;
  - o strategy and future plans;
  - o governmental or regulatory environment;
  - o legal status of the asset being valued.
- financial info, such as:
  - o historical financial information (including annual and interim financial statements and key financial statement ratios and statistics) for an appropriate number of years;
  - o prospective financial information (for example, budgets, forecasts, and projections)- in the absence of which the valuer could consider information on future developments or course of the business;
  - o comparative summaries of financial statements or information covering a relevant time period;
  - o comparative common size financial statements for the subject entity for an appropriate number of years;
  - o comparative common size industry financial information for a relevant time period;
  - o income tax returns for an appropriate number of years;
  - o information on compensation for owners including benefits and personal expenses;
  - o details of and management's response to the inquiry regarding:
    - advantageous or disadvantageous contracts;
    - contingent or off-balance-sheet assets or liabilities;
    - surplus/ non-operating assets.

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SS-IV-51

CA Anup P. Shah

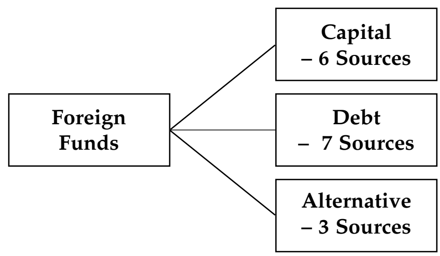
Global Sources of Fund Raising

Overview

Finance to a company is what oxygen is to a living being. However, fund raising is a very complex and complicated exercise since not only does it involve finding the right and cheapest sources of finance but it also entails compliance with various regulatory and tax requirements. One wrong step and the company could end up paying a heavy price, both literally and / or in forms of penalties or prosecution! The intricacies get compounded further when one raises global funds or foreign finance. In addition to the above, the company would also have to consider the myriad requirements of the Foreign Exchange Management Act, 1999 and its numerous Regulations. Nevertheless, foreign funds have always been very attractive for Indian companies due to the relatively cheaper cost associated with them and sometimes out of a (perceived) prestige value. Describing all these finance sources in detail could merit an entire Special Story by itself, however, for the sake of the Article, let us have a bird's-eye view of the important avenues of global finance and some of the salient features associated with them.

Global Avenues

One may divide the international finance sources which could be tapped by an Indian company into Three Broad Buckets – Capital, Debt and Alternative Sources. These could be explained better with the following diagram:



The global **Capital** options may be further expanded into **Six** sources:

FDI	**QIP**	**FVCI**
FPI - Private Placement	**NRI Non Repatriable**	**ADR / GDR**

The foreign **Debt** options consist of **Seven** popular sources:

ECB	**FCCB/FCEB**	**Masala Bonds**
INR NCDs	**FPI Bonds**	**Green Bonds**
	NRI Deposits	

The **Alternative** sources of global funds comprise of **Three** popular avenues:

AIFs	• **Category I to III Alternative Investment Funds**
REITs	• **Only for the Real Estate Sector**
InvITs	• **Only for the Infrastructure Sector**

The important facets of the legal ecosystem to be borne in mind while raising global funds consists of:

(a) Companies Act, 2013 and its Rules, such as the Companies (Share Capital and Debentures) Rules, 2014; Companies (Prospectus and Allotment of Securities) Rules, 2014, etc.

(b) Foreign Exchange Management Act, 1999 and Regulations

(c) SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 for listed companies only

(d) SEBI Takeover Regulations for listed companies and only for raising equity capital

(e) Income-tax Act and the relevant Double Taxation Avoidance Agreements, if any.

Each of the above enumerated **16 sources** of funds are briefly explained below.

(i) **FDI** – Foreign Direct Investment refers to investment in the capital *(equity, compulsorily convertible debentures, compulsorily convertible preference shares, warrants, partly paid up shares)* of a company by any person resident outside India. Schedule 1 of the *FEM (Transfer or Issue of any Security to a Person Resident Outside India) Regulations, 2017* and the *Consolidated Foreign Direct Investment Policy* issued every year by the Ministry of Commerce govern the FDI requirements, sectoral caps, conditions, pricing, valuation, instruments, reporting, etc. FDI is expressly prohibited in certain sectors, such as, tobacco, gambling, atomic energy, etc. Foreign investment in an listed company of 10% or more of the capital / in an unlisted company of any amount would always be treated as FDI whereas foreign investment of less than 10% in a listed company would not be FDI. Almost all foreign entities, except a few such as erstwhile OCBs which have been blacklisted, can invest under the FDI route. The issuer company must also bear in mind the provisions of private placement under s.42 and s.62 of the Companies Act, 2013 as well as the Preferential Issue Regulations under the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 if it is a listed company. In addition, an open offer under the SEBI Takeover Code could get triggered if the foreign investor acquires 25% or more voting rights / shares in a listed company or makes a creeping acquisition of 5% or more in a financial year.

FDI can be bifurcated on the basis of its approval into **Automatic Route**, i.e., where FDI does not require the prior approval of the Government of India and there is only a *post facto* filing with the Reserve Bank of India and **Approval Route**, i.e., where the prior approval of the Government of India is required. Whether FDI in a particular company is under Automatic Route or Approval Route, depends upon the Sectoral Policy applicable to that company. After the abolishment of the FIPB, the nodal ministries for different sectors are the approving authority for FDI. For instance, the competent authority for granting FDI approval for defence is the Department of Defence Production, Ministry of Defence, for Trading it is the Department of Industrial Policy & Promotion, for Banking it is the Department of Financial Services, etc.

(ii) **FPI – Private Placement** – A Private Placement / Preferential Issue of equity shares by a listed company to a SEBI-registered Foreign Portfolio Investor **(FPI)** is also possible under Schedule 2A of the FEM (Transfer or Issue of any Security to a Person Resident Outside India) Regulations,

2017. The maximum holding of all FPIs can be increased up to the sectoral cap, if any, for the company but each FPI must hold less than 10% of the company. The provisions of Chapter VII of the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 would have to be complied with by the issuer company. For instance, Godrej Properties Ltd. made a preferential issue of ₹ 1,000 cr. to Gamnat Pte, a Category I FPI owned by the Government of Singapore.

(iii) **QIP** – A Qualified Institutional Placement, or a preferential issue by a listed company, can be made to foreign Qualified Institutional Buyers, such as, Category I and II FPIs or Foreign Venture Capital Investors. A placement document and a merchant banker are required under Chapter VIII of the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009. A minimum of 2 allottees are needed if the QIP is less than ₹ 250 cr. else 5 allottees are needed. All QIPs put together ≤ 5 times the networth of the issuer company as per its last audited balance sheet. For instance, JM Financial Ltd raised ₹ 650 cr. by a QIP issue from investors which included Category I and II FPIs.

(iv) **NRI Non-repatriable** – Under Schedule 4 of the FEM (Transfer or Issue of any Security to a Person Resident Outside India) Regulations, 2017, Non-resident Indians and Overseas Citizens of India as well as entities owned and controlled by them are eligible to invest on a non-repatriable basis in all Indian companies except those engaged in Nidhi / chit funds / plantations / real estate business, etc. The investment is treated as domestic investment and is not subject to the pricing / reporting / sectoral restrictions which one finds under the FDI regime. The investment can be equity shares / compulsorily convertible debentures / compulsorily convertible preference shares / warrants of listed or unlisted companies. Only the interest and the dividend on the investment is repatriable while the principal and the gains must be credited to the NRO Account of the NRI.

(v) **ADR / GDR** – Indian companies, whether listed or even private limited, can issue American Depository Receipts (listed / issued in the USA) or Global Depository Receipts (listed / issued elsewhere, such as, Luxembourg, Singapore, London, etc.,) under the Depository Receipts Scheme, 2014 which is the governing law for such issues. Under this shares are issued by the Indian company to a Foreign Depository which issues Depository Receipts to foreign investors on the strength of these shares. These receipts could be listed or unlisted but usually, these are listed on a stock exchange abroad. The issue can be made in any of the 34 permissible jurisdictions. The Indian company must also comply with the FEMA Regulations. A two-way fungibility is also possible wherein investors can exchange their equity shares for ADR / GDR and *vice-versa*. A non-resident to a non-resident transfer of depository receipts abroad is exempt from capital gains tax. Recently, HDFC Bank Ltd. raised ₹ 12,000 crore through an ADR issue.

(vi) **FVCI** – A SEBI-registered Foreign Venture Capital Investor **(FVCI)** can invest in the capital / non-convertible debentures of an Indian unlisted company under Schedule 7 of the FEM (Transfer or Issue of any Security to a Person Resident Outside India) Regulations, 2017. There are no sectoral restrictions for a start-up company but for other companies, this investment is possible only in 10 specified sectors, such as, infrastructure, pharma R&D, dairy, poultry, bio-fuels, etc. The benefit of this route is that there are no pricing / reporting requirements like the FDI route and the investment can even carry assured returns / fixed price exit.

(vii) **ECBs** – External Commercial Borrowings are foreign debt in the form of foreign loans, bank loans, foreign supplier's credit, etc., raised by an Indian company. These are governed by the FEM (Borrowing or Lending in Foreign Exchange) Regulations, 2000. Since these involve a scheduled repayment and are a big drag on the country's foreign reserves, the FEMA Regulations provide for a host of conditions. The conditions are divided on the basis of a Trackwise classification of the foreign debt and involve conditions such as, minimum average maturity of the loan, type of currency, who can borrow, who can be the lender, all-in-cost ceilings, end-use restrictions, etc., the ECBs could be raised on an automatic route for certain types of industries and up to a certain amount while the others would need prior RBI approval. Relaxations are prescribed from some conditions for consistent foreign exchange earners, low cost affordable housing projects, start-ups. Certain red flags, include, entities under investigation under FEMA, entities under Corporate Debt Resolution, conversion of ECB into equity, refinancing of ECBs, currency swapping of the ECB, parking of funds abroad, on-lending restrictions, etc. One important factor to be borne in mind are the tax consequences of foreign debt. The thin capitalisation rules u/s. 94B of the Income-tax Act coupled with the concessional TDS @ 5% on interest payments u/s. 194LC are important in this respect. An example of an ECB is Adani Ports and SEZ Ltd. raising 4% Senior Notes listed on the Singapore Stock Exchange with a 10-year tenure for refinancing its existing foreign debt.

(viii) **FCCBs / FCEBs** – Foreign Currency Convertible Bonds are foreign currency denominated bonds issued by an Indian company where the redemption and interest is payable in foreign currency. They are a part of the ECB regime and the issue must also conform to the FDI policy sectoral caps. The FCCBs may or may not be listed abroad and are convertible into equity shares of the Indian issuer company. Thus, they could either be redeemed or converted into shares. Interest on FCCBs carries a concessional tax @ 10% u/s. 115AC of the Income-tax Act. Capital gains on transfer of FCCBs abroad by one non-resident to another + on conversion into shares / debentures is exempt under the Income-tax Act. All other capital gains on FCCBs are taxable @ 10% u/s. 115AC.

Foreign Currency Exchangeable Bonds or FCEBs on the other hand are bonds issued by an Indian company which is the promoter of an Indian offered listed company. The FCEBs issued by the promoter company can be exchanged for equity of the Indian listed offered company. However, the sectoral caps and FDI Policy must be adhered to.

(ix) **Masala Bonds** – These are Rupee denominated Indian Bonds listed abroad (e.g., Singapore Stock Exchange / London Stock Exchange) – they carry a mix of Indian and Foreign and hence, the name "Masala"! These have found immense favour with foreign investors. These plain vanilla bonds can be issued only in nations which are compliant with money-laundering legislations and can be through a public issue or a private placement. Earlier, these were outside the ECB regime but now form a part of it. However, compared to plain-ECBs, they can be issued also for working capital; general corporate purposes; repayment of Rupee loans. The principal and the interest are paid in Indian Rupees to foreign investors. One important factor to be borne in mind are the tax consequences of foreign debt. The thin capitalisation rules u/s. 94B of the Income-tax Act coupled with the concessional TDS @ 5% on interest payments u/s. 194LC are important in this respect. Housing Development Finance Corporation Ltd. raised ₹ 3,000 crore from 7.8% Masala Bonds.

(x) **INR NCDs** – Normally Non-Convertible Debentures **(NCDs)** are not allowed for Foreign Investors since they are treated as ECBs and hence, require compliance with the ECB Regulations. However, Rupee denominated Debentures can be issued by an Indian company through a public offer made to NRIs and PIOs only. Other foreign investors are not eligible to invest in these NCDs. The maximum interest payable is the Prime Lending Rate of State Bank of India + 300 basis points and the minimum redemption time is 3 years.

(xi) **FPI-NCDs** – Another possible avenue of issuing NCDs to foreign investors and they yet not being treated as ECBs is the issue of NCDs to SEBI-registered FPIs under Schedule 5 of the FEM (Transfer or Issue of any Security to a Person Resident Outside India) Regulations, 2017. The NCDs must be listed and the issuer company can pay interest / redemption premium on such debentures. There are no sectoral / end-use restrictions and even private limited companies can issue listed debentures. Full repatriation is allowed of the proceeds. The minimum average maturity of the debentures must be three years but FPIs can sell the listed debentures before that also. The maximum investment by one FPI in a corporate bond issue is 50% of the issue size and hence, minimum two FPIs are needed for an issuance. Further, one FPI can invest a maximum of 20% of its bond portfolio in a single company. Thus, one FPI needs at least five NCD investments. The issuer company must follow the provisions of the SEBI (Issue and Listing of Debt Securities) Regulations. A credit rating and a debenture trustee is a must and secured debentures are also possible. There is a country-wide on-the-tap ceiling for FPIs to invest in listed NCDs. Currently, it stands are ₹ 2.89 lakh crore of which about 67% has been already utilised. One important factor to bear in mind is that such NCDs are outside the ECB regime and hence, there are no all-in-cost ceilings and other restrictions. For any private / public / listed company to issue listed debentures, the provisions of the SEBI (Issue and Listing of Debt Securities) Regulations, 2008 have to be followed.

The RBI has also proposed a Voluntary Retention Route (VRR) under which the above-mentioned restrictions of 20% and 50% would not apply if the FPI commits to voluntarily retain the NCDs in India for a certain specified period.

(xii) **Green Bonds** – Bonds raised for funding clean energy / green projects, such as solar / wind / hydro / renewable energy, etc., are called Green Bonds. Masala Bonds can also be Green Masala Bonds if they are for these projects. For instance, NTPC Ltd. raised ₹ 2,000 crore from 7.4% Green Masala Bonds for financing its wind and solar projects. Green Bonds can also be issued to FPIs.

To ensure that Green Bonds are indeed Green, the SEBI has issued conditions which must be complied with listed Green Bond issuers. Some of these include, getting an suditor's confirmation that funds have been utilised for stated Green purposes. An instance of a Green Bond is IFC Washington investing ₹ 667 crore in the Green bonds issued by L&T Infrastructure Finance Ltd which would be used by the issuer to fund solar power projects.

(xiii) **NRI Deposits** – Indian companies, including, NBFCs, can raise public deposits from NRIs / PIOs on a repatriation basis. The maximum maturity is 3 years and the interest rate cannot exceed that which has been prescribed for NBFCs by the RBI and for others under the Companies Act, 2013.

(xiv) **AIF** – SEBI-registered Alternative Investment Funds can issue units to persons resident outside India but FVCIs can only invest in Category-I AIFs. If the sponsor, investment manager and the asset management company are owned and controlled by resident Indian citizens, then the entire downstream investment by the AIF is treated as a domestic investment. In this case, the quantum of foreign investment in the corpus of the AIF is immaterial.

(xv) **REITs** – SEBI-registered Real Estate Investment Trusts can issue units to foreign investors and use the proceeds to acquire rental income generating real estate assets. The Blackstone-Embassy Group has filed its papers with the SEBI for India's 1st REIT.

(xvi) **InvITs** – Just as REITs help monetise real estate assets for a developer, SEBI-registered Infrastructure Investment Trusts help monetise infrastructure assets, such as, toll roads, power plants, port projects, etc. Foreign investors are permitted to invest in InvITs. For instance, IRB InvIT which has 7 toll-road projects has issued over 30% of its units to FPIs.

Exit Strategy

The purpose of any investment is to make money for the investor and the investor would make money only on exit. Hence, be it a local or a foreign investment, an exit strategy is a must. The popular options for exit of capital are *transfer/ sale; buyback; capital reduction*, etc. While structuring these options, the provisions of FEM (Transfer or Issue of any Security to a Person Resident Outside India) Regulations, 2017, the Income-tax Act and the provisions of the Companies Act, 2013 must be considered. One important aspect is that no assured returns or guaranteed exit price can be given. The exit must be in consonance with the prevailing fair market value of the investee company. However, there are certain cases when the FEMA pricing guidelines are not applicable. These include situations, such as sale of shares of an Indian company from any person resident outside India to any person resident outside India, including an NRI to an NRI.

Put and call options on instruments issued by an Indian company to non-residents are now expressly permissible under the FEMA Regulations as well as under the Securities Contract (Regulation) Act, 1957. However, even in such put and call options, the non-residents can be given a fixed price exit.

Debt instruments can carry a fixed price return since they are in the form of interest and / or premium on redemption. Certain innovative instruments which can also provide a guaranteed return to foreign investors are Masala Bonds, NCDs issued to FPIs and FCCBs.

When it comes to an exit, the income-tax issues are also very important. Some of the key factors, which merit attention are, the treatment of capital gains under the DTAA, if any, applicability of Indirect Transfer Rules u/s. 9(1)(i) of the Income-tax Act, applicability of GAAR provisions / BEPS Action 6 on Treaty Abuse, exemptions available u/s. 47 (e.g., conversion of CCPS / CCDs into equity) of the Income-tax Act, transfer pricing provisions, buyback tax @ 20% in case of unlisted companies, s.56(2)(x) for the buyer, etc.

Putting it all together

Structuring a foreign finance transaction is like placing together a jigsaw puzzle where every piece has its own rightful place. Exchange control, tax, regulatory, valuation, accounting aspects as well as due thought to exit considerations coupled with commercial factors are all relevant factors. All of these must be thought through at the stage of raising the funds and the Term Sheet and Documents must be drafted after thinking through these facets. Quite often, what happens is that companies first raise funds and then think about other features. This leads to a lot of subsequent problems which cannot always be harmoniously resolved. Hence, it would be advisable if companies are more circumspect when raising foreign funds so that they don't act in haste and repent in leisure!!

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B. V. Jhaveri, *Advocate*

DIRECT TAXES

Supreme Court

SLP dismissed against the order passed by the Commissioner u/s. 263 of the Act was not sustainable as the AO's estimation of godown receipts was a plausible view

PCIT vs. V. Dhana Reddy & Co. SLP (Civil) Diary Nos. 34500 of 2018 dated 29th October, 2018.

The assessee is a partnership firm engaged in the business of stevedoring, clearing and forwarding, shore handling and steamer agency services. In response to the notice issued under Section 148 of the Act, the assessee filed returns of income on estimated basis at 7.5% of the gross receipts. Assessment was completed by the Assessing Officer estimating the income at 10% of the gross receipts. The Commissioner of Income-tax invoked section 263 of the Act and initiated proceedings proposing to revise the orders of the AO. The CIT, after considering the explanation submitted by the assessee, had come to the conclusion that the AO erred in determining the income of the assessee at 10% on estimate basis in respect of godown receipts and hence, directed the AO to redo the assessment by assessing the godown receipts separately in addition to the income from contract receipts. In principle, the Commissioner found fault with the manner and method adopted by the AO on the ground that the same has resulted in underestimation of the total income. The assessee challenged the order of the CIT before the Appellate Tribunal, on the ground that invocation of the provisions under Section 263 of the Act itself is not warranted. The Tribunal, following the judgment of the Bombay High Court in *Grasim Industries Ltd. vs. CIT (321 ITR 92)* which had relied on the judgment of the Supreme Court in *Malabar Industrial Co. Ltd. vs. CIT (243 ITR 83)* had held that the AO, on appraisal of the facts and particularly, taking into consideration the undisputed fact that the books were not maintained by the assessee, had adopted the method of estimation of the income and in the process, after taking into consideration the overall material before it, had estimated the income at 7.5% of the gross receipts. The view taken by the AO being a plausible one and even assuming there was another view possible, the Commisioner could not have invoked the revisional power u/s. 263 of the Act, as it is well-settled that such ground is not available for revising the orders. In coming to this conclusion, the Tribunal had examined the material on record and did not accept the argument of the Revenue that the rentals from the godowns are required to be assessed at a higher rate of 12.5%.

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The High Court observed that the Assessing Officer had opined that renting of the godowns is integral part of the business of the assessee. The High Court held that a resort to section 263 cannot be made as the decision is arrived at by the Tribunal on appreciation of facts and the reason for invocation of Section 263 being that there is a possibility for estimating the income at a higher rate, without there being a finding of error in the Assessment Order. In the absence of any other material placed before the High Court, it dismissed the appeal of the Revenue.

The Supreme Court dismissed the Special Leave Petition of the Revenue and thus, the order of the High Court has become final.

SLP dismissed against High Court ruling affirming that the assessee fulfilled requirement to qualify for exemption u/s. 10(23C)(vi) in a case where the assessee society was setup with the object of imparting education and it had entered into franchisee agreement with satellite school and used the franchisee fee received for furtherance of educational purpose

Director of Income-tax (Exemptions) vs. Delhi Public Schools Society [Special Leave Petition (Civil) Diary Nos. 41122 & 42797 of 2018, dated 4th December, 2018] [2018] 100 taxmann.com 370 (SC)

The assessee-society is registered under the Societies Registration Act, 1860. It established 11 schools and also permitted societies or organizations or trusts with similar objects to open schools under its name and accordingly 120 schools were functioning under the assessee's name in and outside India. The arrangement for opening schools by the other societies was through execution of "education joint venture agreement" with the assessee. According to the agreements, the parties jointly agreed to manage the schools where the assessee had control in the management of schools. The assessee's income was exempted under section 10(22) since the assessment year 1977-78 till the assessment year 2007-08, by orders of the Tribunal. In view of the change in law, when section 10(22) was substituted by section 10(23)(vi) with effect from April 1, 1999, the assessee applied in Form 56D for approval of exemption u/s. 10(23C)(vi) from the A.Y. 2008-09 and onwards. The Additional Director (Exemption) issued a notice to the assessee directing it to file the requisite evidence in support of its claim for exemption u/s. 10(23C)(vi). In response to the notice, the assessee stated that it had received maintenance charges from the 120 satellite schools that it ran, according to the education joint venture agreements, which it had entered into with the satellite schools for providing services to such schools. It also stated that the maintenance charges received by it were not in lieu of a franchise of its name and logo, but towards a number of obligations discharged by it which were all in the course of imparting education. The Additional Director rejected the assessee's application on the grounds that the franchisee fees received by it from the satellite schools in lieu of its name, logo and motto amounted to a 'business activity" with a profit motive and certain clauses of the assessee's memorandum of association were not in conformity with its objectives. For the AYs. 1998-99 to 2001-02, 2003-04 and 2005-06, the Assessing Officer reopened the assessments of the assessee and treated the franchisee fees charged from the satellite schools as business activity and thus, a taxable business income for profit motive, to be taxed at maximum marginal rate as was held in the earlier assessment years. The Commissioner (Appeals) upheld the order of the AO. The ITAT deleted the additions of various amounts for the AYs. of 1998-1999 to 2001-2002, 2003-04 and 2005-06, made respectively by the Assessing Officer, holding that the income received by the assessee in each such case as a "franchisee fee" was exempt under section 10(23C)(vi) of the Act and that the provisions of section 11(4A) of the Act were not applicable to any of these cases.

The High Court, dismissing the appeals of the Department and allowing the Writ Petition of the assessee for AY. 2008-09, observed as under:

> "28. In light of the decisive test for determining eligibility for exemption under section 10(23C)(vi) of the Act, it is apparent that the assertion of the DGIT that the Assessee's activities including charging a franchisee fee could not be regarded as a charitable activity within the meaning of section 2(15) of the Act, and thus, inapplicable for exemption under section 10(23C)(vi) of the Act, has not been adequately substantiated, despite examination of the assessee's audited accounts. The DGIT asserted that the assessee is carrying out a business activity for profit motives by entering into franchise agreements, whereby, it has opened and is running around 120 schools, and that these charges were received by the assessee for using the name of Delhi Public School by the satellite schools in and outside India and no separate books of accounts were maintained by the assessee for the business activity as required under section 11(4A) of the Act. This is *prima facie* not correct, because the assessee has maintained, accounts audited in detail for financial years 2000-2001, 2003-04, 2004-05 and 2005-06. That aspect has been found by the ITAT for those assessment years. Such accounts have been maintained in compliance to what is required under the seventh proviso to Section 10(23C)(vi) and section 11(4A) of the Act.
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> "29. Furthermore, the memorandum of association of DPS Society, as well as the joint venture agreements entered into by DPS Society with the satellite schools validate the motive of an educational purpose that the assessee aims through its business activities and substantiate its contentions in that regard. On review of the assessee's audited accounts, it can be observed that the surpluses accrued by DPS Society are being fed back into the maintenance and management of the DPS schools themselves. This, reaffirms the assessee's argument that the usage of the gains arising out of its agreements are incidental to its educational purpose outlined by its objective of the assessee.
>
> "31. ..... On scrutiny, it can be observed that the accounts marked the heading "Secretary's Account", detail the heads of income and expenditure that cater to the various requirements of running and maintaining the satellite schools. Thus, *arguendo* if it were held that the objected activity were indeed commercial in nature, nevertheless, the realisation of profit by the assessee is through an activity incidental to the dominant educational purpose that its memorandum of association sets out, and is in turn being channelled back into the maintenance and management of the same schools, thus, fulfilling the objectives the assessee has set out in its memorandum of objectives.
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> "32. This court also notices that after the assessee filed an application for grant of exemption under section 10(23C)(vi) for assessment year 2008-09 onwards, that was rejected; in a notification, the DGIT under section 10(23C)(vi) issued certain conditions which were also duly fulfilled by the assessee, as follows:
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> "33. In view of the above analysis, it is concluded that the assessee fulfilled the requirements under section 10(23C)(vi) of the Act to qualify for exemption; DPS Society is maintaining its eleven schools and the 120 satellite schools in furtherance of the education joint venture agreements with an educational purpose that also

qualifies as a "charitable purpose" within the meaning of section 2(15) of the Act and is not in contravention of section 11(4A) of the Act."

The High Court therefore held that:

"35. For the foregoing reasons, the writ petition has to succeed. The questions of law framed for the appeals are answered in favour of the assessee and against the revenue. Accordingly, the assessee's writ petition (Writ Petition (Civil) No. 5340/2008) is allowed and all income tax appeals (ITA No. 605/2008; ITA No. 609/2008 ITA No. 521/2008; ITA No. 1086/2005; ITA No. 501/2008 and ITA No. 1432/2010) are dismissed. There shall be no order as to costs."

The Supreme Court dismissed the Special Leave Petition of the Revenue and therefore affirmed the order of the High Court which is reported in 403 ITR 49.

After the merger of the assessee company with another company, subsequent assessment order passed in the name of the assessee company was a nullity. SLP of the Department is dismissed

PCIT vs. BMA Capfin Ltd. [SLP Civil Diary No. 40486 of 2018 dated 19th November, 2018.]

In this case M/s. Xenial Investments Pvt. Ltd., i.e., the original assessee filed a return of income on 1st November 2004. The original assessment was completed but the matter was remitted on two occasions. In the third round, in reply to notice, the assessee had indicated that it underwent an entity change inasmuch as merger and amalgamation had been approved by the High Court *vide* order dated 10th October, 2013 w.e.f. 1st April 2012. The AO took note of this development but instead of completing the assessment in the hands and in the name of the amalgamated or merged entity, i.e., Adhunik Technology Pvt. Ltd., it proceeded to complete the separate assessment in the name of the (by then) non-existent entity, i.e., M/s. Xenial Investments Pvt. Ltd. The CIT(A) allowed the appeal of the assessee. The Tribunal, applying the ratio of the decision of the Delhi High Court in *Spice Entertainment vs. CIT [IT Appeal No. 475 of 2011]* and *CIT vs. Dimension Apparel (P.) Ltd. [(2015) 370 ITR 288 (Delhi)]*, upheld the CIT (A)'s order and held that the assessment was a nullity.

The High Court observed that the settled position arising from the string of judgments, i.e., from *Spice Entertainment vs. CIT* to *CIT vs. Vivid Marketing Services Pvt. Ltd.* are not distinguishable. The rationale for holding that even section 292B is inapplicable in all these cases was that once the corporate entity is merged with another, i.e., transferee corporation, the assessment had to be completed in the latter's hands.

The High Court held that the revenue, despite being intimated did not complete the assessment in the hands of amalgamated company even though the revenue department was notified about the development which the assessee was duty bound to do. The revenue persisted in completing a separate assessment order in respect of an entity which was non-existent.

For the above reasons the High Court held in favour of the assessee and held that no question of law arises.

The Supreme Court dismissed the appeal of the Revenue.

