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K C Mehta & Co LLP
Chartered Accountants

kcm Insight

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Dear Reader,

We are happy to present ***kcm*Insight,** comprising of important legislative changes in finance & market, direct & indirect tax laws, corporate & other regulatory laws, as well as recent important decisions on direct & indirect taxes.

We hope that we are able to provide you an insight on various updates and that you will find the same informative and useful.

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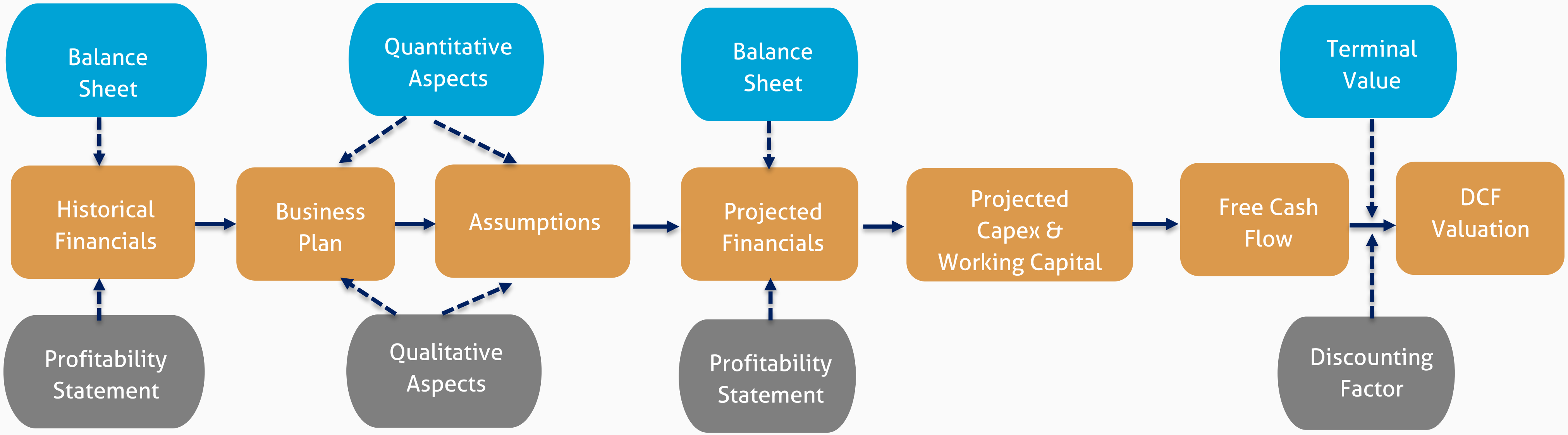
Key Components of Discounted Cash Flow Valuation Model

Introduction

Discounted Cash Flow (DCF) model is a financial valuation method under the income approach used to estimate the intrinsic value of an investment, typically a business or a project. It is based on the principle that the value of money today is more than the same amount in future due to factors like inflation, risk, and the time value of money. The DCF model considers future cash flows and discounts them to their present value using a discount rate or a hurdle rate. There are several key components that play a crucial role in the DCF model which have been discussed here.



Mergers & Acquisitions

Cash Flows: Primary driver of a DCF model is the projected cash flows underlying the business or asset getting valued. Reasonable estimation of future cash flows is essential for an effective DCF valuation exercise. There are two types of cash flows, Free Cash Flow to Firm (FCFF) used to compute the enterprise value or the firm's entire intrinsic value, and Free Cash Flow to Equity (FCFE) used to calculate the equity value or the intrinsic value of a company that is available to common equity shareholders.

1) FCFF = Operating EBIT – Tax + Depreciation or amortization – Capex – Increase in net working capital
2) FCFE = Profit after Tax + Depreciation and Amortization – Capex – Increase in net working capital – Debt repayment

Assuming Company A opts to use FCFF approach and Company B opts to use FCFE approach and other factors remain constant for both the companies as rate of interest on debt (post tax) of 10% and cost of equity of 18%. Capital employed is financed by 35% debt and 65% equity. Net debt as on valuation date is INR 180 lakhs with yearly repayment of INR 60 lakhs. Weighted average cost of capital ("WACC") will be approximately 15%. Valuing equity under both scenarios will be impacted as follows:

INR in lakhs	Free cash flow to firm	WACC @15%	Free cash flow to equity	Cost of equity @18%
Year 1	500	0.870	422	0.847
Year 2	600	0.756	528	0.718
Year 3	750	0.658	684	0.609
Terminal Year	7875	0.658	5525	0.609
Enterprise Value	-	6560	-	4516
Less: Net debt	-	(180)	-	-
Equity Value	-	6380	-	4516

Discount Rate / Hurdle Rate – Weighted Average Cost of Capital: Weighted average cost of capital represents the cost of capital (debt and equity) proportionately weighted as used in financing the business or the project. It reflects a minimum rate of return targeted to be achieved out of the investment. WACC is weighted average of cost of equity and cost of debt. Cost of equity is usually determined using Capital Asset Pricing Model and Cost of debt is the post tax rate of interest on borrowings.

Forecast Period: Explicit forecast period is the timeframe for which cash flow projections are being made. This period typically ranges from 3 to 10 years, depending on the nature of the investment, the asset / project / business being valued and the estimation uncertainty underlying the projections. It is critical to decide the forecast period based on the industry type and how fast dynamics change in that industry. Longer forecast periods are riskier and more uncertain, which can impact the effectiveness of the valuation.

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Let us suppose Company A is in a dynamic industry the forecast period of 3 years is taken, and Company B is in a comparatively stable industry hence the forecast period is taken 6 years, however if an uncertain event occurs in the 4th year which adversely impacts the industry, the valuation estimated will no longer hold valid. The valuation impact is demonstrated below:

INR in lakhs	Company A 3-year projection	Discount rate @15%	Year	Company B 6-year projection	Discount @15%	Company B 6-year projection	Discount @15%
1	500	0.870	1	500	0.870	500	0.870
2	550	0.756	2	550	0.756	550	0.756
3	605	0.658	3	605	0.658	605	0.658
Terminal Year	6,352	0.658	4	666	0.572	908	0.572
			5	732	0.497	1,361	0.497
			6	805	0.432	1,770	0.432
			Terminal Year	8,455	0.432	18,581	0.432
Enterprise Value	5,425		Enterprise Value	5,996		11,242	