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

DIRECT TAXES

High Court

1. Reopening of assessment – within 16 years for an NRI – Assessee had settled a trust when he was an NRI – reopening on ground that no evidence was furnished of sources for settling the trust – reopening on suspicion – reassessment proceedings quashed. [AY 1998-99]

Brahm Datt vs. ACIT– [WP(C) No. 1109 of 2016, order dt. 6-12-2018, Delhi High Court]

The assessee was a senior citizen aged about 84 years. From AY 1984-85 to AY 2003-04, he was a non resident / not ordinarily resident of India. He was previously working and residing in foreign countries viz. Jordan and Iraq and while so, he derived income primarily from salary and professional receipts. Search and seizure operation u/s. 132 was carried out and in his statement recorded on 27-9-2011, the assessee was asked to clarify if he maintained any foreign bank account, to which he stated that though he did not maintain any foreign bank account in his individual capacity, he did settle an offshore trust when he was 'non-resident', out of his income earned from sources outside India. However subsequently AY 1998-99 was reopened *vide* notice dt. 24-3-2015. The assessee challenged the reopening proceedings and in the writ petition it was argued that reopening proceedings were barred by limitation. Once proceedings for assessment year 1998-99 attained finality on expiration of the period of limitation for reopening assessment for the assessment year expired on 31-3-2005, such concluded proceedings could not be reopened by merely taking resort to the subsequent amendment in law i.e., section 149(1)(c), introduced by Finance Act 2012, with effect from 1-7-2012. In other words, the subsequent amendment cannot seek to enhance or extend limitation for reopening assessment for those assessment years in respect of which limitation had already expired/ lapsed before the date the amendment became effective. It was further argued that despite the explanation given in the statement recorded u/s. 132(4), reassessment proceedings have been initiated on the suspicion that income escaped assessment. The department contended that reply given was general and vague statement, without any specific averment or evidence.

Though the assessee could have furnished foreign returns of income, bank account statements for settlement of trust, but nothing was produced. The High Court relied on the decision in case of *K. M. Sharma vs. Income Tax Officer 254 ITR 772(SC)* as well as *S.S. Gadgil vs. Lal & Co. [1964] 53 ITR 231* to hold that once the period of limitation ends, by virtue of the provisions of the Act, it is not open to the revenue, to revisit such issues that are final. The Court further observed that the AO himself had conceded in the order rejecting the petitioner's objection that "It is also found that the assessee was a non-resident as contended by him, in the AY 1998-99." In these circumstances, there can be no question about the applicability of the then existing provision – Section 149 (b), which stated that the normal time limit for reopening assessment was four years. The Court further observed that the interpretation proposed by the revenue has the potential of arming its authorities to reopen settled matters, in respect of issues where the citizen could genuinely be sanguine and had no obligation of the kind which the Revenue seeks to impose by the present amendment. All the more significant, is the fact that absent a clear indication, every statute is presumed to be prospective. The revenue had sought to contend that the amendment to Section 149 is merely procedural and no one has a vested right to procedure; and that procedural amendments can be given effect any time, even in ongoing proceedings. The Court negated this view and held that reopening proceedings were barred by limitation and hence quashed.

2. Relative u/s. 2(41) – Assessee is sister-in-law of petitioners mother-in-law – assessment proceedings and demand notice u/s. 156 on the Petitioner – proceedings against the petitioner quashed. [AY 2010-2011]

M. Kasthuri vs. ITO– [WP No. 23440 of 2018 and WMP No. 27353 of 2018, order dt. 4-12-2018, Madras High Court]

The petitioner approached the High Court and challenged the proceedings namely, the order of assessment dated 29-12-2017 passed in respect of assessment year 2010-11 and the demand notice issued under Section 156 of the Income-tax Act, 1961, calling upon the petitioner and 14 others to pay a sum of ₹ 32,11,010/- being the tax arrears. The Petitioner submitted that she is not an assessee with the Income-tax officer and the proceedings issued by treating the petitioner as one of the legal heirs of the deceased assessee, namely Sadagopan Sulochana was also on a mistaken impression. It was submitted that the deceased assessee, namely Sulochana, is the sister-in-law of the petitioner's mother-in-law. The petitioner was neither a party to the Testamentary Original Suit nor the beneficiary under the Will claimed to have been executed by the said Sulochana. It was further argued that the petitioner does not come within the purview of relative as defined under section 2(41) of the Income-tax Act. The department contended that the petitioner was residing in the same property where the deceased assessee, Sadagopan Sulochana, was residing at the time of her death. Therefore the petitioner had clear nexus with the properties of the deceased and therefore, the initiation of the proceedings and also passing the order of assessment are in accordance with law. The High Court observed that the petitioner herein is not the assessee and on the other hand, Sulochana was the assessee, who also was no more at the time of passing the impugned proceedings. Section 2(41) of the Income-tax Act, 1961 defines the term relative which means the husband, wife, brother or sister or any lineal ascendant or descendant of that individual. Certainly, the definition of the term relative, as defined under section 2(41), does not include the relationship between the petitioner and the deceased assessee. High Court held that merely because the petitioner is residing in the same property where the deceased assessee was living before her death, cannot be a reason to conclude as if the petitioner is also one of the legal heirs of the deceased. If such presumption is permitted, it would go against the definition of "relative" as defined under section 2(41). Accordingly, the writ petition was allowed and both the proceedings were quashed only insofar as the petitioner is concerned.

3. Capital gain vs. business income – sale of shares – loss on account of sale of shares adjusted against gains from sale of shares – bonus stripping – allowed. [A.Y. 2007-2008]

CIT vs. Adar Cyrus Poonawalla – (2018) 100 Taxmann.com 227 (Bombay)

The assessee, an individual, had entered into two transactions; the first one was the sale of shares of City Parks P. Ltd. (CPPL) which were received by the assessee as a gift from his father. The assessee sold the said shares during the assessment year under consideration and earned a Long Term Capital Gain of ₹ 17,32,46,580/-. The second transaction pertained to purchase and sale of shares of HCL Technologies Ltd. wherein the assesse had also received bonus shares in the ratio of one share for every one share held. The assessee sold shares of HCL which resulted into loss of ₹ 14,95,84,935/-, which the assessee claimed as short term capital loss and set it off against the Capital gain earned on sale of CPPL. The Assessing Officer held that both the transactions were in the nature of assessee's business transactions and the assessee had entered into the transactions of HCL Technologies in order to avoid tax liability. As such the AO recomputed the taxable business income at ₹ 16,94,78,713/-. The CIT(A) accepted the assessee's contention in respect of the sale of shares of CPPL treating the gain thereon as Long Term Capital Gains. However, he treated the loss on shares a business loss and accepted the computation made thereof by the AO. The Tribunal however, accepted the capital gains as declared by the assessee thereby allowing the assessee's appeal and further dismissed Department's appeal. The Tribunal also held that there is a marked difference between the provisions of section 94(7) and section 94(8) whereby shares are specifically excluded from the operation of bonus stripping transactions. It also held that there is a difference between abuse of law and use of the provisions of law and the latter could well be used as a means to legitimately undertake a tax planning exercise relying on *CIT vs. Walfort Shares and Stock Brokers – (2010) 326 ITR 1 (SC).* The Department filed further appeal before the Hon'ble High Court contending that: (i) the assessee is a trader in shares and the transactions of the assessee are in the nature of business transactions; (ii) The Assessee had sold the bonus shares in the subsequent years and claimed exemption u/s. 10(38) of the Act; (iii) The assessee had purposely entered into a transaction of sale of shares of HCL after declaration of bonus in order to reduce his tax liability by way of tax planning. The Hon'ble High Court affirmed the order of the Tribunal holding that the entire issue hinges on the question whether the transactions in question were in the nature of business transactions or holding of shares by the assessee was purely in the nature of investment. Surely, the Revenue cannot object to legitimate tax planning. Legitimately, if the assessee had claimed set off of loss against the gain in sale of shares, the Revenue cannot frown upon, simply by pointing out that in the process, the assessee reduced his tax liability. The Court observed that the Tribunal had examined both transactions extensively. With respect to the first transaction of sale of shares in

CPPL, the Tribunal noted that the shares were gifted by his father who himself had held the shares as investment. The company was unlisted private limited company. There was no material on record to suggest that the assessee had entered into the business venture in the process. Likewise in the second transaction also, the Tribunal noted that the Revenue has, in the preceding and succeeding assessment years, accepted, the sale of shares by the assessee as investment and the proceed was treated as capital gains. With respect to HCL Technologies, when the assessee sold the bonus shares in the later year, the Revenue treated the gain as capital gain. Thus the High Court dismissed the department's appeal and affirmed the Tribunal order.

4. Draft order u/s. 144C – Tribunal restored the matter stating that DRP did not deal with the objections raised – AO passed final order – Thereafter issued corrigendum to treat final order as draft order – Since the corrigendum was beyond time limit to pass draft order, assessment order is beyond jurisdiction. [AY 2007-2008]

PCIT vs. Lionbridge Technologies P. Ltd. – ITXA No. 622 of 2016 Bombay High Court, order dt. 3-12-2018

The original assessment order in the case of the assessee was passed on 17-10-2011. This was set aside by the Tribunal *vide* its order dated 25-1-2012 and remanded back to the AO for the reason that the DRP had not dealt with the objections of the assessee. Thereafter the TPO passed his order on 27-1-2014. After receipt of the said order the AO passed the final assessment order on 12-3-2014 without passing a draft assessment order. Subsequently, *vide* a corrigendum dated 16-4-2014 the AO sought to treat the final order as draft order despite the fact that the time limit for passing the draft order had elapsed on 31-3-2014. The said draft order was challenged by the assessee before DRP and thereafter a final assessment order was again passed on 9-1-2015 which was challenged before the Tribunal. The Tribunal quashed the said assessment order holding that the draft order passed on 16-4-2014 was time barred. The Department filed a further appeal against the order of the Tribunal urging that the assessee had accepted the jurisdiction of the AO in passing the draft assessment order on 16-4-2014 by filing objections to the DRP. The Hon'ble High Court while dismissing the appeal held that, in respect of the procedure and determination of the of International Transaction between related person, the law provides a special dispensation. In terms of Section 144C(I) of the Act, the Assessing Officer is to first pass a draft Assessment Order which is subject to challenge, by way of representation to the DRP. It is only after the DRP disposes of the representation, that the Assessing Officer passes a final order in terms of the directions of the DRP and such final order is appealable to the Tribunal. In this case, it is undisputed that on 12th March, 2014, the Assessing Officer passed a final Assessment order in terms of the directions made by the DRP in the earlier round. The time to pass any such order, would expire in the present facts on 31st March, 2014, however, in case a Draft Assessment Order is issued, then the time to pass a final Assessment Order gets extended to one month after the passing of the directions by the DRP in terms of Section 144C(13) of the Act. Nevertheless, the Draft Assessment Order should have in the present facts been passed before 31st March, 2014 in terms of Section 153A(2A) of the Act. In this case, undisputedly, a final order was passed on 12th March, 2014 and is being sought to be corrected by issue of corrigendum on

16th April, 2014 i.e., after the time to pass the Draft Assessment Order has expired. The Hon'ble High Court agreed with the view expressed in *ACIT vs. Vijay Television (P.) Ltd. [2018] 95 taxmann.com 101/407 ITR 642* wherein it was held that the non-issue of Draft Assessment Order could not be corrected by issuing a corrigendum to a final Assessment Order. It further relied on the Judgment of the Hon'ble Bombay High Court in the case of *International Air Transport Association vs. DCIT - [2016] 68 taxmann.com 246/241 Taxman 249* wherein it was held that the Draft Assessment Order is necessary in terms of Section 144 C(1) of the Act before the Assessing Officer can proceed to pass a final Assessment Order. The High Court thus held that in the absence thereof, the order is without jurisdiction. So far the contention on behalf of the Revenue that the Respondent was estopped from challenging the corrigendum dated 16th April, 2004, as the assessee accepted by it and a representation also filed to the DRP, the court held that there can be no estoppel on issue of law pertaining to jurisdiction. Mere consent of parties does not bestow jurisdiction, if the order is beyond jurisdiction. The High Court further observed that the Tribunal in the impugned order held that assessment order of the Assessing Officer was beyond the scope of the remand by order dated 25th January, 2012 of the Tribunal. Remand was ordered merely because the DRP had failed to deal with the objections of the Assessee to the Draft Assessment Order. Therefore, making a reference again to the TPO for fixing the ALP, was not called for. Thus the High Court dismissed department appeal and confirmed the Tribunal order.

5. Business expenditure – section 36(1)(iii) of the Income-tax Act, 1961 – Disallowance of Interest paid on borrowed capital – commercial expediency test – no allegation or finding that interest bearing funds were diverted for non-business purposes – interest paid allowed [A.Y. 2011-12]

Pr. CIT vs. Reebok India Company [2018] 409 ITR 587 (Delhi)

The Assessing Officer in the draft assessment order for the assessment year 2011-12, proportionately disallowed interest deduction under section 36(1)(iii) being part of the interest paid on unsecured loan. Disallowance was made on the ground that the assessee had made advances to third parties on which no interest was charged and received. The Hon'ble DRP affirmed the addition made in the draft assessment order on the ground that the assessee failed to furnish the necessary details and held that the AO is empowered to examine if the assessee met the rigours of "business connection" and "expediency". The Tribunal allowed the claim of the assessee by observing that proportionate interest genuinely paid on unsecured loans taken for business purpose could not be disallowed in the absence of any allegation and finding that the assessee had diverted unsecured loans for non-business purpose. On further appeal by the Department, the Court observed that merely because non-interest bearing advances were given to third parties, that could not justify a finding that the test of "commercial expediency" was not satisfied. Interest free advances were advances to the parties connected with the business of the assessee. Money taken on loan was not diverted for non-business purpose. The unsecured loans were not used for personal purpose. According to section 36(1)(iii) the interest paid on capital borrowed for the purpose of business had to be allowed as deduction. The Court thus dismissed the department appeal.

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

DIRECT TAXES
Tribunal

Unreported Decisions

1. TDS on purchase of an immovable property – Section 194IA of the Act – The exemption of ₹ 50 lakh mentioned in Section 194IA(2) is applicable w.r.t. the amount related to each transferee and not with reference to the amount as per sale deed. Thus, though the total consideration exceeds ₹ 50 lakh but a payment by each transferee does not exceed the prescribed monetary limit, there is no obligation to deduct TDS.

Vinod Soni. vs. CIT (ITA 2736/DEL/2015) [Assessment Year 2014-15], order dated 10-12-2018

Facts

The assessee along with three other purchasers purchased an immovable property for ₹ 1.5 crore. The learned AO received the information from the sub-registrar, Ballabhgarh and observed that the assessee along with other three purchasers did not deduct the tax u/s. 194IA of the Act despite the fact that the total consideration exceeded ₹ 50 lakh. Accordingly, the notices were issued to the respective purchasers and finally, the learned AO passed an order u/s. 201(1) and 201(1A) raising the demand on the assessee. Aggrieved by the same, the assessee preferred an appeal before the learned CIT(A). However the submissions of the assessee did not impress the said authority. The learned CIT(A) confirmed the stand of the learned AO and held that the assessee ought to have deducted tax u/s. 194IA of the Act since the total consideration of the immovable property exceeded ₹ 50 lakh. Thereafter, an appeal was preferred to Hon'ble ITAT. After hearing both the sides, Hon'ble ITAT held as under:

Held

Hon'ble ITAT carefully perused the facts and the relevant section. It observed that Section 194IA(2) provides that Section 194IA(1) will not be applicable where the consideration for transfer of immovable property is less than ₹ 50,00,000/-. However, Section 194IA(1) is applicable to any person being a transferee, so Section 194IA(2) is also, obviously applicable only w.r.t. the amount related to each transferee and not with reference to the amount as per sale deed. Hon'ble ITAT referred to the memorandum explaining the provision and held that the law cannot be interpreted and applied differently for the same transaction, if carried out in different ways. Hon'ble ITAT further noted that the point to be made is that the law cannot be read as that in case of four separate purchase deeds for four persons separately, Section 194IA of the Act was not applicable, and in case of a single purchase deed for four persons Section 194IA of the Act will be applicable. In the light of the abovementioned observations, the issue was decided in favour of the assessee and against the Revenue.

2. Business loss : Section 28 of the Act – Payment made for procuring material is a revenue expenditure and a loss on account of non-receipt of the said material is a revenue loss. When the similar loss was allowed in the preceding assessment year, there is no reason to not allow it for the current year in the peculiar facts under consideration.

Uday Patil. vs. ACIT (ITA 5521/DEL/2014) [Assessment Year 2009-10], order dated 19-12-2018

Facts

The assessee is an individual and the Assessment Year under consideration is 2009-10. For the year under consideration, the assessee paid ₹ 78,88,887/- for obtaining distributorship of herbal products of a company based in Chennai named "Galaxy Amaze Kingdom Ltd.". Since the said distributorship as well as herbal products were not obtained by the assessee after the aforesaid payment and there was no possibility of recovery of the amount, it was debited to Profit and Loss account as "loss on investments". The amount of ₹ 50,00,000/- was also debited under the same head to the Profit and Loss account in the preceding assessment year which was allowed by the Revenue in the scrutiny assessment. However for the present assessment year, the learned AO disallowed the same on the opinion that the said loss loss took place in a capital field. Thus, the learned AO treated the said loss as capital in nature and denied a deduction to the assessee as sought by him in his return of income. Being aggrieved by the same, the assessee preferred an appeal before the learned CIT(A) but did not find any success. Finally, the issue travelled to Hon'ble ITAT. After hearing both the parties and perusing the material facts on record, Hon'ble ITAT observed as under:

Held

Hon'ble ITAT at the outset noted that though the amount was incurred for the purpose of a new business, the said business was in existence from the previous year as the assessee had incurred the amount in the preceding year also. Hon'ble ITAT observed that the amount under consideration was paid for procurement of material and the assessee neither received the material nor the payment. Hon'ble ITAT further observed that the learned AO was influenced by the nomenclature used by the assessee in the Profit and Loss account and did not look at the nature of the transaction closely. The same item was allowed in the preceding assessment year in the scrutiny assessment and the Revenue did not rebut much on the same. Thus, keeping the factual matrix under consideration, Hon'ble ITAT held in favour of the assessee and against the Revenue.

Reported Decisions

3. Set-off of business losses – Section 73 r.w.s 45(3) of the Act – derivative loss is deemed to be a business loss as per the proviso to Section 43(5) of the Act. The *Explanation* to Section 73 of the Act does not have any applicability on the said derivatives losses and the same can be set off against income from business.

Magic Share Traders Ltd. vs. CIT (ITA 770/AHD/2016) [Assessment Year: 2012-13](100 taxmann.com 42 (Ahd.)), order dated 31-10-2018

Facts

The assessee is a Company, engaged in the business of trading and investment in shares and securities, mutual funds and futures and options. The assessment year under consideration is 2012-13. During the year under consideration, the assessee carried out transactions in shares in cash segment as well as in derivatives segment. The assessee incurred loss of ₹ 5,17,80,774/- from F & O business i.e., in derivatives segment and earned profit of ₹ 1,21,60,169/- from share trading in cash segment. In the assessment proceedings, the learned A.O. invoked the *explanation* to section 73 of the Act and held that loss arose from the derivatives transactions are in the nature of speculative loss and therefore, not allowed to be set-off against other streams of business income except the income from another speculative business. Accordingly, the learned AO denied the set-off of derivative loss claimed against income earned from share trading in cash segment. On appeal, the learned CIT(A) observed that, Section 43(5) of the Act provides the definition of speculative transaction which applies only for the purpose of Section 28 of the Act. Further, it was also observed that as per the *explanation* to section 73 of the Act if the assessee being a company, suffered losses from the transactions of shares, then the said transactions should be treated as speculative transactions for the purposes of set off as per Section 73 of the Act notwithstanding the definition of speculative transaction under Section 43(5) of the Act. Accordingly, the learned CIT(A) upheld the action of the learned AO and denied the claim of set-off of losses arising from derivative segment against income arising in other streams of business. Being aggrieved by the order of learned CIT(A), the assessee preferred an appeal before Hon'ble ITAT. Before it, the assessee as well as the Revenue put their contentions and relied upon various decisions. After considering the contentions of both the parties, Hon'ble ITAT observed as under:

Held

Hon'ble ITAT held that the only question that arises for adjudication is whether loss incurred in eligible transactions i.e., derivative transactions within the meaning of proviso (d) to Section 43(5) of the Act not involving any purchase or sale of shares *per se* can be regarded as a speculative loss for the purposes of set-off in view of *Explanation* to Section 73 of the Act or not. The assessee claimed set-off of losses arising from derivatives loss as non-speculative business loss. On the contrary, the revenue contended that the loss arising from derivatives transactions was a 'speculative loss' and consequently denied the set-off of such losses from regular income of non-speculative nature by applying the *explanation* to Section 73 of the Act. Hon'ble ITAT appreciated the contention of the Assessee that the explanation to Section 73 of the Act cannot be applied to the loss arising from derivatives transactions which are categorically excluded from being regarded as a speculative business as defined under Section 43(5) read with proviso (d) thereto. Hon'ble ITAT further referred to the decision of Hon'ble Calcutta High Court in the case of *Asian Financial Services Ltd. vs. CIT [2016] 70 taxmann.com 9 / 240 Taxman 192* and observed that the Hon'ble Calcutta High Court held that once it is deemed to be a normal business loss on the basis of proviso appended to Section 43(5), a question of applying Section 73 of the Act or the *explanation* thereto for the purposes of denying the losses to be set off against business income is wholly incorrect. The Calcutta High Court took a stand that derivatives cannot be treated at par with shares for the purposes of *Explanation* to Section 73 because the legislature has treated it differently. Thus, Hon'ble ITAT held that in view of the aforesaid position enunciated by the Hon'ble High Court in Asian Financial Services (supra), it is good deal of force in the case of assessee. Hence, the claim of the assessee requires to be allowed on this ground alone. Accordingly, the claim of set-off of derivative loss was allowed by Hon'ble ITAT. The issue was decided in favour of the assessee and against the Revenue.

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4. Compensation received for damages caused to reputation – Section 4 r.w.s. 28(i) and 2(24) of the Act – The compensation received for damages caused to reputation is a capital receipt not chargeable to tax. Further the same cannot be said to be any benefit, perquisites arising out of exercise of profession. It is not chargeable to tax at all.

Sushmita Sen. vs. ACIT (ITA 4351 & 4352/ MUM/2015) [Assessment Year 2004-05](99 taxmann.com 252 (Mum.)), order dated 14-11-2018

Facts

The assessee is a film actress by profession and the assessment year under consideration is 2004-05. For the year under consideration, the assessee received ₹ 145 lakhs from Coca Cola India Limited (CCIL) out of which ₹ 95 lakhs were not offered to tax by the assessee in her return of income. During the assessment proceedings, the learned AO asked the assessee to explain the stand taken by her in the return of income. Pursuant to the same, the assessee submitted before learned AO the "CCIL" had raised a claim against the assessee for non-performance of contractual commitment. However the said claim was not correct and the assessee in turn filed a suit against the said company. Finally, the said company paid the compensation to the assessee due to assessee's alleged sexual harassment by an employee of CCIL and asked the assessee to withdraw all her allegations against it. In the light of the same, the Assessee contended that the amount was paid by CCIL to avoid negative publicity/embarrassment which would have jeopardized the business of the company. Further the said amount was received due to reputation loss caused by the assessee in the aforesaid facts. However the learned AO did not agree with the submission of the Assessee and brought the said amount to tax as income. Aggrieved by the same, the assessee preferred an appeal before the learned CIT(A) without any success. Finally, the matter reached Hon'ble ITAT. During the course of hearing, both the parties made their respective submissions. After hearing both the parties, Hon'ble ITAT held as under:

Held

Hon'ble ITAT observed that the additional amount had been received by assessee towards damages for being sexually harassed by "CCIL" employee, for having disparaged her professional reputation by false allegations. It further observed that such type of compensation could not be termed as any benefit, perquisites arising to assessee out of exercise of her profession. The compensation did not accrue/ arise out of exercise of profession by the assessee and could not be construed to be the income of the assessee or profits and gains of profession within the meaning of Section 2(24) r.w.s. 28 of the Act. Hon'ble ITAT further noted that both the authorities below fell in error to adjudicate the same on the threshold of impact of the compensation on profit making apparatus without understating the true nature of the receipts. Hon'ble ITAT finally came to the conclusion that the said compensation was not chargeable to tax. In the light of the abovementioned observation, Hon'ble ITAT held in favour of the Assessee and against the department.

5. Taxability under development agreement – Section 2(47)(v) r.w.s. 48 – Where as per terms of development agreement entered between the assessee, and developer, for construction of a housing project, the assessee would not be paid any monetary consideration but would receive certain percentage in built-up residential area on completion of project, the transfer does not take

place in the year of agreement and the assessee is not required to pay capital gains Tax in the said year.

Aarti Kadam. vs. ITO (ITA 1190/MUM/2018) [Assessment Year 2014-15](97 taxmann.com 284 (Mum.)), order dated 21-8-2018

Facts

The assessee is an individual and the assessment year under consideration is 2014-15. For the year under consideration, the assessee entered into a development agreement with one of the developers. The Agreement did not envisage any monetary compensation immediately. However as per the terms between the parties, the assessee was entitled to receive 35% of built-up residential area on completion of housing project. Subsequently, there was a dispute between the said developer as the developer did not carry out necessary work. The assessee had to file a suit against it. In the return of income, the assessee did not offer any capital gains. During the course of the assessment proceedings, the learned AO asked the assessee as to why the capital gain should not be brought to tax since the development agreement had been entered into by her with the developer resulting in a transfer of a capital asset u/s. 2(47)(v) of the Act. Pursuant to the same, the assessee submitted that since she would receive built up residential area on completion of the project, there was no monetary consideration neither accrued nor was received by her resulting in any capital gains liability. However the learned AO did not accept the same. Aggrieved by the stand of the learned AO, the assessee preferred an appeal before the learned CIT(A) but did not find any success. Subsequently, the assessee preferred an appeal to the Hon'ble ITAT. After hearing both the parties, Hon'ble ITAT held as under:

Held

Hon'ble ITAT observed that it is a fact on record that at the time of entering into the development agreement the assessee has not received any monetary consideration from the developer. Further it observed that the said developer did not stick to its commitment and ultimately, the assessee had to initiate legal proceedings against it. Hon'ble ITAT referred to the provision of Section 53A of Transfer of Property Act, 1882 which has a reference to Section 2(47)(v) of the Act and observed that merely because the assessee has entered into a development agreement, it does not presuppose transfer in terms of Section 2(47)(v) of the Act. As per Section 53A of the Transfer of Property Act, 1882, which has been referred to in Section 2(47)(v) of the Act, one of the conditions of transfer is that the developer should also be willing to perform his part of the contract. In the present case, it appears from the record that the developer has not fulfilled his part of the contract. Therefore, the conditions of Section 53A of the Transfer of Property Act are not fulfilled. Further it categorically noted that since the assessee has not received the consideration in terms of the development agreement in the impugned assessment year, question of accrual of capital gain in the year under consideration does not arise. Hon'ble ITAT referred to the various case laws and decided the issue in favour of the assessee and against the Revenue.

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> All the secret of success is there; to pay as much attention to the means as to the end.
>
> — *Swam Vivekananda*

 

CA Tarunkumar Singhal & Sunil Moti Lala, *Advocate*

INTERNATIONAL TAXATION Case Law Update

A. SUPREME COURT

1. Corporate guarantee cannot be equated with bank guarantee for determining the Arm's Length Price (ALP)

Pr. CIT vs. Glenmark Pharmaceuticals – [TS-1268-SC-2018-TP] – Civil Appeal No. 12632/2017

Facts

(i) During AY. 2008-09, the assessee company extended guarantee in respect of bank loan and L/C facility obtained by its AEs and charged guarantee fee @ 0.53% in respect of guarantee for bank loan and @ 1.47% in respect of guarantee for L/C facility.

(ii) TPO took guarantee fee rate as 3% on the basis of guarantee commission rates charged by banks and proposed a TP adjustment. CIT(A) confirmed the adjustment.

(iii) The Tribunal ruled against Revenue holding that the corporate guarantee was not as foolproof as bank guarantee. Accordingly, relying on various decision including *Everest Kanto Cylinders Ltd. [TA-714-ITAT-2012 (Mum)-TP]* in which rate of 0.25% was considered to be at Arm's Length Price (ALP), the Tribunal held that guarantee commission rates charged by assessee were reasonable and deleted the TP addition.

(iv) The High Court also ruled against the Revenue noting that the Tribunal had relied on a Co-ordinate Bench decision in the case of *Everest Kanto Cylinders Ltd. [TS-714-ITAT-2012(Mum)-TP]* which had been upheld by jurisdictional HC [TS-200-HC-2015 (BOM) TP].

(v) Aggrieved, the Revenue filed SLP before the Supreme Court.

Held

(i) The Apex Court dismissed Revenue's SLP holding that the issue had been rightly decided by the High Court in favour of the assessee and against the Revenue.

B. HIGH COURT

2. Comparability of Cybermate Infoteck Limited restored back to the Tribunal, noting that the Tribunal was to anyway decide on some other issues raised in rectification application by the assessee and that the Tribunal had taken a different view on the said comparability in earlier years

Lionbridge Technologies Pvt. Ltd. vs. Union of India & Others [TS-1294-HC-2018(Bom)-TP] – Writ Petition No. 2960 of 2018

Facts

(i) The Tribunal in its original order, while disposing off the assessee's appeal against the TP adjustment made by the AO / TPO for AY. 2012-13, had rejected the assessee's contention that one comparable, i.e., *Cybermate Infoteck Ltd. (CIL),* which was into software products, could not be considered as a comparable to the assessee, engaged only in software development services.

(ii) The assessee filed a miscellaneous application for rectification *inter alia* contending that the Tribunal had made a mistake apparent on record by not following the judicial precedent laid down by the Jurisdictional High Court in the case of *CIT vs. PTC Software (I) Private Limited (2016) 75 taxmann.com 31 (Bombay)* and also the assessee's own case decided by the Tribunal for earlier years i.e., AY 2009-10 and AY 2010-11 *[Lionbridge Technologies (P.) Ltd. vs. ITO (2015) 64 taxmann.com 461 (Mum)].*

(iii) In the case of *PTC Software (I) Private Limited (supra),* the Court had held that software services and software products are not identical activities and therefore, the two separate companies or entities providing respective services would not give rise to comparable instances. Similar view was taken by the Tribunal in the assessee's own case for above mentioned years.

(iv) The Tribunal however rejected the assessee's aforesaid ground for rectification but allowed the application on other grounds for which further hearing was scheduled on 16th January, 2019.

(v) Aggrieved, the assessee filed a writ petition before the High Court against the Tribunal's order disposing of the rectification application.

Held

(i) The Court remitted the issue of comparability of the said comparable i.e., CIL to the Tribunal with a direction to undertake a fresh and a detailed inquiry as to the permissibility of comparing the instances of CIL with that of the assessee with special focus on the decision of this Court in case of PTC Software India Private Limited (supra).

(ii) The Court explained that it did not express any opinion on the rival contention for the reasons that (i) the Tribunal was anyway hearing the tax appeal on certain limited issues and (ii) *prima facie* it was brought to the notice that the Tribunal in earlier years had dealt with similar issue differently.

(iii) The petition was disposed off accordingly.

3. A corrigendum to final assessment order to convert the said order into draft assessment order, issued after the expiry of the time available to pass an assessment order is defective and could not save the said final assessment order from being held as null and void and unenforceable

Pr. CIT vs. Lionbridge Technologies Pvt. Ltd . – [TS-1267-HC-2018 (Bom)-TP] - ITA No.622 of 2016

Facts

(i) For AY 2007-08, an assessment was completed on 17th October, 2011 under section 144(13) read with Section 143(3) of the Act, by making various additions. On appeal, the Tribunal by its order dated 25th January, 2012 set aside the above assessment order dated 17th October, 2011 and restored the assessment to the AO on the ground that the Dispute Resolution Panel (DRP) had not dealt with the assessee's objections.

(ii) On the above remand, the AO referred the International Transactions to the TPO and on receipt of the TPO's order dated 27th January, 2014, the AO passed an assessment

144(C)(13) of the Act, based on the observations made by the DRP in original assessment proceedings, which has already been set aside.

(iii) Thereafter, on 16th April, 2014, the AO issued a corrigendum to assessment order dated 12th March, 2014 stating that the order dated 12th March, 2014 should be treated as draft assessment order and not as a final assessment order.

(iv) The assessee, thereafter, challenged the draft assessment order, as a result of the corrigendum, before the DRP and the final assessment order dated 9th January, 2015 was passed in terms of DRP directions.

(v) The Tribunal held that the order passed on 12th March, 2012 was the final order as the AO, after having become *functus Officio* (on account of expiry of time available to pass assessment order on 31st March, 2012), could not have issued a corrigendum on 16th April, 2014 to the order dated 12th March, 2012, seeking to convert the final assessment order into a draft order. For this, the Tribunal followed the decision of the Madras High Court on similar facts in the case of *Vijay Television (P) Ltd. vs. DRP 369 ITR 113 (Mad.)* wherein it was held that a corrigendum issued beyond the period of limitation is defective and thus ineffective. The Tribunal also held that the AO had failed to follow the Tribunal's directions given *vide* order date 25th January, 2012. Accordingly, it held the assessment order dated 12th March, 2012 to be null and void and unenforceable.

(vi) Aggrieved, the Revenue filed an appeal before the High Court.

Held

(i) The Court noted that the decision of a single judge of the Madras High Court in *Vijay Television (P) Ltd. (supra)* which was relied upon by the Tribunal was upheld by the Division Bench of the Madras High Court in *ACIT v. Vijay Television (P) Ltd. [407 ITR 642 (Mad.)]* and held that like the facts before the Madras High Court, in the present case also the demand notice and institution of pending proceedings were not withdrawn by the corrigendum.

(ii) Further, it referred to the decision in *International Air Transport Association vs. DCIT [68 taxmann.com 246 (Bom.)]* wherein it was held that the draft assessment order is necessary in terms of Section 144C(1) of the Act and in the absence thereof, the order is without jurisdiction.

(iii) The Court rejected Revenue's contention that assessee was estopped from challenging the corrigendum as it accepted and filed objections before DRP against the same, holding that there can be no estoppel on issue of law pertaining to jurisdiction and mere consent of parties does not bestow jurisdiction if the order is beyond jurisdiction.

(iv) Accordingly, Revenue's appeal was dismissed.

4. Revision proceedings upheld where the AO had erroneously concluded that the assessee-Singaporean company did not have a PE in India, without considering Article 5(1) of the India-Singapore Treaty

Nordic Maritime PTE CIT [TS-740-HC-2018(UTT) – Writ Petition (M/S) No. 3708 of 2018]

Facts

(i) The assessee-company, incorporated in Singapore, was engaged in the business of rendering offshore geophysical services to International oil and gas industry. It was awarded a contract by an Indian company as per which the assessee was supposed to provide a seismic vessel and associated boats along with required persons.

(ii) The assessee claimed the revenue received from the said contract to be not taxable in India in view of the India-Singapore Treaty. It had contended that as per Article 5(5) of the subject Treaty, a tax resident of Singapore would only have Permanent Establishment (PE) in India if it provided services and facilities for a period of more than 183 days in a fiscal year in connection with exploration, exploitation or extraction of mineral oil in India. Moreover, as the contract was only for a period of 102 days in the relevant fiscal year 2014-15, in absence of PE, it was not liable to tax in India. This contention of the assessee was accepted by the AO during assessment proceedings.

(iii) Consequently, the Commissioner of Income-tax (CIT) invoked his revisionary powers u/s. 263 and issued a show cause notice (SCN) to the assessee opining that the seismic vessel itself constituted a 'fixed place PE' within the meaning of Article 5(1) of the India-Singapore Treaty and therefore, the receipts were taxable in India as business income, as per Article 7 of the said Treaty. Accordingly, the CIT held that it was absolutely erroneous on part of the AO to resort to Article 5(5) and that the period of stay was irrelevant.

(iv) Aggrieved by the issuance of SCN, the assessee filed a writ petition before the High Court

Held

(i) At the outset, the Court noted that the SCN was given to the assessee a year ago and instead of giving his explanation to the CIT as it (i.e., assessee) ought to have done, it had filed the present writ petition.

(ii) The Court rejected the reliance placed by the assessee on the decision in the case of *CIT vs. Amitabh Bachchan (2016) 11 SCC 748* (wherein it was held that while exercising revisionary powers under section 263, it is necessary that the CIT comes to the conclusion that the order is both erroneous as well as prejudicial to the interest of the Revenue) by holding that from the CIT's notice it could be seen that there was definitely an application of mind by the CIT on both the aforesaid aspects.

(iii) Accordingly, it dismissed the Writ Petition.

5. Only the shares held directly / beneficially in a subsidiary company are to be considered for determining whether the holding company has 'substantial interest' in the said subsidiary company, without considering the shares held indirectly through another subsidiary company

HDFC Bank Ltd. vs. ACIT [2018] 100 taxmann.com 428 (Bom.) – Writ Petition No. 462 of 2017

Facts

(i) The assessee, a public limited company, was registered as a banking company with the Reserve Bank of India and was primarily engaged in the business of banking.

(ii) During assessment proceedings for AY 2014-15, the assessee-company received a show cause notice for alleged non-reporting of 3 related party transactions as set out in section 40A(2)(b) of the Act, viz. (1) Loans purchased by the assessee from its promoters and its subsidiaries, (2) Payment by the assessee to HBL Global for rendering certain services and (3) Payment of interest by the assessee to HDB Welfare Trust, so as to treat them as 'Specified Domestic Transactions' (SDT) under section 92BA of the Act.

(iii) The AO rejected assessee's submission explaining as to why none of the above mentioned entities fell within the definition of 'person' as contemplated under section 40A(2)(b)(iv) and thus the above mentioned transaction could not be termed as SDT. Post rejection of the aforesaid contention, the AO proceeded to make a reference to the TPO.

(iv) Aggrieved, the assessee filed a writ petition before the Hon'ble High Court against the AO's above order and subsequent reference to the TPO, with a prayer to quash the same.

Held

Loans purchased from holding company and subsidiaries.

(i) The Court accepted assessee's contention that its holding company did not have 'substantial interest' in the assessee so as to fall within the definition of 'person' as contemplated in Section 40A(2)(b)(iv), which required the holding company to hold not less than 20% shares in the assessee-company. It noted that the holding company held only 16.39% of the shareholding in the assessee-company directly.

(ii) It rejected Revenue's contention to club the direct shareholding of 16.39% with indirect shareholding of 6.25% held by the holding company through a wholly owned subsidiary (i.e., 22.64% in total) to establish 'substantial interest'.

(iii) The Court held that two conditions have to be fulfilled for a person to have 'substantial interest' as contemplated in *Explanation* to Section 40A(2)(b) i.e., the person has to be the beneficial owner of the shares and those very shares have to carry not less than 20% of the voting power. Thus, it held that if the Revenue's contention of clubbing was to be accepted, in effect it would mean to hold that the holding company was the beneficial owner of the shares held by its wholly-owned subsidiary in the assessee and the same is contrary to all canons of the Company law. For the same, it relied on the Apex Court rulings in the case of *Bacha F. Guzdar vs. CIT* and *Vodafone International Holdings BV vs. Union of India.*

(iv) Further, noting that the subject transaction of purchase of loans was in fact a purchase of an asset and the asset was reflected in the Balance Sheet and not in the P&L Account, the Court held that the same was not an expenditure at all as contemplated under section 92BA(i), and therefore, the money expended for purchasing loans could never be termed as an 'expenditure' incurred by the assessee.

Payment to HBL Global for rendering certain services

(v) Similarly, the Court held that merely because the assessee held 29% of the shares of ADFC Ltd., which in turn held 98.4% shares in HBL Global, the assessee could not be regarded as having a substantial interest in HBL Global, as the assessee could not be held to be the beneficial owner of 98.4% shareholding in HBL Global.

Payment of interest to HDB Welfare Trust

(vi) The Court noted that the assessee had certain deposits from HBD Employee Welfare Trust and had thus paid interest to the said Trust. The Revenue claimed that assessee had substantial interest in the Trust in terms of *Explanation* (b) to Sec 40A(2)(b) and consequently the assessee should have reported the aforesaid transaction in Form 3CEB as a SDT, thus the reference to the TPO was justified.

(vii) The Court held that as per the said *Explanation*, a person is said to have a substantial interest if such person is at any time during the previous year, beneficially entitled to not less than 20% of the profits of such business or profession.

(viii) Further, noting that the Trust had been set up exclusively for the welfare of the assessee's employees and there was no question of the assessee being entitled to 20% of the profits of such Trust, the Court held that the aforesaid transaction did not fall within section 40A(2)(b) r.w. *Explanation* (b) thereof to be a SDT as understood and covered by section 92BA(i).

(ix) Therefore, the Court held that none of the three transactions fell within the meaning of a SDT as required under section 92BA(i) of the Act and the AO was in error in concluding that these transactions were SDTs and in referring the transactions to TPO for determining ALP.

C. TRIBUNAL

6. India-Cyprus DTAA – Manpower Supply Agreement – Supply of Workforce/employees on Secondment Basis – Deduction of TDS u/s. 195 – Only markup under manpower supply agreement subject to TDS u/s. 195 but not salary reimbursement

DCIT vs. DLF Projects Ltd. [TS-689-ITAT-2018 (Del.)] Assessment year: 2009-10

Facts

(i) DLF Projects Ltd. ('assessee') had made payment to Cyprus based company Laing O' Rourke India (Holdings) Ltd. (LOR Cyprus) for supply of manpower in accordance with the Manpower Supply Agreement effective from April 1, 2008 for a period of three years. The said expenses were claimed under the head 'Project Management Expenses' and the payment was made after deducting TDS on 5% mark-up. However, on the actual cost component, which was in the nature of reimbursement of salaries, no TDS was deducted by the assessee. Further, TDS was deducted by LOR Cyprus u/s. 192 while making payment of salary to employees. The AO disallowed the said expenses u/s. 40(a)(i) on the ground that the assessee had failed to deduct TDS on the entire amount u/s. 195.

(ii) The CIT(A) deleted the disallowance made by the AO noting that reimbursement of salary had no element of income and therefore, the assessee was not required to deduct tax on the same. Aggrieved, the Revenue appealed before the Tribunal.

Decision

The Tribunal held in favour of the assessee as under:

(i) The Tribunal noted that before thrusting liability to deduct TDS, the following pre-conditions must be satisfied:

(a) There must be income element in the hands of the recipient;

(b) The income must be earned/derived in India;

(c) In case the payment is made to a non-resident, satisfaction of conditions mentioned in the relevant Article of the DTAA, if any, is to be seen.

(ii) The Tribunal noted that the payment of man power supply charges were made to a non-resident company, LOR Cyprus, which was a resident of Cyprus and during the year, India-Cyprus DTAA was operative. It noted that the income (mark-up component) from the supply of manpower is earned and derived in India.

(iii) ITAT perused the Manpower Supply agreement and the invoice raised by LOR Cyprus and noted that the non-resident has only supplied workforce/employees to the assessee on secondment basis and further that there was no responsibility of LOR Cyprus with regard to the services performed by seconded employees. It further noted that the invoice raised by LOR Cyprus showed a clear bifurcation of the amount of the reimbursement of actual cost and the mark up @ 5% on which TDS has been deducted by the assessee. Therefore, ITAT held that the payment can conveniently be divided into two parts, one towards reimbursement of the actual cost and the other towards mark-up. ITAT relying on SC ruling in GE India Technology Cen. P. Ltd., upheld the CIT(A)'s order that since reimbursement of actual manpower expense had no element of any income in the case of the service provider LOR Cyprus, the assessee was not required to deduct the tax on the same in terms of Sec. 195.

(iv) It further held that since LOR Cyprus does not have any Permanent Establishment (PE) in India, applicability of Article 7 is ruled out at the very threshold. It further held that the transaction in dispute could not be termed as fees for included services as defined by sub-clause 4 of Article 12 as the non-resident LOR Cyprus has only supplied manpower to the assessee and it was not a case of making available any technical knowledge, experience, skill, know-how or process to the assessee.

(v) Therefore, ITAT held that reimbursement of salary to LOR Cyprus was not in the nature of any technical or consultancy fee and that the same would fall outside the purview of Articles 12 and 13. ITAT relied on Mumbai ITAT ruling in the case of *Mahanagar Gas Ltd. [TS-219-ITAT-2016 (Mum.)]* and *Marks and Spencers Reliance India P. Ltd. [TS-449-ITAT-2013 (Mum.)]* which had been affirmed by the Bombay HC. ITAT also noted that non-resident LOR Cyprus has deducted TDS u/s. 192 while making payments to the seconded employees and as such there was no loss to the revenue. ITAT relied on Ahmedabad ITAT in the case of *Burt Hill Design P. Ltd [TS-127-ITAT-2017(Ahd.)]* and Bombay HC ruling in Marks and Spencer Reliance India P. Ltd. [TS-178-HC-2017 (Bom.)] wherein it has been held that when the payments had been charged to tax in India u/s. 192, the assessee could not be treated as assessee in default for non-deduction of TDS.

(vi) Therefore, ITAT held that it is only the mark up which was liable to withholding tax u/s. 195 and not the reimbursement of actual cost to LOR Cyprus. ITAT upheld the CIT(A)'s order deleting the disallowance u/s. 40(a)(i).

7. Payment by an Indian Subsidiary to its Swedish Parent Co. for software upgradation is not in the nature of FTS or Royalty and hence the same was not liable for tax in India

DDIT vs. Sandvik System Development AB [TS-618-ITAT-2018 (Pun.)] Assessment Year 2009-10

Facts

(i) The assessee is a foreign company incorporated in Sweden. The assessee does not have any office or place of business in India. No return of income was filed by the assessee/appellant for the impugned assessment year. Notice, u/s. 148 of the Act was served on the assessee/appellant for the reason that the assessee has received fee for providing IT support services from Sandvik Asia Pvt. Ltd. (SAPL) in assessment year 2009-10 and the same was not offered to tax.

(ii) The nature of payment received by the assessee is in the form of Royalty and Fees For Technical Services (FTS) as per provisions of section 9(1)(vi) & 9(1)(vii) of the Act as well as Article 12 of the DTAA between India and Sweden.

(iii) In response to the aforesaid notice, the assessee filed return of income on 6-5-2014 declaring total income as 'Nil'. Addition of ₹ 2,55,61,940/- was made by the Assessing Officer on account of FTS *vide* draft assessment order dated 24-3-2015.

(iv) The assessee filed objections before the Dispute Resolution Panel (DRP) against the addition made in the draft assessment order, as well as on reopening of assessment. The DRP *vide* directions dated 23-12-2015 upheld the validity of re-opening of assessment. However, on merits of the addition, the DRP held that the payment received by the assessee is neither Royalty nor Fees For Technical Services. Hence, the same is not liable for tax. Accordingly, the Assessing Officer passed final assessment order on 18-2-2016 deleting the addition.

(v) The assessee submitted at the outset that the issue raised by Revenue in appeal is identical to the one adjudicated by the

Co-ordinate Bench of Tribunal in the case of assessee's holding company, *M/s. Sandvik AB vs. DDIT in ITA No.1720/PN/2011* for the assessment year 2007-08 decided on 28th November, 2014. The DRP granted relief to the assessee by placing reliance on the decision of the Tribunal in the afore-mentioned case.

Decision

On Revenue's Appeal against the Order of the DRP, the Tribunal held in favour of the assessee as under:

(i) The solitary issue emanating from the grounds raised in appeal by the Revenue is; Whether the payment made to assessee by SAPL for upgradation of software is in the nature of Royalty or/and FTS. A perusal of the documents available on record indicate that the assessee had entered into an agreement with SAPL for providing maintenance services in respect of application internally developed namely SOPIC by assessee for Sandvik Group of Companies. During the period relevant to the assessment year under appeal, the assessee provides application development and maintenance services in respect of SOPIC. The cost of all development/updating application was recovered by the assessee from its user company along with maintenance service charges. In the present case, the amount of ₹ 2,55,61,940/- was received by assessee from SAPL towards IT support services viz., software maintenance, system development, help-desk services, enterprise computing etc. The payments for the aforesaid services were held to be in the nature of Royalty/FTS.

(ii) The CIT(A) after analysing the agreement, nature of services and invoices raised by assessee on SAPL, came to the conclusion that the payments were received towards system development and software maintenance services rendered to SAPL. No payment was received by assessee for granting licence to use any software application to SAPL. Therefore, the payments do not fall within the ambit of definition of "Royalty" as defined in the DTAA or within the meaning of *Explanation (2)* under section 9(1)(vi) of the Act.

(iii) As regards holding the payments as FTS, the DRP placed reliance on the decision of Pune Bench of the Tribunal in the case of *M/s. Sandvik AB vs. DDIT (supra).* The DRP has discussed this issue in Paras 4.20 & 4.21 of the direction. For the sake of completeness the same are extracted herein under:

> *"4.20. It is therefore seen from the decisions mentioned above that in order to be considered as FTS, the services rendered by the assessee, apart from being technical or consultancy services, should also satisfy the condition that such services make available technical knowledge, experience, skill, knowhow or processes. The term "make available" has been interpreted to mean that the recipient of this service should be enabled to apply such technical knowledge, experience etc. by itself without recourse to the service provider in future.*
>
> *4.21 In the present case, the IT support services rendered by the assessee to SAPL are in the nature of system development services and maintenance of internally developed applications. It is seen that the assessee merely provides development/ updation and maintenance of the internally developed software applications owned by the assessee and this service in no way equips the recipient of the service i.e., SAPL to carry out such development/updation and maintenance activity by itself in future without recourse to the assessee. Hence, the receipt arising out of IT support services provided by the assessee does not fall under the ambit of "Fees for included services" as defined in the treaty."*

(iv) The Revenue has failed to show that the payments received by assessee from SAPL are either in the nature of Royalty or FTS. We do not find any infirmity in the impugned assessment order/directions of the DRP. Hence, the grounds raised by the Revenue in appeal are dismissed being devoid of any merit.

8. Transponder Fee paid for programme – transmission held not to be "Royalty" and therefore, no liability of the payer to deduction of TDS u/s. 195.

Zee Entertainment Enterprises Ltd. [TS-674-ITAT-2018 (Mum.)] Assessment Year 2013-14

Facts

(i) The assessee, Zee Entertainment Enterprises Ltd. or ZEE in short, is engaged in the business of broadcasting and distribution of TV channels, production, commissioning, purchase and export-sale of TV programmes, films, news, distribution of films, and also acts as canvassing agent for space selling on TV Channels.

(ii) The assessee has entered into a lease agreement for the transponder facility offered by M/s. Intelsat Corporation, USA to enable transmission of uplinked programmes to be seen over the footprint of the satellite (mainly India) and paid ₹ 26,576,716 as user charges for the period January to March 2013. The AO. noted that the assessee has not deducted any tax from the remittance at source relying on a certificate issued by a CA in Form 15CB. It has made a declaration in Form 15CA before making the remittance and based on this declaration, the assessing officer has initiated proceedings under section 201(1) & (1A) of the Act. He arrived at a conclusion that the remittance represents income of the non-resident in the nature of royalty, being payment for use or right to use a process and has held that the assessee was liable to deduct TDS on this amount and has accordingly, held the assessee as assessee in default passing suitable orders under section 201(1) and 201(IA) of the Act.

(iii) Before the AO., the assessee has relied on the ITAT judgment in the case of same remittee *M/s. Intelsat Corporation (ITA No. 4662/Del/2011) for AY 2006-07 dated 16-1-2012* and the decision in the case of *B4U International Holdings, 21 taxmann.com 529 (Mum).* In the judgment in the case of Intelsat, the ITAT held that the service rendered by the non-resident did not fall under the category of term 'process' as contemplated under section 9(l)(vi) of the Act and hence the payment did not constitute royalty under this section. The AO. has gone into the facts of the case elaborately, has noted that in the case of M/s. Intelsat Corporation, the ITAT decided that the case did not fall under the definition of 'royalty' as defined in section 9(l)(vi) of the Income-tax Act and hence there was no need to analyse the transaction with relation to India-US DTAA. He has also observed that the main issue related to whether the service of the non-resident was covered under the term 'use or right to use process' and the word process was not defined in the Act at that time. Since the provisions of section 9(l)(vi) have been amended to include a definition of term 'process', the decision in the case of M/s. Intelsat Corporation (supra) is no longer applicable. As regards the case of B4U International Holdings, the AO has proceeded to analyse the transaction in detail. He has noted that the definition of royalty in both the Act as well as Treaty is *pari materia*. He has also noted that as per Article 3(2) of the Treaty, any term not defined in the treaty shall have the meaning which it has under the laws of that State concerning the taxes to which the Convention applies. Meaning thereby that a term not defined in the Treaty will be interpreted as per the definition in the Income-tax Act. While the term 'process' is not defined in the Treaty, it is defined in IT Act and hence, it is liable to be interpreted as per the definition in the Act.

(iv) The AO held that the business of M/s. Intelsat Corporation was to help ZEE relay its programmes from the satellites in the footprint including India. ZEE has uplinking facility in India from where the programmes are uplinked to the satellite. These programmes are subjected to various processes and subsequently signals were made available in the footprint of the transponders including India. The AO concluded that although the control of the satellite was with M/s. Intelsat, it was the control of the transponder which was important. Zee had the effective control and use of the transponder to the extent of capacity assigned to it. The transponder was an active transponder where amplification of the signal took place. The AO held that a process means a series of action or steps taken in order to achieve a particular end and in the present case, that particular end i.e., viewership by public at large was achieved only through a series of steps taken by receiving the uplinked signals, amplifying them and relaying them after changing the frequency in the footprint area. He held that such an action constituted a process and hence the payment represented royalty in the hands of Intelsat.

(v) The AO. held that the remitted amount constituted an income liable to tax under the Income-tax Act. The AO also held that the assessee had a statutory responsibility to deduct tax on this amount and he had no mandate under the Act to decide *suo motu*, on the basis of a CA certificate, not to deduct TDS on this amount. For this he relied on the Supreme Court decision in the case of *Associated Cement Co. Ltd. vs. CIT (201 ITR 435)* and *Transmission Corporation of AP vs. CIT (239 ITR 587).* Accordingly, he treated ZEE as a defaulter under section 201 of the Act.

(vi) Upon the assessee's appeal, the learned CIT(A) elaborately dealt with the issue. He decided the issue against the assessee by placing reliance upon the decision of the Hon'ble Karnataka High Court in the case of *Lakshmi Audio Visual Inc. vs. Asst. CIT [2001] 124 STC 426 (Kar.).* He also placed reliance upon the decision of Hon'ble Madras High Court in the case of *Verizon Communications Singapore (P.) Ltd vs. ITO [2013] 39 taxmann.com 70 (Mad.).* Accordingly, he confirmed the AO.'s action.

Decision

On assessee's appeal, the Tribunal held in its favour as follows:

(i) The Counsel of the assessee submitted that as per the decision of Hon'ble Delhi High Court the transponder fees are not taxable in the hands of the recipient Intelsat Corporation, USA, there cannot be any liability on the assessee to deduct tax at source u/s. 195 of the Act. Further, the assessee has made submissions in this regard that as per the law laid down by the Hon'ble Apex Court in the case of *G. E. Technology Centre Pvt. Ltd. vs. CIT (327 ITR 456) (SC),* there is no liability to deduct TDS when the income is held to be not chargeable to tax in the hands of the recipient.

(ii) We find that the identical issue was considered by this Tribunal in the case of *Viacom 18 Media Pvt. Ltd. vs. Asst. Director of Income – tax (International Taxation) (in ITA Nos.599 to 614/Mum/2016 vide order dated 9-7-2018*).

(iii) After quoting exclusively from its aforesaid decision, the Tribunal held that since facts are identical and it is undisputed that the Hon'ble Delhi High Court has held that the payment is not taxable in the hands of the recipient, following the precedent of the Hon'ble Apex Court in the case of *G. E. Technology Centre Pvt. Ltd. (supra),* we are of the considered opinion that when this income is not chargeable to tax in the hands of the recipient, no liability is there on the assessee to deduct tax at source. Accordingly, in the background of the aforesaid discussion and precedent, we set aside the orders of the authorities below and decide the issue in favour of the assessee.

9. Taxability of purchase price of Designs and Drawings – Whether in the nature of Fees for Technical Services and taxable as FTS – Held : No, in favour of the assessee

Tata Steel Limited vs. ITO Assessment Year 2016-17 ITA No. 4166/Mum/2017 (Unreported)

Facts

(i) The assessee is a company engaged in the business of manufacturing and sale of steel. The assessee was expanding its production capacity at Jamshedpur, Bihar. For this purpose the assessee company purchased and setup a by product plant (BPP) of Coke Oven Battery 10 &11 which is s subset of steel plant. For that purpose, the assessee had entered into an agreement with M/s. Acre Coking & Refinery Engineering Consulting Corporation MCC of China.

(ii) The non-resident supplier raised an invoice of USD 145,105.75 representing 5% of the contract price for supply of engineering drawing. The assessee issued a certificate in the prescribed form No. 15CB, certifying that the said contract price constitutes Royalty in terms of Indo-China Double Taxation Avoidance Agreement (DTAA), thus chargeable under Indian Income-tax at the rate of 10%. The assessee pursuant to the said certificate deducted 10% tax on said payment.

(iii) The contention of the assessee is that they have imported Designs and Drawing (which were imported on Free-on-Board "FOB" basis) and are inextricably linked and exclusively used for civil structural work in connection with the imported plant, machinery and equipment and consequently formed an integral part of such plant, machinery and equipment, as would be manifest from the fact that Coke Batteries could not have been setup in absence of said imported designs and drawings. The assessee also contended that the said imported design and drawing constitutes goods, the consideration for which is not chargeable to Indian income and, which consideration, therefore, does not attract any withholding tax in India.

(iv) The contention of assessee was not accepted by learned Commissioner (Appeals). Therefore the assessee has filed present appeal before this Tribunal.

Decision

The Tribunal decided the appeal in favour of the assessee as follows:

(i) We have considered the rival submission of the parties and have gone through the order of learned CIT(A). We have noted that on almost similar set of facts, the Tribunal in assessee's own case, while adjudicating the identical grounds of appeal for similar payments made to M/s. Nippon Steel & Sumikin Engineering Company Ltd (Nippon), a tax resident of Japan, passed the following order and decided the issue in favour of the assessee.

(ii) In our opinion, the short issue to be decided is as to whether the payments made by the assessee to Nippon for supply of D&D, as per the agreement, constituted FTS. The term FTS has peculiar meaning as per the provisions of *Expl.* 2 to section 9(1)(vii) of the Act. The section stipulates that for the purposes of clause (vii), FTS means any consideration for the rendering of managerial, technical or consultancy services, but does not include consideration for any construction, assembly, mining or like project undertaken by the recipient, or consideration which would be income of the recipient chargeable under the head salaries.

(iii) The settled law, governing the contracts dealing with supply of plant and machinery, D & D/Know-how, stipulates that if services are intrinsically connected to the sale of goods, same cannot be treated as FIS or FTS. The Hon'ble Apex Court in the case of *Ishikawajima Harima Heavy Industries Ltd (288 ITR 408)* has upheld the above principle. The Hon'ble Calcutta High Court in the matter *Andrew Yule & Co. (207 ITR 899)* has dealt with the identical issue. In that matter, a German company had supplied certain machinery to the Indian assessee and had rendered certain services in setting up of the machinery. Considering those facts, the Hon'ble Court held that services rendered in setting up of machinery could not be treated as personal service, even if the agreement for rendering the services was embodied in a separate agreement, that the German company had no PE in India, that in view of the Indo-German DTAA, no income had accrued in India, that there was no liability to deduct tax at source.

(iv) The order of the Special Bench of the Chennai Tribunal, delivered in the case of *Prasad Production Limited (125 ITD 263)* also supports this view. In that matter, the assessee had purchased theatre equipment, the consideration for which was constituted of the purchase price of the equipment and a technology transfer fee.

(v) Payment of the technology transfer fee made by assessee to the foreign company towards the services of installation of equipment and training of personnel under the agreement for supply, maintenance and installation of theatre equipment was held to be a part of the price of equipment and, therefore, the said payment was held not chargeable to tax in India.

(vi) Considering the above, the Tribunal held that the CIT(A) was not justified in holding that services rendered in pursuance of the purchase agreement could be taxed as FIS/FTS.

(vii) We find that the assessee has been referred to as purchaser in the D & D agreement, that the D & D was supplied to the assessee only for the purpose of completing operating and maintaining the plant. After going through the agreement entered into by the assessee with Nippon, we hold that D & D were critically essential for setting up the Plant and in their absence the Plant could not have been installed. In other words, the D & D were not merely inextricably linked with the plant but the plant would not have been installed and commissioned without D & D. So, it can safely be said that D & D would constitute part of cost of acquisition of the Plant. In the case under consideration, it is also clear that the assessee was not exploiting the D & D for business purposes, that IPR of the D & D were retained by the non-resident supplier. Considering the above, we hold that the FAA was not justified in holding that disputed amount was FTS.

(viii) We have gone through the cases relied upon by the FAA. In none of the cases, referred to by him, the issue was not deliberated upon as to whether the consideration, received by a manufacturer of plant and machinery for supplying to its customer, wherein D & D was essential for installation of plant and machinery, constituted part of cost of acquisition of plant. So, reversing the order of the FAA, we decide the effective ground of appeal in favour of the assessee."

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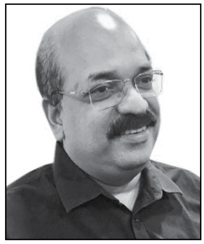

Vaitheeswaran, *Advocate*

INDIRECT TAXES

GST Gyan

IGST on Ocean Freight – Navigating Stormy Waters

Background

Ocean freight is a critical element in any import transaction. When goods are imported into India, Customs Duty is levied under Section 12 of the Customs Act on the value determined in terms of Section 14 of the Customs Act, 1962. In so far as valuation of imported goods is concerned, the same is governed by the Customs (Determination of Value of Imported Goods) Rules, 2007 which is basically the WTO Valuation Rules.

Free on Board (FOB) represents the value of the goods ex-foreign port and Cost-Insurance Freight (CIF) represents the value after addition of freight and insurance to FOB. The value of imported goods shall include the cost of transport, loading, unloading and handling charges associated with the delivery of imported goods to the place of importation and the cost of insurance to the place of import. This value not only attracts customs duty but also attracts IGST.

When goods are imported into India by virtue of the proviso to Section 5 of the IGST Act, there is a levy of IGST under Section 3 of the Customs Tariff Act on the value determined under the said Act at the point of time when duties of customs are levied on the goods under Section 12 of the Customs Act.

Reverse Charge Mechanism in GST

Section 5(3) of the IGST Act, 2017 empowers the Government to specify categories of supply of goods or services where the tax on which shall be paid on reverse charge basis by the recipient of such goods or services or both. In exercise of powers conferred by Section 5(3), the Central Government has issued Notification No. 10/2017-Integrated Tax (Rate). The relevant entry, supplier and recipient of service in terms of the Notification is given below:

Sl. No.	Category of Supply of Services	Supplier of service	Recipient of Service
10	Services supplied by a person located in non-taxable territory by way of transportation of goods by a vessel from a place outside India up to the customs station of clearance in India.	A person located in non-taxable territory.	Importer as defined in clause 26 of the Customs Act, 1962 located in the taxable territory.

Rate of tax

Notification No. 8/2017-Integrated Tax (Rates) deals with IGST rates for various services. Entry 9(ii) provides for a rate of 5% in respect of *the transport of goods in a vessel including services provided or agreed to be provided by a person located in a non-taxable territory to a person located in a non-taxable territory by way of transportation of goods by a vessel from a place outside India up to the customs station of clearance in India.*

In terms of the proviso, credit of Input Tax (other than on ships, vessels including bulk carriers and tankers) used in supplying the service is not available. An explanation provides that this condition will not apply where the supplier of service is located in non- taxable territory.

A corrigendum was issued to Notification No. 8/2017-IGST and reads as under:

> *After line 6, insert '4. Where the value of taxable service provided by a person located in non-taxable territory to a person located in non-taxable territory by way of transportation of goods by a vessel from a place outside India up to the customs station of clearance in India is not available with the person liable for paying integrated tax, the same shall be deemed to be 10% of the CIF value (sum of cost, insurance and freight) of imported goods'.*

Combined effect of Notification No. 10/2017 and No. 8/2017

Where there is transportation of goods by vessel from a place outside India, up to the customs station of clearance in India, there is a levy of IGST at the rate of 5% and the levy is effected through reverse charge mechanism whereby the importer is required to discharge the IGST on ocean freight. The Notification goes one step further and attempts to levy IGST on the importer even on a transaction of supply of service made by a person located in a non-taxable territory to another person located in a non-taxable territory.

If an Indian importer enters into a contract for purchase of goods from USA and the CIF price is 100 dollars and the supplier in USA engages a shipping line located in Japan to deliver the goods to India, the Notification seeks to levy IGST on the Indian importer. The levy is fastened on the Indian importer even though the supplier of service is located in Japan and the recipient of service is located in USA.

IGST on ocean freight on a CIF or a CFR transaction is effectively a levy on

(i) a transaction between two non-residents located outside India;

(ii) a service contract executed outside India;

(iii) a consideration that passes outside India; and

(iv) an importer who is not privy to the freight contract between the persons located in the non-taxable territories.

The impossibility of the importer having information or knowledge or being privy to the value of taxable service between two foreign entities is also evident through the corrigendum dated 30-6-2017 issued by the Government of India to Notification No. 8/2017-Integrated Tax (Rate), wherein 10% of the CIF value is deemed as the value of the taxable service, where the value is not known to the importer.

Is the importer, the recipient of service?

Section 5(3) of the IGST Act is the enabling provision and provides for IGST to be paid by the recipient of notified goods or services. When the foreign supplier located in USA engages a service provider located in Japan for transportation of goods by vessel to India, the recipient of service is only the foreign supplier. When the goods are imported, the importer is liable to pay customs duty and IGST on the import of goods. The key question is whether the importer can be considered as the recipient of service. In the instant case, the recipient of service is the supplier located in USA and not the Indian importer.

Is the transaction an import of service?

Section 7(4) of the IGST Act provides for a levy of IGST on supply of services imported into the territory of India by treating the said supply of services to be in the course of inter-State trade or commerce.

Section 2(11) of the IGST Act defines import of services to mean supply of any service where

(i) the supplier of service is located outside India;

(ii) the recipient of service is located in India;

(iii) place of supply of service is in India.

Where there is a contract for transportation of goods by vessel between a person located in USA and a person located in Japan, the recipient of service is clearly not in India. Place of supply provisions in terms of Section 12 require both the supplier of service and recipient of service to be located in India and one of them outside India for Section 13 to apply. When both parties are outside India, Section 12 and Section 13 which deal with place of supply has no application. Therefore, it cannot be said that there is import of service by the importer for levy of IGST.

Nexus to India

Entry 9(ii), Notification No. 8/2017-Integrated Tax (Rate) notifying a rate of 5% IGST on transport of goods in a vessel including services provided or agreed to be provided by a person located in a non-taxable territory to a person located in a non-taxable territory is violative of Article 245 of the Constitution of India as it seeks to impose tax on a transaction which has no nexus to India. When the shipping line is in the non-taxable territory and the supplier of goods is in the non-taxable territory, IGST Act itself has no application and fixation of rate through Entry 9(ii) is therefore questionable.

When service tax was imposed in respect of goods transport agency segment and Finance Act, 2000 and 2003 amended the law retrospectively to make the provisions compatible, on a challenge to the amended law, the Supreme Court in the case of *Gujarat Ambuja Cements Ltd. vs. Union of India (2006) 3 STR 608*, held as under:

> *....The Central Government is therefore legally competent to evolve a suitable machinery for collection of the service tax <u>subject to the maintenance of a rational connection between the tax and the person on whom it is imposed</u>. By Sections 116 and 117 of the Finance Act, 2000, the tax is sought to be levied from the <u>recipients of the services</u>. They cannot claim that they are not connected with the service since the service is rendered to them.*

The Constitutional Bench of the Supreme Court in the case of *G.V.K. Industries Ltd. and another vs. Income Tax Officer and Another (2011) 332 ITR 130* has held that Parliament is Constitutionally restricted from enacting legislation with respect to extra territorial aspects or causes that do not have, nor expected to have any direct or indirect, tangible or intangible impacts on or effects in or consequences for (a) the territory of India, or any part of India; or (b) the interests of, welfare of, well-being of, or security of, inhabitants of India and Indians.

The levy of service tax on the recipients of goods transport agency services was sustained since the recipients were connected with the service and the service was rendered to them. In the instant case, the service is being received by the foreign supplier located outside India. Similarly, the test laid down by the Supreme Court in G.V.K is not met since the notification has extra-territorial effect without any nexus to India.

In the case of *Vodafone International Holdings B. V. vs. Union of India and Another (2012) 341 ITR 1 vide* concurring with the majority view

His Lordship Justice Mr. K. S. Radhakrishnan has held that Section 195 of the Income-tax Act would apply only if payments are made from a resident to another non-resident and not between two non-residents situated outside India. Where the transaction between two non-residents through a contract executed outside India and consideration also passed outside India, the transaction has no nexus to India.

Double Taxation?

In terms of Section 14 of the Customs Act, cost of transportation to the place of importation, insurance, loading & unloading charges are all part of transaction value of goods for the purpose of levy of customs duty and by virtue of the IGST Act, there is also a levy of IGST on such value. It is a settled principle under the WTO that the freight incurred from the country of origin to the country of landing forms part of the valuation of the goods. Rule 10(2) of the Customs Valuation (Determination of Value of Imported Goods) Rules, 2007 which is based on the WTO Valuation Rules provides for inclusion of cost of transport of imported goods up to the place of importation in the value.

The Supreme Court *vide CCE vs. United Shippers (2015) 39 STR J369*, affirmed the decision of the Tribunal in the case of *United Shippers Ltd. vs. CCE (2015) 37 STR 1043* wherein it was held that when goods are being transported by barges from another vessel to the jetty, that activity is part of the import transaction of bringing the goods into India from a place outside India. There is no question of levying service tax on the transportation by barges since the activity is part of the import transaction leviable to import duty. This is also evident from Section 14 of the Customs Act and the Customs Valuation Rules which specifically includes barge charges and handling charges in the transaction value of imported goods.

Whether tests set out in Govind Saran Ganga Saran met?

The Supreme Court in the case of *Govind Saran Ganga Saran vs. Commissioner of Sales Tax and Others (1985) 60 STC 1* has observed as under:

> *"The components which enter into the concept of a tax are well-known. The first is the character of the imposition known by its nature which prescribes the taxable event attracting the levy, the second is a clear indication of the person on whom the levy is imposed, and who is obliged to pay the tax, the third is the rate at which tax is imposed and the fourth is the measure or value to which the rate will be applied for computing the tax liability. If those components are not clearly and definitely ascertainable it is difficult to say that the levy exists in point of law. Any uncertainty or vagueness in the legislative scheme defining any of those components of the levy will be fatal to its validity.*

It is difficult to conclude that the tests laid down by the Hon'ble Supreme Court are met in the instant case, since the taxable event has no connection to India; the levy is through a Notification on a person who has no connection between the contracting parties namely the foreign shipping line and the foreign supplier of goods; the measure of tax is not known since the freight as agreed between the foreign parties is not known to the Indian importer.

Practically, given the fact that IGST paid under reverse charge mechanism qualifies for input tax credit, not many have questioned the levy. However, when the impact is huge or where ITC is not available or where there is an accumulation on account of inverted rate structure, importers have chosen to question the validity as a result of which a number of writ petitions have been filed across the country. The legal position would emerge as and when these matters are disposed of by the Hon'ble Courts.

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CA Ashit Shah and CA Kush Vora

INDIRECT TAXES
GST – Legal Update

A. CGST NOTIFICATIONS

1. Extension of the time period for completing migration of taxpayers who received provisional IDs but could not complete the migration process.

(Notification No. 67/2018 – Central Tax – Dated 31-12-2018)

The CBIC has extended time limit for making application for migration of GST registration to 31st January 2019. The time limit for communication of new GSTIN to GSTN has been extended up to 28th February 2019.

2. Extension of filing of Form GSTR-3B *(Notification No. 68, No. 69 & No. 70/2018 – Central Tax – Dated 31-12-2018)*

The CBIC has extended time limit for filing of GSTR 3B for the period July 2017 to February 2019 to 31st March 2019.

3. Extension of filing of Form GSTR-1 *(Notification No. 71 & No. 72/2018 – Central Tax – Dated 31-12-2018)*

The CBIC has extended time limit for filing of Form GSTR-1 for the period July 2017 to February 2019 to 31st March 2019.

4. Exempt supplies made by Government Departments and PSUs to other Government Departments and *vice-versa* from TDS provisions *(Notification No. 73/2018 – Central Tax – Dated 31-12-2018)*

The CBIC exempts following persons from the provisions relating to deduction of GST TDS if supply of goods or services takes place between

(a) a department or establishment of the Central Government or State Government; or

(b) local authority; or

(c) governmental agencies; or

(d) such persons or category of persons as may be notified by the Government on the recommendations of the Council

5. **Fourteenth Amendment Rules** *(Notification No. 74/2018 – Central Tax – Dated 31-12-2018)*

The CBIC has made the following amendments in GST Rules

- Amendment in provisions relating to 'GST TDS registration' for categories of person who do not have physical presence in a particular State;
- Amendment in provisions related to 'Tax invoice/ Bill of Supply/ Delivery challan' so as to provide that signature or digital signature of the supplier or his authorised representative shall not be required in the case of issuance of an electronic invoice in accordance with the provisions of the Information Technology Act, 2000;
- Amendment in provisions relating to e-Way Bill so as to restrict generation of e-Way Bill for persons who have not filed GST returns for consecutive period of 2 months;
- Form RFD-01A has been modified and substituted;
- Form GSTR-9 – Annual return has been modified and substituted;
- Form GSTR-9A – Annual return for compositions persons has been modified and substituted;
- Form GSTR-9 – Audit Report has been modified and substituted;
- Form GST RVN-01 has been modified and substituted;
- Form GST APL-04 – Summary of demand has been modified and substituted.

6. **Waiver of late fees for GSTR-1** *(Notification No. 75/2018 – Central Tax – Dated 31-12-2018)*

The CBIC waives late fees payable for delay in filing of Form GSTR-1 beyond due date for the months/quarter from July 2017 to September 2018 , if the such GSTR-1 is filed between 22nd December to 31st March 2019.

7. **Waiver of late fees for GSTR-3B** *(Notification No. 76/2018 – Central Tax – Dated 31-12-2018)*

The CBIC waives late fees payable for delay in filing of Form GSTR-3B beyond due date for the months from July 2017 to September 2018, if the such GSTR-3B is filed is filed between 22nd December to 31st March 2019.

8. **Waiver of late fees for GSTR-4** *(Notification No. 77/2018 – Central Tax – Dated 31-12-2018)*

The CBIC waives late fees payable for delay in filing of Form GSTR-4 beyond due date for the quarter July 2017 to September 2018, if such GSTR-4 is filed between 22nd December to 31st March 2019.

9. **Extension of due date for filing of FORM ITC-04** *(Notification No. 78/2018 – Central Tax – Dated 31-12-2018)*

The due date for filing of GST ITC-04 for the quarter ending July to December 2018 has been extended to 31st March, 2018

B. IGST NOTIFICATIONS

1. **Introduction of IGST Rules** *(Notification No. 04 /2018 – Integrated Tax – Dated 31-12-2018)*

The CBIC has introduced IGST Rules effective from 1st January 2019 elaborating principles relating to place of supply of services.

C. CGST RATE NOTIFICATIONS

1. **Change in GST rate of goods** *(Notification No. 24 & No. 25/2018 – Central Tax (Rate)– Dated 31-12-2018)*

The CBIC has revised various GST rates on various goods pursuant to recommendation in in 31st GST Council meeting. The said changes shall come into force from 1st January, 2019.

2. **Exemption from GST on supply of gold by nominated agency** *(Notification No. 26– Central Tax (Rate)– Dated 31-12-2018)*

The CBIC exempts from levy of GST on supply of gold falling in heading 7108 of the First Schedule to the Customs Tariff Act when supplied by Nominated Agency under the scheme for "Export Against Supply by Nominated Agency" as referred to in paragraph 4.41 of the Foreign Trade Policy, read with relevant provisions of Chapter 4 of Handbook of Procedures.

3. **Change in GST rate of services** *(Notification No. 27 & No. 28/2018 – Central Tax (Rate)– Dated 31-12-2018)*

The CBIC has revised various GST rates on various services pursuant to recommendation in in 31st GST Council meeting. The said changes shall come into force from 1st January 2019.

4. **Reverse Charge mechanism** *(Notification No. 29/2018 – Central Tax (Rate)– Dated 31-12-2018)*

The CBIC has introduced few more services under reverse charge mechanism. Important one being supply of security services provided by person other than body corporate. In such cases, recipient of security services will have to pay GST under reverse charge. The said changes shall come into force from 1st January 2019.

D. CGST CIRCULARS

1. **Guidelines for processing of applications for financial assistance under the Central Sector Scheme named 'Seva Bhoj Yojna' of the Ministry of Culture** *(Circular No. 75/49/2018 – GST – Dated 27-12-2018)*

The Ministry of Culture has introduced a Central Sector Scheme called the "Seva Bhoj Yojna" for the reimbursement of central tax and the Central Government's share of integrated tax paid on the purchase of certain raw food items namely, ghee, edible oil, sugar/ burra/ jaggery, rice, atta/ maida/rava/ flour and pulses used for distributing free food to general public/devotees by charitable/religious institutions like Gurudwaras, temples, Dharmik Ashrams, Mosques, Dargahs, Churches, Math, Monasteries, etc. The detailed guidelines/ procedure regarding the scheme has been clarified in the said circular.

2. **Clarification on certain issues related to GST** *(Circular No. 76/50/2018 – GST – Dated 31-12-2018)*

Several clarifications on below mentioned issues has been clarified *vide* the said circular:

– Sale by Government departments to unregistered person;

– Leviability of penalty under section 73(11) of the CGST Act where return in Form GSTR 3B has been filed after due date;

– Rate of tax in case of debit notes / credit notes issued under section 142(2) of the CGST Act;

– Applicability of the provisions of section 51 in context of notification No. 50/2018-Central Tax;

– Valuation methodology in case of TCS under Income-tax Act and

– Definition of owner of goods related to GST are clarified through this circular.

3. **Denial of composition option by tax authorities and its effective date thereof**

(Circular No. 77/51/2018 – GST – Dated 31-12-2018)

Clarification regarding effective date of withdrawal from composition scheme by the composition taxpayer or from the proper officer is clarified by this circular. It is also clarified that provisions of section 18(1)(c) of the CGST Act shall apply for claiming credit on inputs held in stock, inputs contained in semi-finished or finished goods held in stock and on capital goods on the date immediately preceding the date of issue of the order by the proper officer.

4. **Clarification on export of services under GST** *(Circular No. 78/52/2018 – GST – Dated 31-12-2018)*

In pursuance to various representations, CBIC has clarified various points in case of outsourcing services when exported.

5. **Clarification on refund related issues** *(Circular No. 79/53/2018 – GST – Dated 31-12-2018)*

In pursuance to various representations, CBIC has clarified various points pertaining to GST refunds, as under:

– Physical submission of refund claims with jurisdictional proper officer;

– Calculation of refund amount for claims of refund of accumulated Input Tax Credit (ITC) on account of inverted duty structure;

– Disbursal of refund amounts after sanction;

– Refund application that have been generated on the portal but not physically received in the jurisdictional tax offices;

– Issues related to refund of accumulated Input Tax Credit of Compensation Cess;

– Non-consideration of ITC of GST paid on invoices of earlier tax period availed in subsequent tax period;

– Refund of accumulated ITC of input services and capital goods arising on account of inverted duty structure is clarified through this circular.

6. **Clarification regarding GST rates & classification of goods** *(Circular No. 80/54/2018 – GST – Dated 31-12-2018)*

Clarifications in respect of applicable GST rates on the following items are provided:

– Chhatua or Sattu

– Fish meal and other raw materials used for making cattle/poultry/aquatic feed,

– Animal Feed Supplements/ feed additives from drugs,

– Liquefied Petroleum Gas for domestic ue,

– Polypropylene Woven and Non-Woven Bags and PP Woven and NonWoven Bags laminated with BOPP,

– Wood logs for pulping,

– Bagasse based laminated particle board,

– Embroidered fabric sold in three pieces cloth for lady suits,

– Waste to Energy Plant-scope of entry No. 234 of Schedule I of notification No.1/2017- Central Tax (Rate) dated 28-6-2017,

– Turbo Charger for railways,

– Rigs, tools & Spares moving inter-State for provision of service.

7. **Clarification on GST rate for Sprinkler and Drip irrigation System including laterals.** *(Circular No. 81/55/2018 – GST – Dated 31-12-2018)*

Clarification regarding GST tax rate for sprinkler and drip irrigation system including laterals is provided through circular. It is clarified that sprinkler system consisting of nozzles, lateral and other components would attract 12% GST rate.

E. CGST 'Removal of Difficulty Orders'

1. **Extension of due date for availing ITC on the invoices or debit notes relating to such invoices issued during the FY 2017-18.** *(Order No. 2/2018 – GST – Dated 31-12-2018)*

The Central Government, on recommendations of the Council, has issued order to extend the due date for availing ITC on the invoices or debit notes relating to such invoices issued during the FY 2017-18 till the due date for furnishing GSTR-3B for the month of March, 2019 or for the quarter January, 2019 to March, 2019 i.e., 20th April 2019.

It would be interesting to note that the order has mentioned amendments in Section 16(4) and Section 37(3) of CGST Act, but however, there is no specific amendment under Section 34(2) of CGST Act which deals with issuance of debit notes or credit notes.

2. **Amend Removal of Difficulty Order No. 1/2018 dated 11-12-2018 so as to extend the due date for furnishing of annual returns for FY 2017-18.** *(Order No. 3/2018 – GST – Dated 31-12-2018)*

The Central Government, on recommendations of the Council, has issued order to amend Removal of Difficulty Order No. 1/2018 dated 11-12-2018 so as to extend the due date for furnishing of annual returns in Form GSTR-9, Form GSTR-9A and reconciliation statement in Form GSTR-9C for FY 2017-18 till 30th June 2019.

3. **Extension of due date for furnishing the statement in FORM GSTR-8 by e-commerce companies for the months of October to December, 2018.** *(Order No. 4/2018 – GST – Dated 31-12-2018)*

The Central Government, on recommendations of the Council, has issued order to extend the due date for furnishing the statement in Form GSTR -8 by e-commerce companies for the months of October to December, 2018 till 31st January 2019.

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> Infinite patience, infinite purity, and infinite perseverance are the secret of success in a good cause.
>
> — *Swami Vivekananda*

 

CA Naresh Sheth & CA Jinesh Shah

INDIRECT TAXES

GST – Recent Judgments and Advance Rulings

A. Rulings by Appellate Authority of Advance Ruling

1. M/s. Opta Cabs Pvt. Ltd. – AAAR Karnataka (2018-TIOL-26-AAAR-GST)

Facts, issues involved and query of applicant

Applicant is in the business of Taxi Aggregation Service and Taxi Service. The taxi driver who provides the service in his own name does the billing for the taxi service. The taxi driver collects the amount from the customer on the completion of the trip. The applicant does not collect any amount on behalf of the taxi driver. Applicant collects monthly service charges from taxi drivers for usage of IT services i.e., Mobile App and Billing related services. The applicant is duly discharging their GST liability on service charges collected from the taxi drivers. As far as taxi drivers are concerned, customers pay them directly and their collections may not necessarily exceed ₹ 20 lakhs p.a.

Applicant seeks ruling as to whether the money paid by the customer to the driver of the cab for the services of the trip is liable to GST and whether the applicant is liable to pay GST on this said amount.

Discussions by and Observations of AAR

The service is provided by the taxi operator and the amount is collected from the customer by him. The applicant company has no role to play other than issue of invoice on behalf of the taxi operator to the customer. The customer would log in to the application of the applicant and book the taxi.

Sub-section (5) of section 9 of the CGST Act, 2017 states as under:

"(5) The Government may, on the recommendations of the Council, by notification, specify categories of services the tax on intra-State supplies of which shall be paid by the electronic commerce operator if such services are supplied through it, and all provisions of this Act shall apply to such electronic commerce operator as if he is the supplier liable to pay tax in relation to the supply of such service."

Notification No.17/2017 - Central Tax (Rate) dated 28th June, 2017 notifies that the tax on intra-state supplies by way of transportation of passengers by a radio-taxi, motor cab, maxi cab shall be paid by the electronic commerce operator.

A conjoint reading of the above provisions makes it clear that the electronic commerce operator shall be liable to pay tax on services supplied through them by way of transportation of passenger in motor cab or maxi cab or motor cycle or radio-taxi. Further electronic commerce operator shall be deemed to be the supplier in such cases.

There is no doubt that the services of transportation of passengers is supplied to the consumers through the applicant and by virtue of above mentioned provision, it shall be deemed that the applicant would be a deemed supplier, liable to pay tax in relation to the supply of such transportation services by the taxi operator.

Ruling of AAR

In accordance with the provisions of section 9(5) of the CGST Act, 2017 read with Notification No. 17/2017-Central Tax (Rate) dated 28-6-2017, the applicant is liable to pay tax on the amounts billed by him on behalf of the taxi operators for the service provided in the nature of transportation of passengers through it.

Appeal to the AAAR and Observations of AAAR

Aggrieved by the above-referred ruling, the applicant preferred an appeal to AAAR against the same. The appellant reiterated the grounds stated in the application and further stated that in order to fall under the definition of "e-commerce operator" it is essential for "such services are supplied through it". However, in the appellant's case the services were not provided through it but only booked through it. The AAAR observed that the services provided by the appellant falls under the definition of "e-commerce service" and it is thus an e-commerce operator. Further, it observed that booking a cab is an integral part of supply chain and hence there is no merit in appellant's argument that services are only booked through it and not supplied through it.

Ruling of AAAR

The AAAR upheld the order No. KAR ADRG 14/2018 dated 27-7-2018 passed by Karnataka Advance Ruling Authority and dismissed the appeal filed by the appellant.

B. Rulings by Authority of Advance Ruling

1. M/s. Enmarol Petroleum India Pvt. Ltd. – AAR Maharashtra (2018-TIOL-285-AAR-GST)

Facts, issues involved and contention of the Petitioner

The applicant is an authorised dealer of M/s. Innospec Limited, a Company registered in England & Wales. The applicant sells the marine fuel additive chemicals of Innospec Limited to shipping lines in India and outside India.

In the instant case, M/s. AZA Shipping Pvt. Ltd. ("AZA"), an Indian Company, placed a purchased order ("PO") on the applicant for 75 ltrs. of Innospec Fuel Specialties Octamar L15 product. The said requirement had been specifically placed for making delivery at Singapore Port for a vessel M T CHAFA. On the receipt of the above-confirmed PO from AZA, the applicant placed PO on M/s. Innospec Limited for making delivery of aforesaid goods at Singapore Port. Thereafter, M/s. Innospec Limited delivered the goods through its Singapore Logistics Partner M/s. CWT Logistics Pte. Ltd. ("CWT") to the vessel M T CHAFA at Singapore Port. Thereafter, Innospec Limited raised invoice on the applicant. The applicant raised invoice on its customer AZA. The applicant states that it has not charged GST on the invoice raised to AZA considering the said supply to be non-taxable under GST in India.

Applicant has sought advance ruling for the following questions:

1. *Whether the applicant is liable to pay GST on supply of goods located outside India to customers within India without physically bringing the goods to India?*

2. *Whether the out & out supplies in the facts of present case will be considered as export supplies or exempted supplies for the purpose of the GST?*

The applicant submits the following grounds for non-taxability:

The said supply does not take place in India

The applicant submits that as per Section 1 of CGST Act and Section 1 of IGST Act, the GST Act applies to whole of India including the State of J & K. In the present case, though the supplier and recipient is located in India, the supply in form of sale of goods has taken place in Singapore where the goods are located and the delivery has been given at Singapore Port. Singapore does not fall in the said definition of India and hence such supply would not be covered under the ambit of CGST Act and IGST Act. Hence, aforesaid transaction would not be liable to GST.

The said supply is an out & out transaction

The transaction is neither import of goods into India nor export of goods outside India. The applicant submits that following provisions are relevant for purpose of understanding the out & out transaction:

Section 2(5) and 2(10) of IGST read as under:

"(5) "export of goods" with its grammatical variations and cognate expressions, means taking goods out of India to a place outside India

(10) ''import of goods" with its grammatical variations and cognate expressions, means bringing goods into India from a place outside India;"

Above definitions are with respect to movement of goods and not the location of supplier or recipient. Place of supply of an import or export of goods is determined u/s. 11 of IGST Act, extracted as under:

"The place of supply of goods,—

(a) imported into India shall be the location of the importer;

(b) exported from India shall be the location outside India."

In the instant case, there is no movement of goods into India or from India, therefore, Section 11 will not apply.

The place of supply for the said transaction cannot be determined u/s. 10 of IGST Act

The applicant further submitted that Section 10 is also not applicable, as it can apply only when movement of goods has taken place within India. In the present case, no leg of the transaction is even remotely taking place in India, therefore, Section 10 of IGST will not apply.

Section 7(5) of IGST Act, 2017 is also not applicable

Relevant extract of Section 7(5)(a) reads as under:

"(5) Supply of goods or services or both,—

(a) when the supplier is located in India and the place of supply is outside India;

shall be treated to be a supply of goods or services or both in the course of inter-State trade or commerce.

The applicant submitted that to apply Section 7(5)(a) two variables should be available: (a) the supplier is located in India and (b) the place of supply is outside India. In the present case, both the variables are absent. Location of supplier of goods is not defined under GST law, only location of supplier of service is defined. Even if it is interpreted contextually, then the same has to be located *qua* a particular supply made under GST law. Since sale is taking place outside India, it is not a supply under GST law.

The place of supply for the aforesaid transaction can't be determined under GST law neither u/s 10 nor u/s 11 of IGST Act. Thus, second variable is also not determinable. Therefore, Section 7(5)(a) is not applicable.

The goods are not consumed in any state of India

The applicant submitted that GST is a destination based consumption tax and the same is taxable in India only if the consumption of goods or services take place in India. Since in present case, the consumption of the goods does not take place in India, the transaction will not be taxable in any State of India.

Discussions by and observations of AAR

The applicant would be purchasing goods from M/s. Innospec on the basis of PO received from customers in India and said goods would be delivered by M/s. Innospec from outside India to ship / vessel of customer of the customer which is also outside India i.e., Singapore. Thus, the transaction is similar to selling of goods on high sea sales basis since in both the cases the goods purchased do not cross the custom frontiers of India. Therefore, the Chapter IV of IGST Act is to be referred to confirm the nature of supply of the aforesaid goods i.e., intra-state or inter-state.

Section 7(2) of the IGST Act reads as under:

"(2) Supply of goods imported into the territory of India, till they cross the customs frontiers of India, shall be treated to be a supply of goods in the course of inter-State trade or commerce."

The aforesaid goods are delivered from a place outside India to a place outside India, i.e. these goods have not crossed the customs frontiers and therefore, falling u/s. 7(2) of IGST Act. Since nature of supply is inter-state, therefore, GST will be leviable u/s. 5 of IGST Act. However, proviso of Section 5 of IGST Act reads as under:

"Provided that the integrated tax on goods imported into India shall be levied and collected in accordance with the provisions of section 3 of the Customs Tariff Act, 1975 on the value as determined under the said Act at the point when duties of customs are levied on the said goods under section 12 of the Customs Act, 1962."

Therefore, as per Section 7(2) and proviso to Section 5(1) of IGST Act, it is very clear that in respect of import goods there is no levy and collection of GST.

Following definitions are to be taken into account to understand question (2):

Section 2(47) of CGST Act, "exempt supply" means supply of any goods or services or both which attracts nil rate of tax or which may be wholly exempt from tax under section 11, or under section 6 of the Integrated Goods and Services Tax Act, and includes non-taxable supply;

Section 2(78) of CGST Act, "non-taxable supply" means a supply of goods or services or both which is not leviable to tax under this Act or under the Integrated Goods and Services Tax Act.

Thus, it is very clear that goods sold in the subject transaction are non-taxable supply. The above legal position is further reiterated and confirmed by Circular No. 3/1/2018 – IGST dated 25-5-2018 issued by the Central Board of Indirect Taxes and Customs, GST Policy Wing.

Ruling of AAR

In respect of question (1), the applicant is not liable to pay GST on aforesaid supply of goods.

In respect of question (2), the supplies would be "non-taxable supply", therefore, it will not be considered as export supplies.

2. Lions Club of Poona Kothrud – AAR Maharashtra (2018-TIOL-299-AAR-GST)

Facts, Issues involved and contention of the petitioner

The applicant is Lions Clubs of Poona Kothrud. The applicant consists of association of persons, joined together to undertake social activities without any profit motive. Funds collected as fees are pooled together to be expended for meeting expenses and forwarding to the international office for administrative expenses. The annual dues which are received from the members is used by the applicant to defray the subscription price of the Lion Magazine, and also holds programmes, Seminars and Institutes for Leadership Development and these programmes are only for the Lion members and not for non-members. These funds received from members are utilised for mutual benefit of members. Surplus, if any, is used for charitable activities. Funds collected by Lions Club can be broadly divided into following categories: (a) Club member fees (b) District fees (c) Cabinet member fees.

Applicant has sought advance ruling for the following question:

1. *Since the amount collected by individual Lions Clubs and Lions district is for convenience of Lion members and pooled together only for paying meeting expenses & communication expenses and the same is deposited in single bank account. As there is no furtherance of business in this activity and neither any services are rendered nor any goods being traded. Whether registration is required?*

The applicant submitted that **aforesaid transaction(s) not covered u/s. 7 of CGST Act.** To tax a transaction between an association or club and its members, said transaction must either fit under 7(1)(a) or (c) of 'Supply' as under:

"(a) 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;

(c) activities specified in Schedule I, made or agreed to be made without a consideration."

The term 'Business' in clause (a) above is defined u/s. 2(17)(e) of the Act as under:

"provision by a club, association, society, or any such body (for a subscription or any other consideration) of the facilities or benefits to its member".

In case of Lions Club, the members of the club only come together for a social cause and there is neither furtherance of business nor benefits or facilities to the members. According to the definition of supplier u/s. 2(105) and recipient u/s. 2(93) of the Act, 2017, the recipient is the "person" who pays the consideration to the supplier. Hence two different persons have been envisaged by the law to tax a transaction being supply made for a consideration. Now the question remains that whether the club and its members can be treated as different persons?

In Service Tax Regime, Court in several cases held that in absence of deeming fiction, treating club/association & its members as distinct persons, service tax shall not be payable. Thereafter to nullify these decisions w.e.f. 1-6-2012 clause (a) to *Explanation 3* to Sec 65B inserted to create the deeming fiction of distinct persons. However, there is no deeming fiction to treat association and members as distinct persons in Section 2(84) of the Act or elsewhere in the GST law. Further, members are not covered u/s. 25 of the Act as distinct persons.

However, Circular No. 35/9/2018-GST dated 5th March 2018 invoked the concept of deemed sale as provided under Article 366(29A) of the Constitution. It must be noted that clause (e) of said Article only enables to tax **supply of goods** by an association to its members as deemed sale. It does not enable to tax supply of service as a deemed service. Even Para 7 of Schedule II only covers **supply of goods** by any unincorporated association. It does not cover supply of services. Therefore, unless provision similar to that deemed sale is made either in the Constitution or the Act, services provided by an association to its members cannot be taxed.

Entry 2 of Schedule I provides that supply of goods or services or both between related or distinct persons as specified u/s. 25 of the Act, when made is the course or furtherance of business (even if without consideration), shall be taxable. *Explanation* u/s. 15 of the Act defines a list related person, on perusal of the same it can be concluded that there must be two or more persons who can be considered as related person. As an association and its members are the same because of principle of mutuality, they cannot be regarded as related person. Therefore, aforesaid transaction will not be covered within the scope of supply u/s. 7 of the Act.

Following were the contentions of the Jurisdictional officer:

Earlier in Service tax regime, deeming provision had been introduced w.e.f. 1-7-2012 to the effect that the club and members were decided to be separate persons. In GST regime, the definition of "business" u/s 2(17)(e) is enough comprehensive to include **a service by a "club" by way of a subscription to its members** in the term "business".

The club organizes seminars and Leadership Institute programs for its members and not for non-members. Hence, the funds received are used for the mutual benefit of members. This amounts the club to engage in the activities which may amount to "facilities" or "benefits" to the member. In context to above, this is very much essential to decide whether the applicant falls in/out purview of the definition under "business" u/s. 2(17) of the CGST Act 2017. In final hearing, written submissions were made by the club that they are not providing any facilities to their members.

Discussions by and observations of AAR

The purpose and activities as mentioned in constitution and bye-laws of the club have been gone through by the authority and formed observations that the above stated section 2(17)(e) speaks about **subscription by members, however, this subscription must be for the facilities or benefits** that would be provided. As can be seen, the club is not formed to provide any supply of goods or services to its members *qua* the fees received from them. There being no supply *qua* the fees received, there arises no occasion to visit the definition of 'Supply' for the purposes of the Act. Therefore, no more discussions in this matter would be required.

The matter discussed by official, about seminars for Leadership Development which is organised for the members, has been dealt with. Such activities do not appear to be for transforming members into leaders generally, but for the members to become leaders to perform towards the causes of the club. Thus, here too, the amounts spent are for building and empowering a human resource to help perform the activities of the club in a better way.

Ruling of AAR

In respect of above question, the applicant is not required to get registered under GST for the aforesaid supply of services.

3. M/s. Micro Instruments – AAR Maharashtra (2018-TIOL-287-AAR-GST)

Facts, issues involved and contention of the petitioner

The applicant, M/s. Micro Instruments, Mumbai, ("Micro") is a sole proprietary concern, and is carrying on trading business in Laboratory Instruments, its spare parts, Laboratory Instruments / equipments, and other related activities such as servicing, repairs and maintenance of Laboratory instruments / equipments. One of the activities of the Micro relates to providing services to its Principals in Germany, by way of procuring Purchase Orders (PO) from the parties desirous of purchasing advanced type of Laboratory Equipment, by negotiating the terms of supply including fixation of price above the floor price fixed by the Principals (known to applicant alone). If Micro can negotiate better price than the floor price, the difference between the floor price and actual price is given to Micro by way of "commission" in "convertible foreign exchange".

Modus operandi of the negotiated transactions can be summarised below:

1. The prospective customer (e.g., "M/s. Panama Laboratory" hereinafter referred as "Panama") in India places PO directly on the Principals at Germany. Principal directly supplies the equipments to Panama.

2. In the majority of cases, barring exceptions, the PO states the name of Micro, and also mentions that Panama will be entitled to have some "discount in kind", like getting some items free of cost such as TV set, a camera etc., which is to be provided by Micro as a necessary charge on the

"commission" it receives in convertible foreign exchange.

3. Once the PO is completed, the principal issues a credit note for the commission which is remitted in freely convertible foreign exchange. Micro was not issuing any document and making accounting based on credit note.

Applicant has sought advance ruling for the following questions:

1. *Whether the "Commission" received by the applicant in Convertible Foreign Exchange for rendering services as an "Intermediary" between an exporter abroad receiving such services an Indian importer of an equipment, is an "export of service" falling under section 2(6) & outside the purview of section 13(8)(b), attracting zero rated tax under section 16(1)(a) of IGST Act, 2017?*

2. *If answer to above Q. 1 is in the negative, whether the impugned supply of service forming an integral part of the cross-border sale/purchase of goods, will be treated as an "intra-state supply" under section 8(1) of the IGST Act read with section 2(65) of SGST Act attracting CGST/SGST? And, if so, at what rate?*

In the present case, Micro being the supplier of service (located in India) and customer i.e., recipient of service (i.e., supplier of goods is located outside India, Germany), Section 13 of the IGST Act, 2017 gets attracted. It appears from aforesaid discussion that Section 13(8)(b) of IGST Act, 2017 covers the present case which is reproduced below-

"(8) The place of supply of the following services shall be the location of the supplier of services, namely:

(b) Intermediary services."

The term "Intermediary" is defined in Section 2(13) of the IGST Act, which says:

"(13) 'Intermediary' means a broker, an agent or any other person, by whatever name called, who arranges or facilitates the supply of goods or services or both, or securities, between two or more persons, but does not include a person who supplies such goods or services or both or securities on his own account".

Consequently, Micro being an agent or broker between the German seller of the goods and the Indian buyer of the goods, it shall be covered under the definition of Intermediary under Section 2(13) of the IGST Act; but may not be regarded as providing "Intermediary Services", which expression is a coined phrase by the draftsman, and not defined in any GST Law. Apparently, "Intermediary" is an adjective of the noun that follows, namely, "services".

It may be argued that the "Intermediary" providing such agency or broker services may fall in the expression of "Intermediary services" appearing in Section 13 (8)(b) of the IGST Act, 2017. If it were to be true interpretation, the registered place of Supplier (Micro) being in India, the place of supply becomes 'India/ Taxable Territory' and hence CGST + SGST may get attracted. Since place of supply is in taxable territory, the aforesaid transactions cannot be treated as "Export of Services" as per Section 2(6) of IGST Act, 2017.

GST effective from 1st July, 2017 is a destination based taxation seeks to levy and collect tax based on location of consumption. Now, look at a case, in which Micro procures PO from the customer at Gujarat. By virtue of Section 13(8)(b) the Place of Supply will be Maharashtra. Therefore, the destination based taxation policy would get a jolt; since the actual use of the goods imported would be in Gujarat.

Now for the new approach, two definitions of "**Intermediary**" and "**Agent**" under Section 2(13) of the IGST Act, 2017 and Section 2(5) of the CGST Act, 2017 respectively, are important. Since Micro does not supply or receive goods/ services on behalf of anyone, Micro carries on business of its own, it is certainly not an "Agent". However, surely the activities of Micro are in the nature of "intermediary", for bringing together the Principals abroad (Germany) and the Indian Customer (M/s. Panama Laboratory), who want to buy a high end product. What is received by the Micro may be called 'brokerage' (even if it is called "commission") for the sale of goods i.e. for import of goods.

All the analysis & discussion above, finally boils down to and depends on the true meaning and purport of the expression: "intermediary services" in section 13(8) (b) of the IGST Act. If it is not the same thing as "intermediary", the provisions of Section 13 (8) (b) will not apply; and consequently, provisions of section 7 (5) (a) of the IGST Act will get attracted, as can be seen from the quoted provision:

"(5) Supply of goods or services or both, -

(a) When the supplier is located in India and the place of supply is outside India."

In that case, Section 16 of the IGST Act will apply and there would be two options available:

a) Export the services under bond/ LOU without payment of IGST Act and claim refund of un-utilized input tax credit; or

b) Supply export services on payment of IGST and then claim refund of such tax under section 54 of the CGST Act/ Rules, 2017.

Now one has to construe the true meaning of the undefined term, namely, "intermediary services" which is clearly different from the term "intermediary" defined u/s. 2(13) of the Act.

It may be noted that the expression "Intermediary services" was firstly adopted by the Place of Provision of Services Rules, 2012 (POPS Rules, 2012). Rule 9 (c) of the said rules has been placed in its new GST avatar as Section 13(8)(b) of IGST Act. A clarification was issued by CBEC on June 20, 2012 on the concept of "Intermediary services" which is reproduced below:

"5.9.6 'What are "Intermediary services"? Generally, an "intermediary" is a person who arranges or facilitates a supply of goods, or a provision of service, or both, between two persons, without material alterations or further processing. Thus, an intermediary is involved with two supplies at any one time:

i. The supply between the principal and the third party; and

ii. The supply of his own service (agency service) to his principal, for which a fee or commission is usually charged."

For the purpose of this rule, "an intermediary" in respect of goods (e.g., Selling agent) is excluded by definition. Also excluded from this sub-rule is a person who arranges or facilitates a provision of a service, but provides the main service on his own account. In this connection, one must take a note of the below mentioned amendment made by notification No. 14/2014-Service Tax, to the definition of "intermediary" to include the intermediary of goods in its scope.

"In Rule 2 for clause (f), the following clause shall be substituted, namely,

(f) "Intermediary" means a broker, an agent, or any other person, by whatever name called, who arranges or facilitates a provision of a service (hereinafter called the 'main' service) or a supply of goods, between two or more persons, but does not include a person who provides the main service or supplies the goods on his account."

When this amended definition of "intermediary" as of 01-10-2014, was rebottled in the GST law, two changes happened:

i. The original and basic distinction as to the "main" service and "intermediary" in the context of two co-existing services did not figure in the new definition in section 2 (13) IGST Act; and

ii. The definition of consignment agent has been shifted to Section 2(5) of the CGST Act.

The pivotal issue in the case on hand turns on the interpretation of the expression: "intermediary services" in Section 13 (8) (b) of the IGST Act. If the legislature wanted to have wider meaning of "Services", it would have used phraseology "Services of Intermediary" rather than "Intermediary Services". It is not open to inject definition of "Intermediary" as amended in 2014, by interpretative process when the context of Section 13(8) is specifically restricted & made applicable to specified services. Thus, the language of a taxing statute should be strictly construed; common sense approach, equity, logic, ethics and morality have no role to play. *[J. Srinivasa Rao v. Govt. of A.P. and Anr. 2006(13) Scale 27]*

In other words, the clause must be made applicable only if intermediary is acting as broker / agent in the main transaction of supply of services between the service provider and service recipient; not where the seller is supplying "goods" to the buyer or recipient. It is, therefore, follows that the section 13(8)(b) cannot be held as taking away the benefit of export of service to Micro as the supplier of service in the taxable territory and the recipient is in non-taxable territory. Therefore, Section 7(5)(a) of the IGST Act shall apply and "zero rated tax" benefit u/s. 16 would be available.

However, concerned jurisdictional officer contended that CGST Act limits AAR to decide issue mentioned u/s. 97(2), therefore, question involving examination of place of supply cannot be taken by the AAR for lack of jurisdiction. Without prejudice to above, he further submitted that dealer's contention to differentiate intermediary service for services and intermediary service for goods is not correct. Further, it is established principle of interpretation that specific provision prevails over general provision. Hence, Section 13(8) being a specific provision will apply and place of supply will be "Location of Supplier".

Discussions by and observations of AAR

From the facts and submissions before the authority, it is found that Micro is covered by the definition of an intermediary because they are definitely acting as a broker and facilitating the process for sale of materials by their foreign principals to the Indian parties because they locate the customer, negotiate the prices and probably ensure the sale. **It is very clear from the facts that the applicant is neither providing services nor supplying the goods on their own account.**

The applicant will be covered u/s. 13(8)(b) based on aforesaid facts and place of supply will be location of supplier i.e., taxable territory. Therefore, intermediary services will not be classified as export of services. Further, contention of applicant that though he is covered under definition of "Intermediary", the services provided by him are not "Intermediary services" are not tenable for the reason that services provided are clearly the services as given in the definition of "Intermediary" as referred in the discussion above.

We now discuss Inter-state provisions as well as intra-state provisions under the GST laws. In the instant case, when the recipient is located outside India, provisions of Section 7(5)(c) shall be applicable which is reproduced below:

"Supply of goods or services or both-

c) In the taxable territory, not being an intra-state supply and not covered elsewhere in this section.

Shall be treated to be a supply of goods or services or both in the course of inter-state trade or commerce."

As per the intra-state provisions contained in Section 8(2), the said provisions are subject to the provisions of section 12 of the IGST Act, which would be applicable only for the place of supply of service where the location of supplier and the location of recipient of the services is in India. When recipient is located outside India, the provisions of Section 12 cannot be applied.

Ruling of AAR

In respect of question (1) above, the intermediary services are covered u/s. 13(8)(b) and therefore, does not attract zero rated tax u/s. 16 of IGST Act.

In respect of question (2) above, said supply will be treated as inter-state supply and IGST will be levied @18%.

4. Shri Patrick Bernardinz D'Sa– AAR Karnataka (2018-TIOL-292-AAR-GST)

Facts, Issues involved and contention of the petitioner

Applicant, a land owner, entered into an agreement with M/s. NForce Infrastructure India P. Ltd., Builders & Developers, for development and promotion of "NForce – Pauline", a residential/commercial building at Valencia, Mangalore. The builder offered to develop and promote a multistoried residential apartment-cum-commercial building in the property belonging to the applicant as well as other land owners. The applicant had contributed only his land and in return gets his share of 50% of the total 12 flats constructed and also 50% share out of 4000 sq. ft. of commercial construction. The agreement was signed in January 2016 and construction is reported to be completed in January 2018.

After completion of construction, the applicant has sought advance ruling for the following question:

1. *"Whether the applicant being the land owner is liable to pay GST on premises allotted to him, which he intends to distribute among his family members?"*

Discussions by and observations of AAR

From the facts, contents of agreement and submissions made by applicant before the authority and in the context of the question raised by the applicant, authority examined and discussed Notification No.4/2018-Central Tax (Rate) dated 25-1-2018, which notifies the following classes of registered persons namely:

"a) Registered persons who supply development rights to a developer, builder, construction company or any other registered person against consideration, wholly or partly, in the form of construction service of complete, building or civil structure; and

b) Registered persons who supply construction service of complex, building or civil structure to supplier of development rights against consideration, wholly or partly, in the form of transfer of development rights."

This notification notifies a person or persons who supply development rights to a developer / builder etc., against a consideration, which may be in the form of construction service, is liable to be registered under CGST/KGST Act 2017. It also provides that the person who supplies the development rights shall pay central tax at the time when the developer / builder transfers possession or right in the building by way of Conveyance deed or similar instrument. Therefore, the applicant being the person who has supplied development rights to a developer in respect of the land, is liable to registration and payment of tax.

Section 2(94) of CGST Act defines *"Registered person" as a person who is registered under Section 25 but does not include a person having a Unique Identity Number."* Further, on reading of Section 25 and Section 22, it can be stipulated that every supplier, who makes a taxable supply of goods or services or both, shall be liable to be registered, if his aggregate turnover crosses the prescribed limit.

Ruling of AAR

In respect of above question, the applicant is supplier of a taxable service by way of transfer of undivided share of land and hence is liable to register himself and discharge the tax accordingly.

5. Sonkamal Enterprise Pvt. Ltd. – AAR Maharashtra (2018-TIOL-301-AAR-GST)

Facts, issues involved and contention of the petitioner

Applicant having its registered office at Mumbai and branch in Gandhidham (Gujarat), both being registered under the GST Act, deals into imports of chemicals especially phenol which are currently being imported at JNPT Port (Maharashtra) and Kandla Port (Gujarat) and stored at a rented Customs warehouse at Haldia Port (Kolkata, West Bengal). They wish to import the chemicals at Haldia Port and sell the goods to the customers in Kolkata and nearby states by raising a bill in name of Mumbai GSTIN and charge IGST. However, they do not have any establishment or place of operation in West Bengal.

The applicant as per sec 10(1)(a) of IGST Act, 2017 states the place of supply as West Bengal. The applicant further states that it results into inter-state supply of goods as defined in sec 7(3) of IGST Act, 2017

Applicant has sought advance ruling for the following questions:

1. *Whether the procedure to raise the invoice from Mumbai Head Office for imports received at Haldia Port, Kolkata where they do not have any separate GST registration and charge IGST from Mumbai to the customers is correct?*

2. *If they do not need separate registration in West Bengal, can they do the transaction on Mumbai Head Office GSTIN, then in case of issuance of E-way bill is it correct to mention the GSTIN of Mumbai and dispatch place of Haldia Port?*

Discussions by and observations of AAR

Since the applicant wishes to import the chemicals viz., goods at Haldia port, the nature of supply is an inter-state supply as defined in Sec 7(2) of the IGST Act, 2017 as it deals with supply of goods imported into territory of India and not Sec 7(3) of the IGST Act, 2017 as stated by the applicant. Secondly, the place of supply of imported goods as per Sec 11(a) of IGST Act, 2017 shall be the location of the supplier and not Sec 10(1)(a) of the IGST Act, 2017. In this case, the applicant makes a taxable supply of goods from Mumbai HO as he does not have an office in West Bengal and hence as per Sec 22(1) of CGST Act, 2017 the place of supply of Goods shall be the location of supplier i.e., Mumbai HO and hence it appears that separate registration need not be taken in the State of West Bengal.

Ruling of AAR

In respect of question (1), the place of supply is the location of the importer situated in Maharashtra and the applicant will be clearing goods by paying IGST from their GSTIN issued in Mumbai. The sales, whether that that would be interstate or intrastate supply would depend upon the place of supply of goods and hence the applicant can clear the goods through invoices issued by Mumbai HO and not requiring to take any separate registration in West Bengal.

In respect of question (2), since the place of supply for the applicant will be Mumbai and goods will be cleared by raising an invoice through GSTIN of Maharashtra, they can further do the transaction on Mumbai HO GSTIN and can mention Mumbai HO office in the E-way bill and dispatch place as Customs Warehouse, Kolkata.

6. DRS Marine Services Pvt. Ltd. – AAR Maharashtra (2018-TIOL-304-AAR-GST)

Facts, issues involved and contention of the petitioner

Applicant is engaged in selecting and recruiting the shipping personnel on behalf of the foreign ship owner (M/s. Reefership Marine Services Ltd. "RMS") and have been charging administrative fees in this regard and paying GST on the same.

RMS has requested the applicant for disbursal of salary to the crew members from its side in view of the RBI Circular *(which allows to open foreign currency account and incur various expenses in connection with the management of ship/crew).* For this, the RMS would be transferring the sum of total salary to the applicant and then, applicant would be disbursing the salary to the crew members through banking channels. For this activity, the applicant would be charging/

invoicing service charges to the RMS and on the said charges it would be discharging its GST liability.

Applicant has sought advance ruling for the following question:

"Whether GST is applicable on Reimbursement of salary on behalf of foreign entity."

The applicant submitted that it is a pure agent as specified in Rule 33 of CGST Rules, 2017. It does not provide manpower to RMS but provides service for recruiting the manpower. Since the activity would be done on behalf of the RMS and applicant would not be deducting any charges from the amount of salary received for disbursement, the amount so remitted towards disbursal of salary would not be taxable under GST. Further, the applicant would be discharging its GST liability on service charges in connection with disbursal of salary.

Discussions by and observations of AAR

Based on facts, documents and submissions made before authority, it was found that the entire amount received by the applicant from RMS towards salary of crew is disbursed as such. Hence, with respect to this transaction it is crystal clear that the applicant is acting as a pure agent of RMS in view of Rule 33 of CGST Rules, 2017.

"Rule 33. Value of supply of services in case of pure agent –

Notwithstanding anything contained in the provisions of this Chapter, the expenditure or costs incurred by a supplier as a pure agent of the recipient of supply shall be excluded from the value of supply, if all the following conditions are satisfied:

(i) the supplier acts as a pure agent of the recipient of the supply, when he makes the payment to the third party on authorisation by such recipient;

(ii) the payment made by the pure agent on behalf of the recipient of supply has been separately indicated in the invoice issued by the pure agent to the recipient of services; and

(iii) the supplies procured by the pure agent from the third party as a pure agent of the recipient of supply are in addition to the services he supplies on his own account.

For the purposes of this rule, the expression "pure agent" means a person who-

(a) enters into a contractual agreement with the recipient of supply to act as his pure agent to incur expenditure or costs in the course of supply of goods or services or both;

(b) neither intends to hold nor holds any title to the goods or services or both so procured or supplied as pure agent of the recipient of supply;

(c) does not use for his own interest such goods or services so procured;

(d) receives only the actual amount incurred to procure Such goods or services in addition to the amount received for supply he provides on his own account."

From the above provisions of Rule 33 and the facts of the proposed transaction explained by the applicant, it was found that the applicant will be acting as a pure agent of RMS in as much as the entire amount received by them as crews salary will be disbursed to the crew and no amounts from the said receipt will be used by the applicant for his own interest. In fact, for performing as a pure agent they will also be receiving compensation separately in the form of fixed fees to be charged as service charges on which GST has been discharged.

Ruling of AAR

In respect of above question, GST is not applicable on reimbursement of salary on behalf of the foreign entity.

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CA Rajiv Luthia & CA Keval Shah

INDIRECT TAXES
Service Tax – Case Law Update

Citation: 2018-VIL-778-CESTAT-MUM-ST

Case: ***Rallis India Limited vs. CCE & ST, Pune I***

Background facts of the case
The appellant is manufacturing insecticides, pesticides and various hazardous effluents and wastes are generated as by products that pose risk to the life of workers. To mitigate any medical exigency and first aid requirement of workers in case of any mis-happening, it has maintained Occupational Health Care (OHC) at its factory premises and has availed manpower supply by engaging medical staff at such OHC as an input service. Such credit was held to be inadmissible during excise audit conducted by the department and appellant was issued SCN for recovery of the same along with interest and penalty. Service Tax demand along with interest and penalty of equivalent amount was confirmed by adjudicating authority. CCE (A) upheld the said order, therefore appellants are before the CESTAT

Arguments put forth
The appellants submitted as under:

a) The maintenance of OHC facility is indispensable under the Factories Act, 1948, for grant of licence to manufacture hazardous effluents and appellant had availed the credit under *bona fide* belief. Appellant relied upon decisions of *M/s. Larsen & Toubro Limited vs. UOI (2016-VIL-302-BOM-CE)* and decision of *M/s. Jaypee Sidhi Cement Plant vs. CCE, Bhopal, [2014-TIOL-2456-CESTAT-DEL]*., It was argued that even maintenance of first aid facilities for the workers has to be treated as service used in or in relation to the manufacture of final products. Therefore, denial of CENVAT credit is not sustainable.

The Respondents submitted as under:

a) The provisions contained in Rule 2(l)(c) of the CENVAT Credit Rules, 2004 has excluded w.e.f. 1-7-2012 manpower supply service from the purview of availment of CENVAT credit. He also pointed out that Order-in-Original indicates that such OHC was actually CHC i.e., Community Health Centres where other employees including contract labours also get treatment for general health sickness. Therefore, interference by Tribunal in the Order-in-Appeal is uncalled for.

Decision

a) From the licence copy, the type of appellant's factory is found to be hazardous factory and from the "Maharashtra Pollution Control Board" certificate it is found that recycling of hazardous waste was made obligatory for the factory that was also directed to comply with the industry specific standards and concur to Rule 5(2) of the Hazardous Wastes (M,H & TM) Rules, 2008. What can be inferred from these documents is that the factory is a hazardous factory. Under Rule 73W of Maharashtra Factories Rules, 1963, hazardous factory shall maintain OHC. First aid and other particulars mentioned therein shall be compulsory maintained by the appellant factory.

b) Admittedly, health services are put under exclusion clause in 2012 amendment to CENVAT Credit Rules, 2004. Therefore, such health services if provided by a manufacture or service provider to its employees generally is no more to be treated as admissible credit but when there is statutory requirement to have provisions for first aid facility and primary treatment for employees in case of accident and injuries sustained by them and the said service is made available to other employees additionally without any extra expenditure, it cannot be excluded from the purview of availment of credit since to obtain licence and run such hazardous manufacturing unit, emergency health care facility by way of OHC is a basic requirement and the same has a relation to the manufacturing process. Denial of CENVAT credit on the ground that they fail to keep records of emergency treatment would not deprive the appellant to avail such credit, since it is made to meet a contingency/emergency situation and without any such hazardous accident also, the manpower engaged are entitled to get their remunerations.

Accordingly the appeal filed by the assessee was allowed and the CENVAT Credit was allowed.

Citation: 2018-VIL-541-MAD-ST

Case: ***Modular Auto Limited vs. CCE Chennai***

Background facts of the case

The appellants/assessee are all job workers for M/s. Brakes India Limited (hereinafter referred to as BIL) and are engaged in the manufacture of excisable goods and hold the registration for the said activity. The assessees contended that they are eligible to avail credit for Excise Duty paid for Inputs & Capital Goods and also eligible to avail credit for the service tax paid for Input Service received. The credits so availed are utilised by the appellants/assessee for payment of duty on excisable goods manufactured and cleared by them.

The respondent department issued show cause notices based upon a verification done by the Internal Audit Wing of the department. The allegation against the assessee were that they were availing CENVAT Credit facility on the inputs, inputs service and capital goods used in the manufacture and clearance of their finished goods under the CCR, 2004. During the course of verification, it was noticed that the assessee had availed Input Service Credit on "Multi Protocol Label Switching" (MPLS) service based on the invoices issued by BIL. The assessee stated that the BIL are receiving MLPS service from BSNL and Reliance Communications Limited and the server for the same is situated at the premises of BIL. The service has been utilized by BIL for communicating and retrieving the data from the job workers, namely, assessees. The department alleged that the services are rendered by BSNL and Reliance Communications Limited and received by BIL, whereas the BIL has raised the bill on the assessee claiming reimbursement of the above said MLPS charges with Service Tax.

Arguments put forth

The assessees as appellants submitted as under:

a) The assessee contended that the SCN have been issued without proper verification of facts and understanding of the transaction. The assessee contended that the BIL are retrieving data relating to the assessee from the server and are further processing the same for their end use and but for assessee providing the details, the BIL themselves are retrieving the data and therefore, by retrieving data relating to assessee for utilizing the same for further operations, the BIL is rendering the service.

b) Further, the assessees have explained that but for BIL retrieving data, assessees would have retrieved the data and passed on the same to BIL. It was further explained that reimbursement means, on behalf of assessee, the BIL have already incurred certain expenditure for the service and therefore, that expenditure is being recovered by BIL and paid by the assessees and in the instant cases, the expenditure incurred by BIL is towards certain services relating to assessee.

c) Further, it was contended that only because in the hands of BIL, it was insisted by the service tax authorities that since there has been service by BIL to assessee in the matter of retrieval of data, service tax has been collected and paid by BIL. Therefore, the correctness, legality or otherwise of the tax paid by subject service provider cannot be called into question by Central Excise Officers having jurisdiction over the assessee availing credit. Thus, it was pointed out that in the show cause notices, the department seeks to object the service tax payment by BIL on the plea that no service has been rendered by BIL to the assessee and this is without jurisdiction.

The Respondent submitted as under:

a) They produced a lecture on Multi Protocol Labels Switching with Quality of Service in High Speed Computer Network to explain as to what is Multi Protocol Label Switching (MPLS) and it has been stated therein that it is a method that directs data from one system node to the next based on short path labels rather than long network addresses in high-performance telecommunication association. Referring to a chart showing the working methodology, it is submitted that it is a facility created and the beneficiary is BIL and no input service is rendered by the BIL to the assessee for them to claim Input Tax Credit.

Decision

a) In the instant cases, it is not in dispute that whatever the portion of service tax component which was collected from the assessee by BIL was only the amount on which the CENVAT credit has been claimed by the assessees. Therefore, unless and until the assessment made on BIL was revised, which obviously could have been done, at this juncture, on account of the expiry of the period of limitation, the interpretation given by the Commissioner (Appeals) as well as the Tribunal with regard to the nature of invoice raised on the assessee is unsustainable.

b) What is important to note that the assessee specific case is that there has been a service by BIL to the assessee in the matter of retrieval of data and service tax has been collected and paid by BIL and the correctness, legality or otherwise of the tax paid by the subject providers cannot be called in question by the CEO having the jurisdiction over the assessee availing the credit. This question has not been considered. If the impugned orders are allowed to stand, then it would in effect mean that the jurisdictional assessment officers of the assessee are sitting in the judgment over the assessment made on BIL, over which, they have no jurisdiction

c) Accordingly the appeal filed by the appellants was allowed.

Citation: 2018- TIOL-3849-CESTAT-MUMBAI

Case: M/s. FIS Solutions India Pvt Ltd. vs. Commissioner of Central Tax

Background facts of the case

Appellant is engaged in rendering services of IT software and Business Auxiliary Service which are exported by them to its client located outside India. It had availed CENVAT credit on input services in respect of the input services such as group term life insurance service, employee insurance service, rent-a-cab service and club membership service. The refund application filed under Rule 5 of CCR, 2004 was rejected partly on the ground that the input on which credit was taken are covered under the exclusion clause.

Arguments put forth

The appellants submitted as under:

a) SCN was mandatory requirement before rejection of refund claim or denial of cenvat credit and without providing opportunity to the appellant to justify the admissibility of cenvat credit against which refund has been claimed, certain claim amount has been rejected in gross violation of the principles of natural justice. Relied on judicial decisions reported in *Keva Fragrances Pvt. Ltd. vs. CCE - 2017-Tiol-4079-CESTAT-Mum* and *Rajasthan Spinning & Weaving Mills vs. CCE 1999 (112) ELT 457.*

b) It had taken group term life insurance for its employees and not individual insurance policy to provide life insurance coverage in general to employees for their personal benefits since the policy availed by the appellant is strictly restricted to the period of employment of the employees in the company.

c) The appellant wanted to establish the linkage between input and output service in respect of other services for which credit has been denied.

The Respondents submitted as under:

a) The input services availed by appellants of life and health insurance, rent-a-cab and Membership of club service are covered under the exclusion clause & are outside the purview of CENVAT credit.

Decision

a) Before rejection of claim of the appellant they were not noticed to justify the linkage between input and output service.

b) Except a noting in the order-in-original at para 6 to which Table 3 is annexed that above input services were inadmissible as per provision of Rule 2(I) of the CENVAT Credit Rules 2004, nothing can be inferred from the Order-in-Appeal as to why those are inadmissible credits.

c) It can be noticed that among supporting documents placed before the adjudicating authority, invoice copies of input services were placed along with CENVAT credit account. Invoice cannot establish the relationship between input and output service and the scrutiny made the adjudicating authority in respect of invoices *vis-à-vis* abstract of CENVAT credit cannot be sufficient document for the purpose of establishment of such relationship.

d) Such scrutiny by the adjudicating authority was made in the absence of the appellant who, given an opportunity, would have been in a position to justify the same, subject to satisfaction of the adjudicating authority.

e) Going by the exclusion clause of CENVAT Credit Rules it can be said that there is no service referred in those clauses that would be considered as absolute since each of those category of services are qualified one, dependant on personal use, consumption of employees, etc. In the premise, it is a fit case which is required to be re-adjudicated upon with reference to production of relevant documents that would establish the linkage between input and output service and the same would ensure natural justice to the appellant also.

Citation: 2018- TIOL-2671-HC-MUM-CX

Case: Commissioner of CGST & Central Excise, Raigad vs. M/s. Dorf Ketal Pvt. Ltd.

Background facts of the case

This appeal is filed by the revenue to challenge the judgment of the CESTAT dated 26th May, 2017.

The respondent assessee raised preliminary objection contending that the tax effect involved in this appeal is below ₹ 50 lakh, which is the minimum prescribed by the CBIC in its circular dated 11th July, 2018 to enable the department to file and press the appeals before the High Court.

Arguments put forth

The Appellants (Revenue department) submitted as under:

a) He has not been instructed to withdraw the appeal, though he agreed that the tax effect involved in this appeal is less than ₹ 50 lakh.

b) A copy of a letter dated 22nd November, 2018 written by the Assistant Commissioner, Raigad conveying to him that the question of withdrawal of any departmental appeal lies with the discretionary powers of the Commissioner

c) This case is not considered fit for withdrawal and no instructions have been received to withdraw the same.

Decision

a) As a policy for reduction of litigation, the CBDT and CBIC have been issuing circulars from time-to-time instructing the department not to file and in some cases if so filed, not to press appeals before Higher Authorities, Tribunal, High Court or Supreme Court as the case may be unless the tax effect involved is higher than the minimum threshold respectively prescribed in such circulars.

b) Circular dated 11th July, 2018 revising the monetary limits for appeals to be filed by department is issued in exercise of powers under Section 35R of the CE Act, 1944, which pertains to appeal not to be filed in certain cases.

c) The circular in Paragraph No. 3 provides that in respect of pending cases process of withdrawal would be undertaken as per such revised limits. This paragraph also clarifies that all other terms and conditions of the earlier instructions will continue to apply. Paragraph No.4 of the circular further clarifies that the cases filed in Paragraph No. 1.3 of the instructions dated 17th August, 2011 would be contested irrespective of the prescribed monetary limits.

d) In case of *Director of Income Tax vs. S. R. M. B. Dairy Farming (P.) Ltd. (2018) 400 ITR 9(SC) = 2017-TIOL-441-SC-IT*, the SC had the occasion to examine the contents of a similar circular issued of the CBDT on 9th February, 2011 prescribing revised monetary limits for filing appeals & referred to the GOI's Litigation Reduction Policy and held that revised monetary limits would apply even to pending cases.

e) The circular dated 11th July 2018 is issued in exercise of statutory powers and thus has statutory force. The department, however, cannot contend that it is solely within the discretion of the Commissioner whether to apply such policy or not.

Citation: 2018-TIOL-3822-CESTAT-Ahmedabad

Case: ***Core Health Care Ltd. vs. CCE, Vapi***

Background facts of the case

The CCE (Appeals) rejected the appeal filed along with stay application by the assessee for non-compliance to pre-deposit.

The issue involved was whether assessee's product Amino acid imported is eligible for exemption under Notification No. 16/2000-Cus on the facts that the same was used for manufacture of intravenous amino acids which contains carbohydrates and electrolytes.

Since, the CCE (Appeals) rejected the appeal without going to the merits of the case, the present appeal before Hon'ble CESTAT was filed.

Arguments put forth

The appellants submitted as under:

a) The issue in hand has been settled in their favour as per the judgments of this Tribunal in the case of *Commissioner of Customs, Chennai vs. Tablets (India) Ltd. 2005(191) E.L.T. 280 (Tri- Chennai)* which has been upheld by the Hon'ble Supreme Court in the case of *Commissioner vs. Tablets (India) Ltd.- 2006 (198) E.L.T. A36 (S.C.).*

b) Also placed reliance on the judgment in the case of *Fresenius Kabi India Pvt. Ltd. Commr. of Cus. (Imports) 2010 (256) E.L.T. 257 (Tri-Mum).*

c) Hence, the appellants had strong *prima facie* case in their favour for stay application being made by them.

The Respondents submitted as under:

a) Since the end product is not only consisting of Amino acids but also other inputs such as carbohydrates and electrolytes, therefore, imported goods were not used for the end product specified the Notification 16/2000-Cus dated 1st March, 2000.

b) As per Board's Circular No. 45/2000-Cus, dated 16-5-2000, the appellant is not entitled for the exemption in the case where the goods contain in addition to amino acids other ingredients such as glucose or sorbitol, etc

Decision

a) That appellant has strong *prima facie* case in their favour as per the judgments of this Tribunal in the case of Tablets (India) Pvt. Ltd. which was upheld by the Supreme Court.

b) Being prima facie the matter in favour of the appellant, there is no need of any pre-deposit for hearing the matter. Therefore, we waive the pre-deposit and remand the matter to the Commissioner (A) to hear on merit.

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Believe in yourself and the world will be at your feet.

— *Swami Vivekananda*

Janak C. Pandya, *Company Secretary*

CORPORATE LAWS

Company Law Update

[In the Supreme Court of India]

Civil Appellate Jurisdiction

Civil Appeal No. 12023 of 2018. Judgment dated December 12, 2018.

Jaipur Metals & Electricals Employees Organization through General Secretary Mr. Tej Ram Meena vs. Jaipur Metals & Electricals Ltd.

NCLT has a jurisdiction under Section 238 of the IBC to admit an application under section 7 of the IBC by a secured financial creditor as an independent proceeding and same has nothing to do with the transfer of pending winding up petition before the High Court.

Brief Note

The present writ petition has been filed by an employees' union ("Union') of Jaipur Metals & Electricals Ltd. ("Company') against the Judgment dated 1-6-2018 of the Rajasthan High Court ("High Court").

1. Company had become a non-performing asset and also had negative net-worth.
2. A reference to the Board for Industrial and Financial Reconstruction ("BIFR") under the Sick Industrial Companies (Special Provisions) Act, 1985 ("SICA") was made/filed.
3. BIFR had a *prima facie* opinion that the Company ought to be wound up.
4. BIFR had forwarded its opinion to the High Court.
5. The High Court has registered the case.
6. The Alchemist Asset Reconstruction Company Limited ("R3") acquired substantially all the financial debts of the Company.
7. The State of Rajasthan tried to revive the Company but without any success.
8. Union had filed a writ petition and on 7-12-2017, the High Court has directed the Official Liquidator for evaluation of the value of goods and material for making payment of workmen dues.
9. On 11-1-2018, R3 had filed an application under section 7 of the IBC.
10. In its application, it has stated that it has assigned the debt and same was admitted by the Company and that till date, no liquidation order had been passed.
11. NCLT has admitted the application and declared a moratorium under section 14 of the code and appointed an interim resolution professional.
12. On 26-4-2018 by way of an interim order, High Court has stayed the NCLT order.
13. On 1-6-2018, High Court has passed the impugned judgment and refused to transfer the winding up proceedings pending before it.

The following submissions are made by the applicant and R3.

1. As per the amendments made to the CA13 and Eleventh Schedule of the IBC and section 434, shows that all winding up proceedings pending before the High Court stand transferred to the NCLT.

2. As per Rule 5 of the Companies (Transfer of pending Proceedings) Rules, 2016 and particularly Rule 5(2) makes clear that on and after 29-6-2017, winding up of companies initiated under SIC cannot be continued to be dealt by the High Court.
3. The High Court judgment was incorrect, as Rule 5 and not Rule 6 should be made applicable.
4. Proviso to section 434(1)(c) states that … any party to any pending winding up proceedings before the High Court may file an application for transfer of proceedings and Court has to oblige.

The following submissions are made by other respondents in favour of High Court Judgment.

1. Rule 5(2) made it clear that the present proceedings would continue before the High Court as same is under section 20 of the SICA.
2. The omission of this Rule in the amendment made to Rule 5 on 29-6-2017 would not impact High Court dealing with this as SICA had been repealed from 1-12-2016.
3. Section 238 of the IBC has no application as it is a *non-obstante* clause for any clash between IBC and other statutes.
4. Amendments to section 434 of the CA13 is made pursuant to the Eleventh Schedule of the IBC itself, thus, winding up petition before the High Court would have to reach their logical conclusion.

Judgment

The Hon. Supreme Court has allowed the appeal and set aside the High Court's Judgment.

1. Section 255 of the IBC and Eleventh Schedules has made various amendments to the CA13 including section 434 related to "Transfer of Certain pending proceedings".
2. On 17-8-2018, by amendment to Eleventh Schedule of the IBC, section 434 of CA13 was substituted. The new proviso allows any party to make an application
3. On 7-12-2016, The Companies (Transfer of Pending Proceedings) Rules, 2016 ("Transfer Rules') came in to force with effect from 1-4-2017.
4. As per section 434 as substituted by the Eleventh Schedule to the IBC, from 15-11-2016, all winding up proceedings under the CA13 pending before the date to be notified shall stand transferred to the NCLT.
5. Analysis of Rule 5 and Rule 6 of the Transfer Rules provides for three types of proceedings.
   (a) Rule 5(1) refers to winding up petition under clause (e) of section 433 of the Companies Act, 1956 ("CA56") and also under clauses (a) and (f) of section 433 to be transferred to NCLT. Provided, the petition has not been served on the respondent. In such situation, said petition shall be treated under Sectios 7, 8, & 9 of the IBC.
   (b) Under Rule 5(2), the cases where the BIFR under section 20 of SICA has forwarded an opinion to the High Court for winding up, such cases shall continue to be dealt by the High Court.
6. As the cases under section 20 of SICA are dealt separately under Rule 5(2), such cases cannot be treated as petitions under section 433(f) and thus, High Court is not correct to apply Rule 6.
7. As per section 434 (amended) and Rule 5 of the Transfer Rules, all proceedings under section 20 of SICA pending before the High Court are to continue as such unless post 17-8-2018, a party files an application before the High Court for its transfer.
8. Once application is made, High Court must transfer such proceedings to the NCLT.
9. The R3 application to the NCLT and its admission is an independent proceedings under IBC and has nothing to do with the transfer of pending winding up before the High Court. R3 may at any time before a winding up order is passed to apply under section 7 of the IBC.
10. If there is any inconsistency between Section 434 and IBC, the IBC must prevail.
11. NCLT was absolutely correct in applying section 238 of the IBC to an independent proceedings by a secured financial creditor and it has Jurisdiction.

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CA Mayur Nayak, CA Natwar Thakrar & CA Pankaj Bhuta

OTHER LAWS
FEMA – Update and Analysis

In this article, we have discussed recent amendment to FEMA through reissue of Notification by RBI and review of policy on FDI in E-commerce brought out by Press Note 2 of 2018 by DIPP

A. Issue of Notification 3 (R) – Borrowing & Lending Regulations, 2018

In a complete overhaul of the existing FEMA regulations relating to Borrowing & Lending, RBI has superseded **Notification Nos. FEMA 3, 4** and **Regulation 21 of Notification No. FEMA 120** and issued a new one stop **Notification No. 3 (R) titled – Borrowing & Lending Regulations 2018.** This new Notification No. 3 (R) consolidates all FEMA regulations relating to Borrowing and Lending, both in Foreign Currency & Indian rupees, at one place.

It has been clarified that existing borrowings / lendings under erstwhile regulations can be continued till the date of their maturity.

A person resident in India, not being a company incorporated in India, is allowed to borrow in Indian Rupees from NRI/Relatives who are OCI Cardholders outside India, subject to such terms and conditions as may be specified by the RBI from time-to-time in consultation with the GOI. The borrowed funds cannot be used for restricted end uses.

Para 3 of Schedule I defines eligible borrowers to mean all entities eligible to receive FDI under Notification No. FEMA 20(R), including Start-ups. Therefore, LLPs eligible to receive FDI are now included in the list of eligible borrowers.

Borrowing for "Real estate Activity" as defined under Regulation 2(xi) is now prohibited. "Restricted End Uses" defined under Regulation 2(xiv) extends prohibition on borrowings for investment in capital market including margin trading and derivatives and investment in real estate activity.

This being a new notification, the salient features are summarised in the following paragraphs:

1. Regulation 2 – New Definitions

The notification inserts several new definitions such as External Commercial Lending, Real estate Activity, Restricted End Uses, etc. to eliminate ambiguities in interpretation of these terms.

Some of the important definitions are as follows:-

i. 2v – **"External Commercial Lending (ECL)"** is defined to mean lending by a person resident in India to a borrower outside India in accordance with framework decided by the RBI in consultation with the GOI;

ii. 2xi – **"Overseas Citizen of India (OCI)"** Cardholder shall have the same meaning as assigned to it under Section 7(A) of the Citizenship Act, 1955, as amended from time-to-time;

iii. **2xii – "Real Estate Activity"** means any activity involving own or leased property for buying, selling and renting of commercial and residential properties or land and also includes activities either on a fee or contract basis assigning real estate agents for intermediating in buying, selling, letting or managing real estate.

However, this would not include development of integrated township, purchase/ long term leasing of industrial land as part of new project/modernisation or expansion of existing units or any activity under 'infrastructure sub-sectors' as given in the Harmonised Master List of Infrastructure sub-sectors approved by the GOI *vide* Notification F. No. 13/06/2009-INF, as amended/ updated from time-to-time

iv. **2xiv – "Restricted End Uses"** shall mean end uses where borrowed funds cannot be deployed and shall include the following:

a. In the business of chit fund or Nidhi Company;

b. Investment in capital market including margin trading and derivatives;

c. Agricultural or plantation activities;

d. Real estate activity or construction of farm houses; and

e. Trading in Transferrable Development Rights (TDR), where TDR shall have the meaning as assigned to it in the Foreign Exchange Management (Permissible Capital Account Transactions) Regulations, 2015.

v. **2xvi – "Start-up"** means an entity which complies with the conditions laid down in Notification No. G.S.R 180(E) dated February 17, 2016, as amended/ updated from time-to-time, issued by Department of Industrial Policy and Promotion, Ministry of Commerce and Industry, GOI.

vi. **2xvii – "Trade Credit"** refers to the credits extended by the overseas supplier, bank /financial institution for imports into India in accordance with the Trade Credit framework decided by the RBI in consultation with the GOI.

It has been clarified that use of Credit Card (a) in India by a person resident outside India or (b) outside India by a person resident in India shall not be deemed as borrowing or lending in Indian Rupee/foreign exchange.

2. Regulation 4 – Borrowing in Foreign Exchange by a Resident

1. By an Authorised Dealer (AD) or its branch outside India

– RBI authorised to specify limit and terms and conditions for borrowings by AD Banks from its Head Office or branch or correspondent outside India or any other entity in consultation with GOI.

– A Branch outside India of an AD in India shall follow directions issued by RBI and the Regulatory Authority of the country where the branch is located.

– An AD is authorised to borrow in foreign exchange from a bank or a financial institution outside India, for the purpose of granting pre-shipment or post-shipment credit in foreign exchange to its exporter constituent, subject to compliance with the guidelines issued by the RBI.

– An AD is also allowed to raise ECB from outside India in accordance with the provisions contained under newly issued Schedule I.

– RBI to prescribe form for approval of ECB/ issuance of LRN.

– Certain hybrid instruments, such as optionally convertible debentures, presently covered under ECB, would be governed by specific hybrid instruments' Regulations when notified by the GOI.

– RBI to prescribe list of negative end-use in consultation with the GOI.

2. By Persons other than Authorised Dealers

– Eligible resident entities can raise ECB as per the guidelines prescribed under Schedule I.

– Trade Credit can be raised in accordance with provisions contained in Schedule II.

– A person resident in India can borrow, whether by way of loan or overdraft or any other credit facility, from a bank situated outside India, where export of goods or services is proposed to be made on deferred payment terms or in execution of a turnkey project or a civil construction contract, provided the terms and conditions stipulated by the authority which has granted the approval to the arrangement are in accordance with the regulations contained under Notification FEMA 23(R).

– Financial Institutions, set up under an Act of Parliament, can raise foreign exchange borrowings with prior approval of the GOI. Borrowings in the nature of ECB shall be governed by the provisions in Schedule I.

– An individual resident can borrow a sum not exceeding USD 250,000/- or its equivalent from his/her relatives outside India subject to terms specified by the RBI.

– An individual resident in India studying abroad can raise loan outside India for an amount not exceeding USD 250,000/- or its equivalent for the purposes of payment of education fees abroad and maintenance subject to terms and conditions specified by the RBI.

3. Regulation 5 – Lending in Foreign Exchange by a Person Resident:

1. Lending by an Authorised Dealer in India or its branch outside India

– An AD in India or its branch outside India can extend foreign currency denominated External Commercial Loan (ECL) to a borrower outside India in accordance with the provisions contained in Schedule III.

– An AD can also grant loans to its constituents in India for meeting their foreign exchange requirements or for rupee working capital requirements or capital expenditure subject to prudential norms, interest rate directives and guidelines, if any, issued by RBI in this regard.

– An AD in India may extend foreign exchange loans to another AD in India subject to the directions or guidelines issued by the RBI.

– Branches outside India of AD banks may extend foreign exchange loans against security of funds held in NRE/ FCNR Deposit accounts or any other account specified by the RBI, maintained in accordance with FEMA Notification No. 5 (R) – (Deposit) Regulations.

2. **Lending by persons other than Authorised Dealer**

Eligible resident entity may extend foreign currency denominated ECL to a borrower outside India in accordance with the provisions contained in Schedule III.

4. Regulation 6 – Borrowing in Indian Rupees by a Person Resident in India

1. **Borrowing by an Authorised Dealer**

An AD may raise Rupee denominated ECB from outside India in accordance with the provisions contained in Schedule I.

2. **Borrowing by persons other than Authorised Dealer**

– Eligible resident entities may raise Rupee denominated ECB in accordance with Schedule I.

– Eligible resident entities, as defined by the GOI, may borrow from overseas Multilateral Financial Institutions/ International Development Financial Institutions, where the source of funds of such institutions is Rupee denominated bonds issued overseas or resources raised domestically, or any other source as approved by the GOI.

– Trade Credit may be raised in Indian Rupees by importers for import of capital or non-capital goods as permissible under the extant Foreign Trade Policy of the DGFT in accordance with Schedule II.

– Any foreign investment in the nature of debt arising out of transfer or issue of security, not covered under the above sub-regulations, should be in compliance with FEMA Notification No. 20 (R).

– Any person resident in India accepting any deposit from, or making any deposit with, a person resident outside India, including loans/ overdrafts against security of funds held in such accounts, should be in compliance with FEMA 5 (R) – Deposit.

– A person resident in India, not being a company incorporated in India, may borrow in Indian Rupees from NRI/ Relatives who are OCI Cardholders outside India, subject to such terms and conditions as specified by the RBI from time-to-time in consultation with the GOI. The borrower should ensure that the borrowed funds are not used for restricted end uses.

– Financial Institutions, set up under an Act of the Indian Parliament, may raise Rupee denominated borrowings from outside India with the prior approval of the GOI for the purpose of onward lending.

Borrowings which are in the nature of ECBs shall be subject to provisions contained in Schedule I.

5. Regulation 7 – Lending in Indian Rupees by a Person Resident in India

1. **Lending by an Authorised Dealer**

– An AD in India is allowed to grant loan to a NRI/OCI Cardholder for meeting the borrower's personal requirements/ own business purposes/acquisition of a residential accommodation in India/ acquisition of motor vehicle in India / or for any purpose as per the loan policy laid down by the Board of Directors of the AD and in compliance with prudential guidelines of RBI.

– An AD is authorised to provide a temporary overdraft, for value not exceeding Rupees 5 billion or any other amount as may be prescribed, in rupee accounts maintained with it by its overseas branch or correspondent or Head Office outside India, subject to such terms and conditions as the RBI may direct from time-to-time.

2. **Lending by persons other than Authorised Dealer**

– A registered NBFC in India or a registered Housing Finance institution in India or any other financial institution as may be specified by the RBI from time- to-time, is allowed to provide housing loan or vehicle loan, as the case may be, to a NRI/OCI Cardholder.

– An Indian entity may grant loan in Indian Rupees to its employee who is a NRI/OCI Cardholder in accordance with the Staff Welfare Scheme subject to such terms and conditions as prescribed by the RBI from time-to-time.

– A resident individual may grant Rupee loan to a NRI/OCI Cardholder relative within the overall limit under the Liberalised Remittance Scheme subject to such terms and conditions as may be prescribed by the RBI from time to time.

6. Regulation 8 – Continuation of loan in the event of change in the residential status of the lender/borrower

– An authorised dealer/authorised bank, may allow continuance of loans granted to a resident individual who subsequently becomes a person resident outside India, subject to such terms and conditions as specified by the RBI from time-to-time.

– In case a loan was granted by a resident individual to another resident individual and the lender subsequently becomes a non-resident, the repayment of the loan by the resident borrower should be made by credit to the NRO account or any other account of the lender maintained with a bank in India.

– In case a loan was granted by a NRI/OCI Cardholder to a person resident in India in accordance with provisions contained in these regulations and the lender subsequently becomes a resident, the repayment of the loan may be made to the designated account of the lender maintained with a bank in India.

– A resident individual will be permitted to service loans taken overseas earlier as a person resident outside India subject to terms and conditions and limit as specified by the RBI from time-to- time.

Schedule I, II & III can be referred in the notification.

(Comments: Key takeaways from FEMA 3(R) – Foreign Exchange Management (Borrowing and Lending) Regulations, 2018

a) **In the old regulation, all the financial institutions which dealt with infrastructure or export finance and also financial institutions which had participated in the textile and steel industry were allowed to raise ECB. IDFC, IL&FS, Power Finance Corporation, Power Trading Corporation, IRCON and Exim Bank were exclusively allowed to raise ECBs. In the revised ECB regulations, any financial institution, set up under an Act of the Indian Parliament, with prior approval of the Government of India may raise foreign exchange borrowings or rupee denominated borrowings from outside India for the purpose of onward lending. Hence, the eligibility to borrow in the approval route is now not restricted to institutions stated in the old regulation. This gives an opportunity to all the financial institutions which are set up under an Act of Parliament to raise ECB.**

b) **Also, in the revised ECB regulations, an individual resident in India**

studying abroad is allowed to raise loan outside India for the purpose of payment of education fees abroad and maintenance not exceeding USD 250,000 or its equivalent subject to terms and conditions as specified by the Reserve bank in consultation with the Government of India.

c) **In the revised regulations, a bank outside India can maintain an overdraft in rupee account with AD in India. A temporary overdraft for value not exceeding INR 5 billion is permitted to an overseas branch or correspondent or Head office of a bank outside India subject to terms and conditions as the Reserve bank may direct. The ceiling for temporary draft was INR 50 million in the old regulation.**

d) **Trade credits can be raised in freely convertible foreign currency as well as in Indian Rupee. Under revised regulations, importers can raise credit up to USD 50 million equivalents per import transaction for import of capital or non-capital goods in the Automatic Route. The same was up to USD 20 million equivalent in the old regulation.**

e) **Even foreign equity holders and financial institutions in International Financial Services Centres (IFSCs) in India are allowed to lend trade credits in the revised ECB regulation.**

f) **The period of trade credit reckoned from the date of shipment shall be under a period of three years for import of capital goods in the revised regulation as compared to five years in the old regulation.**

g) **As per the revised regulation, the all-in-cost ceiling for raising Trade Credit in foreign currency is 250 basis points over 6 months LIBOR. It was 350 basis points over 6 months LIBOR in the old regulation. The all-in-cost ceiling for rupee denominated credit shall be commensurate with prevailing market conditions or as prescribed by the Reserve Bank in consultation with the Government of India.**

All the above liberalised amendments brought out by RBI through Notification FEMA 3(R) is welcome. However, we expect RBI to bring out the revised Master Direction on External Commercial Borrowings (ECB) as soon as possible so as to remove some anomalies or confusion which arise from reading of FEMA 3 (R) with the current Master Direction on ECB)

B. DIPP Press Note No. 2 (2018 Series)

DIPP has issued Press Note 2 (2018 series) on 26/12/2018 concerning review of FDI policy in e-commerce. The changes are summarised in the table below:

Condition	Press Note 3/2016	Press Note 2/2018
(iv)	E-commerce entity providing a marketplace will not exercise ownership over the inventory i.e., goods purported to be sold. Such an ownership over the inventory will render the business into inventory based model.	E-commerce entity providing a marketplace will not exercise ownership over the inventory i.e., goods purported to be sold. Such an ownership over the inventory will render the business into inventory based model. *Inventory of a vendor will be deemed to be controlled by e-commerce marketplace entity if more than 25% of purchases of such vendor are from the marketplace entity or its group companies.*

Condition	Press Note 3/2016	Press Note 2/2018
(v)	An e-commerce entity will not permit more than 25 per cent of the sales affected through its marketplace from one vendor or their group companies.	*An entity having equity participation by e-commerce marketplace entity or its group companies or having control on its inventories by e-commerce marketplace entity or its group companies will not be permitted to sell its products on the platform run by such marketplace entity.*
(ix)	E-commerce entities providing market place will not directly or indirectly influence the sale price of goods or services and shall maintain level playing field.	*E-commerce entities providing market place will not directly or indirectly influence the sale price of goods or services and shall maintain level playing field. Services should be provided by e-commerce market place entity or other entities which e-commerce market place as direct or indirect equity participation or common control to vendors on the platform at arm's length and in a fair and non-discriminatory manner.*
		Such services will include but not limited to fulfillment logistics warehousing advertisement marketing payments financing etc. Cash back provided by group companies by market place entities to buyers shall be fair and non-discriminatory. For the purposes of this clause provision of services to any vendor on such terms which are not made available to other vendors in similar circumstances will be deemed unfair and discriminatory.
(xi)	Absent	*E-commerce marketplace entity will not mandate any seller to sell any product exclusively on its platform only.*
(xii)	Absent	*E commerce market place entity will be required to furnish a certificate along with a report of a statutory auditor to Reserve Bank of India confirming compliance of above guidelines by 30th of September of every year for the preceding financial year.*

(Comments:

- **Paragraph 15.2 to Regulation 16.B of FEMA Notf. 20(R)/2017 dated 07/11/2017 [Foreign Exchange Management (Transfer or Issue of Security by Person Resident Outside India) Regulations, 2017] lays down the Sector Specific policy for Total Foreign Investment pertaining to individual sectors. Para 15.2 was introduced based upon Press Note 3 of 2016 issued by DIPP. With the issuance of Press Note 2 of 2018 (taking effect from 1-2-2019 onwards), it effectively replaces Press Note 3 of 2016. Amendment in FEMA Notf. 20(R)/2017 will be notified over time.**
- **Most of the changes introduced in Press Note 2 of 2018 are in line with the spirit of law that has always intended to disallow B2C trading in any manner. There has been no alteration of the definitions segment**

of Press Note 3 of 2016 (including the definition of Marketplace based model of e-commerce) which bears witness to the stated position that foreign investment was allowed even then only into a marketplace entity which acted as a facilitator between the buyer and a seller.

- **However, there are certain policy changes that have been introduced that (unintentionally) go beyond intended** consequences. Conditions (i), (ii), (iii), (vi), (vii), (viii) & (x) have not been modified and continue to remain the same whereas alterations and additions have been introduced under Conditions (iv), (v), (ix), (xi) & (xii).

- **Clause-by-clause analysis of Press Note 2 of 2018:**

  i. *Condition (iv):* **Typically wholesale arms of marketplace entities engaged in bulk purchase through group companies and undertake onward sales to their related parties who act as vendors on the marketplace. This arrangement has also had a bearing on pricing points of such vendors. Going forward, such arrangements would classify the e-commerce entity as following an inventory based model of e-commerce thus violating FDI policy if more than 25% of purchases of any vendor are made from the marketplace entity or its group companies. The modification is in line with the intent of law that a marketplace entity should only be engaged in acting as a facilitator between buyer and seller rather than engaging as a shadow vendor.**

  ii. *Condition (v):* **Previously this condition mandated that not more than 25% of sales value on financial year basis could have been made by any one vendor or its group companies. In replacement of previous condition, going forward, vendors having any equity participation or having control over its inventory by marketplace entity or its group companies will no longer be able to conduct any sales on the marketplace. The modification once again reflects the intention of allowing marketplace entity to be engaged in acting only as a facilitator between buyer and seller. Refinement in the policy will come as a huge setback to many marketplace entities who used to permit related party vendors to sell on the marketplace within the limit of 25% of total sales value of marketplace. It may be noted that the amended condition will not only affect marketplace entities selling goods but also entities operating food marketplaces as well as travel marketplaces. However, it will not affect online food groceries since they are covered under government approval route for FDI in food product retail trading.**

  iii. *Condition (ix):* **Multiple conditions have been introduced under this clause. Various support services enumerated under Condition (iii) usually provided by marketplace entities or their group companies to vendors cannot be provided in a discriminatory manner between vendors. This may affect logistics and order fulfillment operations of select vendors who were granted preferential treatment by marketplace entities. However, marketplace entities** can continue to accord such preferential treatment provided they can demonstrate similarity in circumstances of vendors. Further, cash back cannot be provided by group companies of marketplace entities in a discriminatory manner to buyer. This is intended to provide level playing ground to vendors by not inducing any buyer to favour one vendor over another. These modifications are also in spirit of law to ensure fair growth of all vendors listed on a particular marketplace.

iv. *Condition (x):* The guidelines on cash and carry wholesale stipulate that wholesale trading of goods to group companies cannot exceed more than 25% of total turnover of wholesale venture. Taking into account Condition (iv), (v) & (x), marketplace entities can still carry on wholesale trading to group companies within cumulative limits of Condition (iv) and (x), however, such group companies may be able to sell only on other platforms and not the one operated by the marketplace entity.

v. *Condition (xi):* This is an additional condition that has been imposed. Though introduction of this additional condition has been guided by strengthening of intention of law, its consequences surpass such intention. Since marketplace entity is supposed to act merely as a facilitator between buyers and sellers, it is not expected to impose any conditions of exclusivity upon any vendor. However, now with introduction of this condition, even if any specific vendor would want to opt for such exclusivity with the aim of enhancing its sales volumes, the marketplace entity may not be able to offer that exclusivity.

vi. *Condition (xii):* Level of compliance with Press Note 3 of 2016 was uncertain since there were no reporting requirements prescribed there under. This new condition puts the onus on statutory auditor to certify compliance with all the conditions of Press Note 2 of 2018 thus enabling essential implementation of true intent of FDI policy on e-commerce.)

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CA Nilesh S. Vikamsey & CA Hasmukh B. Dedhia

In Focus – Accounting and Auditing

The National Financial Reporting Authority (NFRA) Rules, 2018 – a new beginning

1. Background

1.1 The Companies Act, 2013 ('the Act') contains the provisions pertaining to creation and role of National Financial Reporting Authority ('NFRA'). Section 132 of the Act which deals with NFRA, unlike most other sections of the Act was not part of the original Companies Bill 2009 and was introduced midway without prior debates in various committees leading up to the Act. NFRA as an Authority is proposed under the Act for establishment and enforcement of Accounting Standards on Companies & Accounting and Auditing Standards on Auditors, oversight of quality of work of auditors with respect to compliance with accounting and auditing standards and investigate professional or other misconduct of Chartered Accountants with respect to the class of Companies covered by NFRA.

1.2 The quality of audit and financial reporting functions has been subject matter of widespread debate over last several years; more so, after the infamous Satyam Computers scam in 2009. Numerous provisions were introduced in the Act in the aftermath of this financial reporting scam, one of which is NFRA.

1.3 For almost 5 years after the Act was passed, the section pertaining to constitution of NFRA was not notified by Central Government (possibly, the only section remaining unnotified for so long), considering the representations from Institute of Chartered Accountants of India ('ICAI') about the multiplicity of the overlapping regulators over viewing the financial reporting, auditing and allied matters. In fact, the Standing Committee of Finance of the Parliament comprising members from ruling and opposition parties, which was headed by Dr. M. Veerappa Moily, also recommended in December 2016 that ICAI should be strengthened and overlapping regulators should be avoided whilst discussing proposed NFRA in their Report. ICAI, set up under an Act of Parliament [viz The Chartered Accountants Act, 1949 ('CA Act')], has been entrusted with functions of regulating the profession of Chartered Accountancy for last about 7 decades. It is an autonomous body administratively functioning under the Ministry of Corporate Affairs ('MCA'), with ample oversight by Government of India ('GOI'). The CA Act, regulations thereunder and other provisions have had jurisdiction over the members of ICAI only. It is note-worthy that ICAI never had any powers to regulate audit firms or the errant companies; therefore, its mechanism of disciplinary proceedings and actions was always confined only to its members (i.e. CA's). ICAI has sought powers to initiate actions against the CA firms way back in 2011 which is still awaited even for other entities / companies not covered under NFRA.

1.4 MCA has now vide notification dated November 13, 2018 announced constitution of NFRA, its role / responsibilities and its powers. This newly constituted body, as per the last draft rules, would comprise of 13 members - 4 full time and 9 part-time members under chairmanship of a former IAS officer Shri Rangachari Sridharan. It replaces NACAS – the body earlier entrusted with function of recommending/notifying the accounting standards. ICAI shall be represented in NFRA by three of its council members, ex-officio i.e. (i) President (ii) Chairperson of Accounting Standards Board and (iii) Chairperson of Auditing and Assurance Standards Board.

1.5 The trigger for this notification creating NFRA seems to be another scam, coming to light recently, of providing huge accommodative funding by a public sector bank to a Diamond trader group through dubious modes of Letter of Understanding, which was alleged to have remained undetected for several years. Here also it is pertinent to note that the internal audit of the said branch and functions was carried out by bank's officers who were not Chartered Accountants. Further, the Bank itself has mentioned that the fraud was of such nature and outside the books that it was not possible to be detected in the normal course of statutory audit. Yet, outcome of this Bank irregularity seems to have become the ultimate trigger for creation of NFRA. It is also argued that most of the developed economies of world have independent audit quality oversight regulators; India should match in these matters with other countries. It is pertinent to note that in many countries like US the Accounting Body is a 'not for profit' organization and unlike ICAI is not formed under an Act of parliament. Even these independent audit quality oversight regulators have been subjected to criticism for not being able to achieve the objectives they have been set up for; such criticisms along with the report of Standing Committee of Finance of the Parliament, referred to in para 1.3 above, do not appear to have been considered adequately whilst conceiving the setting up of NFRA. The CA Act being a specific Act to regulate the profession of Chartered Accountancy, question as to whether a provision made in the Act, which is a general Act for regulations of the Companies, could contain overlapping regulatory provisions; thus, possibilities of NFRA Rules being 'ultra-wires' are being deliberated despite there being non-obstinate clause at inception of S. 132 of the Act.

Whilst one may argue about need and rationale for creation of new regulatory authority instead of strengthening the present set up of regulatory mechanism within ICAI, this write up attempts to summarise notified NFRA Rules and issues allied thereto.

2. NFRA Rules, 2018

2.1 Which Entities are covered for regulation under NFRA Rules?

2.1.1 All companies/Bodies Corporate whose securities are listed whether in India or abroad.

2.1.2 Unlisted Public Companies having:

(i) paid up share capital of ₹ 500 crores or more OR
(ii) annual turnover of ₹ 1000 crores or more OR
(iii) Outstanding loans, debentures and deposits of ₹ 500 crores or more as on the 31st March of immediately preceding financial year.

2.1.3 Banking Companies, Insurance Companies, Electricity generation/distribution companies and companies or Bodies Corporate set up under special Acts within meaning of Section 1(4) of the Act.

2.1.4 All the overseas associates or subsidiaries of any of the above if the overseas income or net worth exceeds 20% of the consolidated income or net worth.

2.1.5 Any other company, body corporate or entity as may be referred to NFRA by GOI

2.2 By implication, the firms or individuals auditing any of the above companies or entities would be covered within the framework of NFRA rules.

2.3 It is clarified in the Rules that once if a company or entity is covered under NFRA Rules, it shall remain so covered for 3 years even after it ceases to be listed OR its paid up capital, annual turnover, loan/debentures/deposits fall below the prescribed limits as sated above.

2.4 It is estimated that about 8000 companies/ entities out of about a million would be covered by NFRA Rules

2.5 Which entities are not covered under NFRA Rules?

- All unlisted public companies who do not satisfy any of the threshold of paid up capital or annual turnover or loan/debentures/deposits
- All private Limited companies, Section 8 Companies, One-person companies
- All non-company entities like Partnership Firms, Trusts, LLP's, Societies, Proprietorship

<u>The above entities would continue to be governed by ICAI under the framework of the CA Act.</u>

2.6 Some issues for consideration with regard to applicability of NFRA framework:

- From the Rules notified, it appears that only statutory audit (compliance with accounting and auditing standards and oversight of audit quality) is intended to be covered under NFRA. According to one view, the professional work in nature of internal audit, tax-audit, consultancy assignments or special purpose certification would continue to be governed / regulated by ICAI only. But Section 132(4) of the Act states that "professional or other misconduct" under NFRA framework shall have same meaning assigned to it under Section 22 of the CA Act; therefore, another view is that all the professional services by a CA for the entities covered under NFRA are proposed to be covered`.
- As per provisions of Section 132(4) of the Act, where NFRA has initiated an investigation, no other institute or body shall initiate or continue any proceedings in matters of misconduct. However, as per Rule 10(3), the action in respect of cases of entities covered under NFRA for professional or other misconduct shall be initiated only by NFRA and no other institute or body shall initiate any such proceedings against such entities;. It appears that the Rule is superseding the section and the way this Rule is worded, there could be questions about process of initiation and practical difficulties could arise.
- There could be instances where a complaint is lodged with NFRA but for reasons of materiality or other reasons (say, no public interest concerns), NFRA does not initiate any action; such matters (even though valid to be examined) cannot be initiated by ICAI, considering the above Rule. Incidentally, unlike the provisions of CA Act, there is no mention of any provision for Complaints to be lodged with NFRA.
- As regards the Disciplinary proceedings under Rule 11(5), the decision will be by way of summary procedure and personal hearing will be given '...where necessary or appropriate of being heard in person and after considering the submissions, if any, made by the auditor,.....'.

Whereas in ICAI framework, the Disciplinary process is two levels i.e. the prima facie level which is a summary procedure without personal hearing. If considered, prima facie, guilty the Board of Discipline / Disciplinary Committee of ICAI have to give option of Personal hearing. The above summary process in NFRA framework, where personal hearing is not available as a Right to the accused but is dependent on the discretion of NFRA needs to be tested legally on the grounds of Natural Justice.

MCA should modify the rules if the issues flagged earlier or later in this Article have merit.

3. Functions, Duties and Powers of NFRA

3.1 To protect the public interest and interests of investors, creditors and others associated with the entities covered under NFRA Rules by establishing high quality standards of accounting and auditing and exercising effective oversight.

3.2 To maintain the details of particulars of auditors of the entities covered under NFRA Rules. To facilitate maintenance of such details, the covered entities have been obligated to file the particulars of appointment of their auditors in Form NFRA 1 as per the Rules. Further, every auditor of the entities covered under NFRA Rules shall file a return with NFRA on or before April 30th every year in a form as may be prescribed by GOI.

3.3 To recommend accounting and auditing standards for approval by GOI, to monitor compliance thereof and to promote awareness about compliance to these standards. <u>As per provisions of Section 133 of the Act, GOI may prescribe the accounting standards or any addendum thereto as recommended by ICAI in consultation with and after examination of the recommendations made by NFRA.</u>

3.4 To oversee the quality of service of the professionals associated with compliance and to suggest measures for improvements in quality.

3.5 To co-operate with national and international organisations of independent audit regulators.

3.6 To perform such functions as are ancillary or incidental OR as may be delegated to NFRA by GOI.

3.7 The NFRA shall receive recommendations and may seek additional information from ICAI on proposals for new accounting or auditing standards or for amending the existing ones.

3.8 In performing the above functions and duties NFRA may exercise the following powers under the Rules:

- Review the financial statements and reports of auditors to monitor compliance with accounting standards and seek further information from entities as well as auditors by seeking personal presence of the auditees and auditors.
- Review the working papers including audit plan, risk evaluation methodology of auditors and documentation, manner of documentation to monitor compliance with auditing standards and seek further information from entities as well as auditors by seeking personal presence of the auditees and auditors.
- Direct the auditor to implement measures for improvement of audit quality and refer the cases for overseeing the quality of audit to Quality Review Board set up by ICAI under the CA Act.
- Investigate in any matter referred to it or suo moto and forward the findings for enforcement. And can also take disciplinary actions in the fitting cases of mis-conduct including issuance of show cause notices to entities or auditors. Under the provisions of Section 132(4) of the Act, NFRA has been given same powers as vested in a civil court under CPC 1908 for carrying out the hearings, summoning and enforcing the attendance of the parties etc.
- Where a professional or other misconduct is proved, NFRA is empowered to (i) impose penalty of ₹ 1 lakh to five times of the fees received in case of an individuals and ₹ 5 Lakhs (raised to ₹ 10 Lakhs by 2017 Amendment Act) to ten times of fees received in case of firms AND (ii) debar the member or firm from practice of CA for period of six months to 10 years.

Some matters for consideration:

- The NFRA Rules do not seem to contain details about appellate body, framework and procedures; there could be another set of Rules notified concerning appellate Tribunal as referred to in Sec 132(5) of the Act.
- The penalty, if any, levied on the accused auditor is not paid or appealed against by depositing 10% with Appellate Tribunal within 30 days, the Authority shall inform each company where the said person / firm is auditor to appoint a another auditor. This provision, in our view, needs to have some mitigating provisions for genuine cases to avoid undue hardship.

4. NFRA vis a vis ICAI

4.1 ICAI is understood by most as self-regulatory body. This is not fully correct considering participation of government in every forum of ICAI. It must be noted that 20% of the composition of central council of ICAI (its apex decision making forum) is represented by Government appointed nominees. Further, 2 out of 5 members in Disciplinary Committee of ICAI are government nominees. The appellate authority within ICAI's framework comprises of 5 members, of which Chairman and 2 other members are government nominees and remaining 2 being past central council members whose appointment to appellate authority is approved by GOI. The Chairperson and majority of 11 members of Quality Review Board ('QRB') of ICAI are government nominees; the other 5 members being ICAI nominees are also approved by GOI. The respective roles of government nominees and central council members of ICAI are so coordinated as to bring well blended, balanced & professional approach in all its major decision-making process. There haven't been instances or cases anytime where government nominees communicating bias in functioning of any arm of ICAI.

4.2 The disciplinary mechanism of ICAI with several government nominees on its Board / Committee (including on appellate body) has been working reasonably well considering the fact that most decisions rendered by it on disciplinary matters have been judicially tested and by and large confirmed by the High courts. If there were some issues pertaining to procedural delay in delivering the decisions, (which is truer for entire legal / judicial system of our country), those issues could have been otherwise resolved and strength of this regulatory forum of ICAI could have been enhanced/increased with more powers and necessary infrastructure. Of late, some perception is being created, based on ill-informed & imperfect facts, about slow decision making and ineffectiveness of ICAI to penalise the wrongdoers. It is reiterated that ICAI under the CA Act never had any power to regulate Firms of CA or errant companies/auditees. Example worth quoting (there could be several others) to counter allegation of so-called delay in ICAI's proceedings:

- In the infamous Satyam case, ICAI ran its disciplinary proceedings under challenging situations; mostly meeting on weekends to allow respondents to meet their obligations with Investigative agencies during week days and concluded penal actions on such errant members (its powers were confined to that only); ICAI concluded its proceedings and meted out the maximum punishment possible under the CA Act on the members involved within 3 years, long before other domestic and international regulators, armed with more powers, could decide on the errant company or firm of auditors. ICAI does not have powers to proceed against the firm and hence only the members involved were punished.

Therefore, the so-called 'delay' in deciding disciplinary matters by ICAI needs to be viewed in the light of prevailing circumstances and overall judicial parameters within which these proceedings are to be completed. The CA Act was amended in 2006 to improve the speed of Disciplinary matters by debottlenecking the process. Post these amendments, the pendency of Disciplinary matters which used be huge around 8 to 10 years has been brought down to 3 to 4 years and vigorous efforts are being made to reduce the pendency further despite many constraints.

4.3 Even if need for an independent authority for regulating the financial reporting and auditing functions is felt indispensable, executive machinery of GOI should be cautious enough without being too bureaucratic. In carrying out such regulatory oversight functions, it is necessary to have updated Professional knowledge of accounting and auditing as also pragmatism to meet avowed objectives. It wouldn't be out of place to briefly touch upon here the contents of the draft NFRA rules circulated earlier in June 2018 for seeking views of ICAI. These draft NFRA Rules were observed to be travelling far beyond the authority conferred under Section 132 and other applicable provisions of the Act. Secondly, the said draft Rules attempted to make NFRA almost like parallel institute requiring registration by the auditors with NFRA, providing for draft Code of Ethics under NFRA, prescribing eligibility conditions for auditors like (i) fit & proper person (ii) financial solvency (iii) minimum net worth etc. The draft Rules also empowered NFRA to make Regulations, the power, which is not conferred under provisions of the Act. All these provisions in the draft rules were, prima facie, ultra vires the Act / CA Act. ICAI made representations to MCA and MCA thankfully avoided many such overlapping or ultra vires provisions in the final notified NFRA Rules. Yet, some of the NFRA Rules still need to be reconsidered to avoid overlap and being ultra vires as referred to in this write-up.

4.4 Another important issue is that of review of audit process (may it be regulatory review or quality review or some event-based review) can best be made by person or forum or authority which has domain expertise in the same field. Whether a medical professional surgeon has proficiently carried all necessary medical procedures on the patients or whether taken timely and appropriate actions in the given case of treatment can only be reviewed and commented upon by another medical professional surgeon and not by any person or authority not having the domain expertise. Similarly, in course of an audit, several judgmental calls are to be taken, numerous verification and analytical procedures are to be followed and interpretation to be drawn therefrom before arriving at conclusion. It may be easy to arrive at a wrong conclusion or decision with availability of hindsight wisdom. Whether due professional care and diligence was used in carrying out such procedures and arriving at audit conclusion at the time of audit can best be reviewed by another audit professional having domain expertise. In reviewing or investigating such matters post facto, disregarding the hindsight, is utmost important before alleging someone to be negligent or professional misconduct. Moreover, distinction between genuine bona-fide errors and intentional wrongdoings (mens' rea) would have to be duly considered in deciding the matters. If one surgery or operation in case of medical profession fails and the surgeon/medical staff later is found to be guilty of negligence, there must be penal actions on responsible persons but for such instances one does not close down entire hospital by banning it. It is hoped that NFRA would appreciate these matters in course of its disciplinary and investigative proceedings.

4.5 It is note-worthy that the CA Act or Regulations thereunder have not been changed at all despite periodic requests for changes from ICAI to make it contemporary. The initiatives of ICAI in framing and recommending accounting and auditing standards and bringing out publications like guidance notes and other educational materials as also in the matters of Peer review and Quality review should be of immense use to NFRA in accomplishing its objectives. It is worthwhile noting that NFRA cannot direct ICAI in framing or amending the Accounting Standards but it can recommend notifying the same to GOI with/without changes. The legal force of such notified standards becomes stronger. It is primary responsibility of the company's management and KMPs to comply with all such standards

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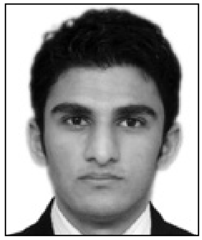

Rahul Sarda, *Advocate*

Best of the Rest

Arbitration and Conciliation Act, 1996 – Power of arbitrator to impose costs – Whether Arbitrator can impose costs payable to the Arbitrator?

On application of parties, the Court appointed a sole arbitrator as the arbitral tribunal for adjudication of disputes between the parties. A preliminary meeting was held and certain directions were given for filing the pleadings in the matter and it was directed that no extensions/adjournments would be granted except in the gravest circumstances and subject to the payment of costs.

Thereafter, an e-mail was sent by the respondent to the Arbitrator seeking extension of time for filing their pleadings. The arbitrator replied to the said mail that there was no specific ground mentioned not filing pleadings within the timeframe. However, the time for filing the said document was extended subject to depositing cost of ₹ 50,000/- with the Tribunal. On two occasions, the petitioner also sought extension for filing its pleadings. The learned arbitrator by procedural order recorded that the other party should deposit as and by way of cost of ₹ 1,00,000/- with the tribunal and the entire schedule was altered.

The petitioner addressed letter to the respondent stating that the learned arbitrator was passing order/ directions to pay costs to him for condonation of delay in filing pleadings which is against the provision of law and also the Arbitration Agreement entered into between the parties. The petitioner sought consent from the respondent for terminating the mandate of the arbitrator. Since there was no response from the respondent, the petition was filed before the Court.

The Court held that the learned arbitrator was certainly entitled to receive his fees. However, he was not entitled to ask the parties to pay costs to him if they sought extension of time to file the pleadings. If a party/parties seek/s and obtains adjournment/s on the days fixed for hearing, the Arbitrator may still insist that his fees or part thereof be paid. However, the Arbitrator, apart from charging fees, cannot direct any party to pay costs to him on any ground, including the ground that the pleadings are not filed on time by the parties, or for granting extension/s to file pleadings. However, the learned arbitrator directed payment of costs to himself which he certainly could not do. If the learned arbitrator was of the view that the party was seeking time without showing any grave circumstance, and was doing so only with a view to delay the matter, he had all the powers to reject the application seeking extension/adjournment, but could not direct the party/ies to pay costs to him, which was not covered in the term 'fees', which he was entitled to charge. The mandate of the learned arbitrator therefore automatically stands terminated under Section 15(1)(b) of the Act.

Modi Diary vs. Alfa Laval (India) Ltd., Arbitration Petition No. 104 of 2018 dated 8-8-2018 – Bombay High Court.

Insolvency and bankruptcy Code, 2016 – Is a joint application u/s. 9 of the Code against JV partners maintainable?

The present appeal arose before the NCLAT from an order passed by NCLT, New Delhi.

The facts of the case are that the appellant, who is an allottee of real estate, filed an application u/s. 7 of IBC to initiate CIRP jointly against the respondents i.e., AMB Infrabuild Pvt. Ltd., and Earth Galleria Pvt. Ltd., (Corporate Debtors). The Tribunal rejected the application *inter alia* observing that there were infirmities in the application *inter alia* that the payment was alleged to be made to Corporate Debtor No. 2 while insolvency resolution process was sought to be initiated against Corporate Debtor Nos. 1 and 2. It was further held that there was no provision in the Code where a petition for insolvency resolution process could be initiated against two Corporate Debtors who have collaborated for a 'Joint Venture'. Hence, the petition was dismissed. The appellant being aggrieved by the said order filed an Appeal before NCLAT, New Delhi.

The question that appears before the Appellate Tribunal is whether application under Section 9 was jointly maintainable against the respondents or not?

A 'Collaboration Agreement' dated 3-5-2013 was entered into between owner of the Land (AMB Infrabuild Pvt. Ltd.) and the developer of land (Earth Galleria Pvt. Ltd.). Under the said agreement, it was agreed that developer will sell flats to the extent of its share and the land owner will sell the developed portion of its own shares. It was also agreed by the land owner to make it a 'Joint Venture Project' and for all purposes be treated as 'Joint Venture Agreement'. Soon thereafter, a Memorandum of Understanding was reached on 20-6-2014 between Earth Galleria and the Appellant in respect of booking a Cineplex (1 Screen). The sale consideration was ₹. 3 crore out of which 5 lakh was already paid by the appellant.

Thereafter, a Memorandum of Undertaking was reached on 6-2-2016 between three allottees i.e. the Appellant, Respondent No. 1 (i.e. Land Owner) and Respondent No. 2 (Developer of Land). The NCLAT observed that in the said Memorandum of Understanding, the 'Developer' and the 'Land Owner' had been jointly referred to as the "Company". The Developer was empowered by the Owner of the Land to advertise the project and to do marketing for the developed property as a 'Joint Venture Project'.

The Tribunal held that the 2nd Respondent cannot plead that it is not a signatory to the Memorandum of Understanding dated 20th June, 2014, the 2nd Respondent is being represented by 'Earth Infrastructure Ltd.' pursuant to the 'Collaboration Agreement'. Further held that the NCLT failed to consider the aforesaid facts and erroneously held that the CIRP could not be initiated against the two Corporate Debtors. If the two 'Corporate Debtors' collaborate and form an independent corporate unit entity (Joint Venture Project, in the present case) for developing the land and allotting the premises to its allottee, the application under Section 7 was held maintainable against both of them jointly and not individually.

It held that both the 'Developer' and the 'Land Owner', if they are corporate entity they should be jointly treated to be one for the purpose of initiation of 'Corporate Insolvency Resolution Process' against them. The Tribunal has set aside the impugned order and remitted the case back to the Adjudicating Authority for admission of the Petition.

Mrs. Mamatha vs. AMB Infrabuild Pvt. Ltd. & Ors., Company Appeal (AT) (Insolvency) No. 155 *of 2018 dated 30th November 2018 – NCLAT, New Delhi.*

Insolvency and Bankruptcy Code, 2016 – Amendment dated 6-6-2018 in the Code, Section 30(4) was amended – whether provisions are applicable to Resolution Plans which were not approved by the 'Committee of Creditors' or by the Adjudicating Authority?

The Appellant, a financial creditor, being aggrieved by the impugned order dated 11th June 2018 passed by NCLT, Ahmedabad Bench, sought to challenge it before NCLAT. The impugned order asked the 'Resolution Professional' to place the resolution plan before the Committee of Creditors for a relook and for proper consideration in terms of amended section 30(4) which required a resolution plan to be approved by a lower percentage of voting share.

The facts are that the Corporate Insolvency Resolution Process was instituted against Alok Industries Ltd. On 13th April 2018, before completion of resolution period the resolution plans submitted by 'JM Financial Asset Reconstruction Company Limited' along with 'Reliance Industries Limited' was placed before the 'Committee of Creditors'. The same received 70.28% assenting voting shares of CoC i.e., less than the mandatory 75%. Alok Employees Benefit and Welfare Trust & Anr.' filed Interlocutory Application for seeking approval of the 'Resolution Plan'. Whereas, the 'Resolution Professional' filed Interlocutory Application seeking liquidation of the 'Corporate Debtor'. While the application was yet to be decided, Adjudicating Authority approved the application allowing Resolution Professional to continue with the interim arrangement and Management of the Corporate Debtor Company.

While the matter was pending, there was an amendment in Section 30(4) in the IBC and the term "seventy five per cent" was replaced by "sixty six per cent" of the voting shares of the 'Financial Creditor' for approval of Resolution Plan.

It was contended by the Appellant that the amendment came into force from prospective date of 6th June, 2018, hence, the said provision cannot be made applicable to the 'Resolution Plan' submitted prior to 6th June, 2018.

Whereas, on behalf of the 'Successful Resolution Applicant', it was submitted that the amendment which has come into force from 6th June 2018 will also be applicable to all cases which were pending for adjudication and where no order of liquidation under Section 33 has been passed.

The Tribunal relying on the amended sub-section (4) Section 30 held that though the amended sub-section (4) of Section 30 came into force from 6th June, 2018, it is applicable to all 'Resolution Plans' which were not approved by the 'Committee of Creditors' or by the Adjudicating Authority.

Held that the Resolution Plan was not approved by the Adjudicating Authority and with the assent of more than 70% voting shares, the 'Committee of Creditors' wanted to approve the plan, and in absence of any allegation that the sole 'Resolution Applicant' is ineligible under Section 29A of the 'I&B Code', the Adjudicating Authority had rightly asked the 'Resolution Professional' to place the matter before the 'Committee of Creditors' in terms of amended sub-section (4) of Section 30 for its consideration in accordance with the said provision.

SICOM Limited v. Alok Employees Benefit and Welfare Trust & Ors., Company Appeal (AT) Insolvency No. 344 of 2018 dated 29th November 2018 – NCLAT, New Delhi.

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CA Anish Thacker & CA Parag Ved, *Hon. Jt. Secretaries*

The Chamber News

Important events and happenings that took place between 7th December, 2018 and 7th January, 2019 are being reported as under:

I. ADMISSION OF NEW MEMBERS

1) The following new members were admitted in the Managing Council Meeting held on 14th December, 2018.

LIFE MEMBERS			
1	Mr. Khan Mohammed Abid Ulla	CA	Bengaluru
2	Mr. Savla Alpesh Keshavji	CA	Mumbai
3	Mr. Sheth Smit Naren	CA	Mumbai
4	Mr. Sodhani Arpit Chandraprakash	CA	Mumbai
ORDINARY MEMBERS			
1	Mr. Lala Karan Chandan	CA	Mumbai
2	Mrs. Jain Ruchita Divyesh	CA	Mumbai
3	Mr. Soni Harshit Kamal Kumar	CA	Mumbai
4	Mr. Gowdar Ramanagowda S.	Adv.	Bengaluru
5	Mr. Thakkar Harshit Shailesh	CA	Mumbai
6	Mr. Deshmukh Nandkumar Yashwantrao	CA	Nashik
7	Mr. Gupta Amitkumar Virendra	CA	Lucknow
8	Mr. Ranjan Nitish	CA	Bengaluru
9	Mr. Hiremath Shreyas Shashikant	B Com	Solapur
10	Mrs. Hiremath Sunita Shreyas	B Com	Solapur
11	Mr. Gujar Deven Shridhar	B Com	Mumbai
12	Mr. Nakade Abhishek Satish	CA	Nagpur
STUDENT MEMBERS			
1	Mr. Temkar Saurabh Raman	ICAI	Mumbai
2	Mr. Shah Heet Rupesh	ICAI	Mumbai

II. PAST PROGRAMMES

1. ACCOUNTING & AUDITING COMMITTEE

A Lecture Meeting on National Financial Reporting Authority (NFRA) Rules was held on 13th December, 2018 at Babubhai Committee Room, 2nd Floor, IMC, Churchgate. The lecture meeting was addressed by CA Mukund Chitale, Past President, ICAI.

2. CORPORATE CONNECT COMMITTEE

A Lecture Meeting on Compulsory Dematerialisation of Shares and Companies Amendment (Ordinance), 2018 was held on 20th December, 2018 at Banquet Hall, Dadar Club, Lane No. 3, Lokmanya Tilak Colony, Near BAPS Shri Swami Narayan Mandir, Dadar East, Mumbai-400014. The lecture meeting was addressed by CS S. Sudhakar, Vice-President (Corporate Secretarial), Reliance Industries Limited.

3. INDIRECT TAXES COMMITTEE

A Workshop on GST Annual Returns & GST Audit Report was held on 15th December, Walchand Hirachand Hall, 4th Floor, IMC, Churchgate. The workshop was addressed by CA Ashit Shah and CA Naresh Sheth. The panellists for the workshop were CA Parind Mehta, CA Divyesh Lapsiwala and CA Abjay Desai. CA Rajiv Luthia was the moderator for the workshop.

4. INTERNATIONAL TAXATION COMMITTEE

An Intensive Study Course on The Foreign Exchange Management Act, 1999 (FEMA) was held on 21st and 22nd December, 2018 at Hotel West End, next to Bombay Hospital, Churchgate. The workshop was addressed by CA Naresh Ajwani, Mr. Vikram Nankani, Advocate, CA Manoj Shah, CA Rajesh L. Shah, Mr. Joseph Jimmy, CA Harshal Bhuta, CA Hinesh Doshi, CA Shabbir Motorwala and Ms. Nivedita Dwivedi (Assistant General Manager – Foreign Exchange Department – RBI). The panellists for the course were CA Rashmin Sanghvi & Mr. Himanshu Mohanty (Ex-General Manager – RBI). CA Dilip J. Thakkar was the mentor for the course.

III. FUTURE PROGRAMMES

1. DIRECT TAXES COMMITTEE

- A Lecture meeting on TDS Procedures Covering Issues on Processing by CPC is scheduled to be held on 29th January, 2019 at Walchand Hirachand Hall, 4th Floor, IMC, Churchgate.
- A Study Course on Interpretation of Taxing Statutes is scheduled to be held on 15th & 16th February, 2019 and 22nd & 23rd February, 2019 at Babhubhai Chinai Committee Room, 2nd Floor, IMC, Churchgate.

2. INDIRECT TAXES COMMITTEE

- The 7th Residential Refresher Course on GST is scheduled to be held from 24th to 27th January, 2019 at Hotel Novotel, Hitec City, Hyderabad.
- A Workshop on GST Law jointly with AIFTP (WZ), BCAS, GSTPAM, MCTC & WIRC of ICAI is scheduled from 17th January, 2019 to 14th March, 2019 at GSTPAM, Mazgaon Library, 1st Floor, Vikrikar Bhavan, Mazgaon, Mumbai.

3. INTERNATIONAL TAXATION COMMITTEE

- The 13th Residential Refresher Course on International Taxation, 2019 is scheduled to be held from 20th June, 2019 to 23rd June, 2019 at The Grand Bhagwati, Surat.
- The 5th International Study Tour to Central Europe is scheduled to be held from 25th May, 2019 to 5th June, 2019..

4. **IT CONNECT COMMITTEE**

A Half day Workshop on IT Security in Tax Consultants' Offices is scheduled to be held on 22nd February, 2019 at Kilachand Hall, 2nd Floor, IMC, Churchgate.

5. **MEMBERSHIP & PR COMMITTEE**

CTC Box Cricket is scheduled to be held on 12th January, 2019 at Dr. Antonio D'Silva School Turf, S. K. Bole Road, Opp. Kabutar Khana, Dadar (W), Mumbai - 400 028.

6. **RESIDENTIAL REFRESHER COURSE & SKILL DEVELOPMENT COMMITTEE**

- "Surila Yaarana" A Musical Evening is scheduled to be held on 11th January, 2019 at Club W-Ballroom, Level P-6, Lodha World Tower, Lower Parel.
- The 42nd Residential Refresher Course is scheduled to be held from 28th February, 2019 to 3rd March, 2019 at Hotel Ramada, Hyderabad.

7. **STUDENT COMMITTEE**

The Chamber's Debate Competition is scheduled to be held on 18th & 19th January, 2019 at H. R. College of Commerce & Economics, Churchgate.

(For details of the future programmes, kindly visit www.ctconline.org or refer The CTC News of January, 2019)

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[Contd. from page 138]

else be penalised; ICAI couldn't have enforced compliance to these and penalise the errant companies/auditees within its present framework. In fact, both the regulators can together play role complimenting each other and provide qualitative regulatory framework.

5. Conclusion

The ICAI would continue to play pivotal role as 'Partner in Nation Building' despite all odds against it. It will continue to retain its regulatory powers in respect of unlisted public companies and private companies and other entities not covered under NFRA Rules. It shall continue to critically review the international standards on accounting as well as auditing standards and making them converged to Indian conditions and notify as also forwarding the same for consideration of NFRA to recommend to GOI for notifying for the Companies. ICAI will continue to instill the best practices in financial reporting and auditing profession. Its contribution through Quality Review Board, Financial Reporting Review Board & Peer Review Board towards quality enhancement would continue to be immense and useful for financial reporting professionals. Its representation (3 out of 13 members) in NFRA, though abysmally low as mentioned earlier, would provide a professional input in deciding the complex professional and disciplinary matters. The publications of ICAI like Guidance Notes and technical guides on various professional matters as also research materials would continue to guide the corporate world as well as members. The success of NFRA would largely depend on bureaucracy giving its way to pragmatic and solution-oriented approach towards betterment of financial reporting, being open to taking help of professionals to decide on Quality, Disciplinary & Investigative matters and thrust on regulatory governance.

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Indirect Taxes Committee

Study Circle on Issues in Real Estate Sector was held on 5th December, 2018 at AV Room, Jai Hind College, Churchgate

Mr. Bharat Raichandani, Advocate (Mentor) addressing the delegates

CA Keval Shah addressing the delegates

International Taxation Committee

FEMA Study Circle on Issues in Reporting under FEMA: LRS and ODI Part 3 Sector was held on 5th December, 2018 at CTC Conference Room

CA Natwar Thakrar (Chairman) addressing the delegates

CA Vishal Shah (Group Leader) addressing the delegates

Commercial & Allied Laws Committee

Study Circle on An Overview of the Fugitive Economic Offenders Act 2018 was held on 6th December, 2018 at CTC Conference Room

Mr. Anjani Kumar Singh, Advocate addressing the delegates

Membership & PR Committee

Self Awareness Series Meeting on Work-Play-Inspire-Repeat was held on 10th December, 2018 at CTC Conference Room.

CA Varsha Shah addressing the participants

Study Circle & Study Group Meeting

Study Group on Recent Judgments under Direct Taxes was held on 18th December, 2018 at Walchand Hirachand Hall, 4th Floor, IMC, Churchgate

Mr. Vipul Joshi, Advocate addressing the participants

Direct Taxes Committee

Intensive Study Group on Recent Important Decisions under Direct Taxes was held on 18th December, 2018 at CTC Conference Room

CA Chintan Gandhi

IT Connect Committee

Seminar on Records Retention: Legal Provisions and Document management solutions was held on 7th December at Babubhai Chinai Committee Room, 2nd Floor, IMC, Churchgate

CA Hinesh R. Doshi (President) giving his opening remarks. Seen from L to R: S/Shri CA Dinesh Tejwani (Chairman), CA Maitri Savla (Vice Chairperson), CA Amlesh Gupta (Speaker), CA Anand Paurana and CA Uday Shah (Convenor)

CA Dinesh Tejwani (Chairman) welcoming the speakers

Faculties

CA Amlesh Gupta

CA Maitri Savla

CA Anand Paurana

Pune Study Group

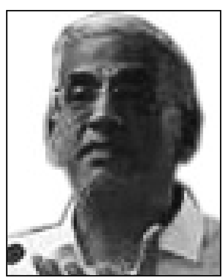
Pune Study Group Meeting was held on 15th December, 2018 at ELTIS Plot No. 419, Model Colony, Gokhale Cross Road, Next to Atur Centre, Pune – 401 101

CA Bhadresh Doshi addressing the delegates on the topic "Taxation of Shares & Securities-Domestic Taxation"

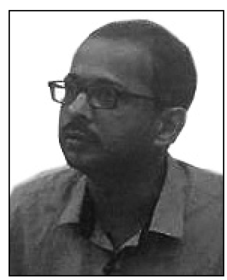
CA Saurabh Dhadphale addressing the delegates on the topic "Cross border Taxation – Direct & Indirect Transfer of Shares & Securities"

Bengaluru Study Group Meeting

Bengaluru Study Group Meeting was held on 20th December, 2018 at FKCCI, 3rd Floor, Hall No. 4, K. G. Road, Bengaluru – 560 009



CA Padamchand Khincha addressing the delegates on the topic "Introduction to MLI & Case Studies on MLI"

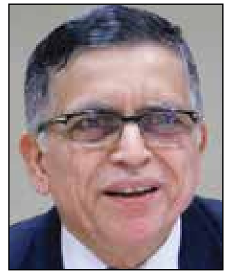


CA K. K. Chythanya addressing the delegates on the topic "Introduction to MLI & Case Studies on MLI"

Accounting & Auditing Committee

Lecture Meeting on NFRA Rules was held on 13th December, 2018 at Babubhai Chinai Committee Room, 2nd Floor, IMC, Churchgate

CA Hinesh Doshi, President giving his opening remarks. Seen from L to R: S/Shri CA Heneel Patel, Chairman; CA Mukund Chitale, Speaker; and CA Tejas Parikh, Vice-Chairman



CA Mukund Chitale addressing the delegates

Section of audience

Corporate Connect Committee

Lecture Meeting on Compulsory Dematerialisation of Shares & Companies Amendment (Ordinance), 2018 was held on 20th December, 2018 at Banquet Hall, Dadar Club, Near Swami Narayan Mandir, Dadar East.

CA Hinesh R. Doshi, President giving his opening remarks. Seen from L to R: S/Shri CA Sunil Dedhia, President-CVO Chartered & Cost Accountants Association; CA Paras K. Savla, Chairman; CS S. Sudhakar, Speakerl; and CA Hiten Timbadia, Member – Matunga CPE Study Circle

CA Paras K. Savla welcoming the speaker. Seen from L to R: S/Shri CA Sunil Dedhia, President, CVO Chartered & Cost Accountants Association; CA Hinesh R. Doshi, President; CS S. Sudhakar, Speaker and CA Hiten Timbadia, Member – Matunga CPE Study Circle

CS S. Sudhakar, Vice President - Corporate Secretarial – Reliance Industries Ltd. addressing the participants

International Taxation Committee

Intensive Study Course on FEMA was held on 14th, 21st & 22nd December, 2018 at Hotel West End, New Marine Lines, Churchgate

Day 1

Inaugural Session. Seen from L to R: S/Shri S. S. Mundra, Ex. Dy. Governor, RBI; CA Hinesh Doshi, President; CA Dilip J. Thakkar, Advisor; CA Rajesh P. Shah, Chairman; CA Rajesh L. Shah, Co-Chairman; CA Vipul Choksi, Vice-President and Mr. Himanshu Mohanty, Ex-General Manager, RBI

CA Hinesh R. Doshi, President giving his opening remarks. Seen from L to R: S/Shri CA Rajesh P. Shah, Chairman; CA Dilip J. Thakkar, Advisor; Mr. S. S. Mundra, Ex-Dy. Governor, RBI; CA Vipul Choksi, Vice-President and CA Rajesh L. Shah, Co-Chairman

CA Vipul Choksi, Vice-President welcoming the speakers Seen from L to R: S/Shri CA Rajesh P. Shah, Chairman; CA Dilip J. Thakkar, Advisor; Mr. S. S. Mundra, Ex-Dy. Governor, RBI; CA Hinesh Doshi, President and CA Rajesh L. Shah, Co-Chairman

CA Rajesh P. Shah, Chairman welcoming the delegates.

Faculties

Mr. S. S. Mundra, Ex-Dy. Governor, RBI giving his inaugural and keynote address to the delegates. Seen from L to R: S/Shri CA Rajesh P. Shah, Chairman; CA Dilip J. Thakkar, Advisor; CA Hinesh Doshi, President; CA Vipul Choksi, Vice-President and CA Rajesh L. Shah, Co-Chairman

International Taxation Committee

Intensive Study Course on FEMA was held on 14th, 21st & 22nd December, 2018 at Hotel West End, New Marine Lines, Churchgate

Mr. Himanshu Mohanty, Ex-General Manager, RBI addressing the delegates. Seen from L to R: S/Shri CA Rajesh P. Shah, Chairman; CA Dilip J. Thakkar, Advisor; CA Hinesh Doshi, President and CA Rajesh L. Shah, Co-Chairman

CA Anup P. Shah addressing the delegates

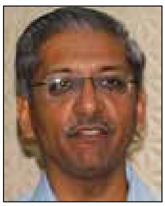
CA Paresh P. Shah addressing the delegates

Day 2

Faculties

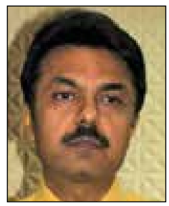
CA Hinesh Doshi Chairman of the session

CA Harshal Bhuta



CA Naresh Ajwani

Mr. Vikram Nankani, Advocate



CA Manoj Shah

CA Rajesh L. Shah

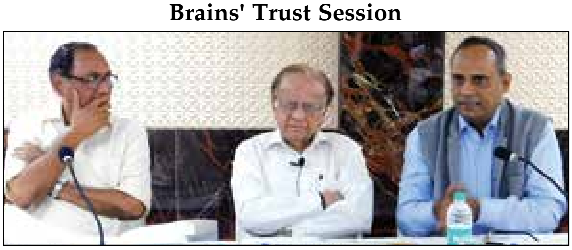
Mr. Joseph Jimmy

Day 3

Faculties

Mr. Rajesh P. Shah welcoming the Moderator and Panellist. Seen from L to R: S/Shri CA Rashmin Sanghvi, Panellist, CA Dilip J. Thakkar, Moderator and CA Rajesh L. Shah, Co-Chairman).

Brains' Trust Session



CA Rashmin Sanghvi, Panellist, CA Dilip J. Thakkar, Moderator and Mr. Himanshu Mohanty, Panellist replying the queries

CA Shabbir Motorwala addressing the delegates

Ms. Nivedita Dwivedi addressing the delegates

Indirect Taxes Committee

Workshop on GST Annual Return & GST Audit Report was held on 15th December, 2018 at Walchand Hirachand Hall, IMC, Churchgate

CA Hinesh R. Doshi, President giving his opening remarks. Seen from L to R: S/Shri CA Hemang Shah, Convenor; CA Ashit Shah, Speaker; CA Naresh Sheth, Chairman; CA Sumit Jhunjhunwala, Convenor

CA Naresh Sheth, Chairman welcoming the speakers. Seen from L to R: S/Shri CA Hemang Shah Convenor; CA Ashit Shah, Speaker; CA Hinesh Doshi, President; CA Sumit Jhunjhunwala, Convenor

CA Ashit Shah addressing the delegates

CA Naresh Sheth addressing the delegates

Panel Discussion. Dignitaries on the dais from L to R S/Shri CA Atul Mehta, Vice-Chairman; CA Naresh Sheth, Chairman; CA Rajiv Luthia, Moderator; CA Divyesh Lapsiwala, CA Parind Mehta, Panellist and CA Abhay Desai, Panellist

Section of Delegates

Membership & PR Committee

Full Day Seminar on Direct Taxes, Indirect Taxes & Investors Awareness (SME Listing) was held on 21st December, 2018 at Dhirubhai Ambani Vaninjya Bhavan, Jamnagar

CA Sachin Gandhi (Co-Chairman) giving his opening remarks. Seen from L to R: Mr. Prakash Jhaveri, Secretary-The Commercial Tax Practitioners' Association Jamnagar, Mr. Rajendra Parekh, Vice President-The Commercial Tax Practitioners' Association Jamnagar; CA Bhavik Dholakia, Joint Secretary-The Income Tax Practitioners' Association – Jamnagar; CA Umesh Ravani, President-The Income Tax Practitioners' Association – Jamnagar; CA Hemang Shah, Speaker; Mr. Tulsibhai Gajera, President-The Jamnagar Chamber of Commerce & Industry), CA Jignesh Parikh (Speaker), CA Amit Mehta (Chairman- Jamnagar Branch of WIRC of ICAI; CA Shraddha Mehta Secretary-Jamnagar Branch of WIRC of ICAI; CA Kamlesh Rathod, Vice President - The Jamnagar Chamber of Commerce & Industry and Mr. Bipendrasinh Jadeja, Secretary - The Jamnagar Chamber of Commerce & Industry

Faculties

CA Hemang Shah

CA Jignesh Parikh

CA Yogesh Jain

Section of audience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03 It has a lock in of three years that is lower than other tax savings investment options

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*U/S 80C of Income Tax Act

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THE CHAMBER'S JOURNAL
Posted at the Mumbai Patrika Channel
Sorting Office, Mumbai 400 001.
Date of Posting: 16th of Every Month

No. MCS/149/2019-21
R.N.I. No. MAHENG/2012/47041
Date of Publishing 12th of Every Month

Printed and Published by Shri Kishor D. Vanjara on behalf of The Chamber of Tax Consultants, 3 Rewa Chambers, Ground Floor, 31, New Marine Lines, Mumbai - 400 020 and Printed at Finesse Graphics & Prints Pvt. Ltd., 309 Parvati Industrial Premises, Sun Mill Compound, Lower Parel (W), Mumbai - 400 013. Tel.: 4036 4600 and published at The Chamber of Tax Consultants, 3, Rewa Chambers, Ground Floor, 31, New Marine Lines, Mumbai - 400 020. Editor : K. Gopal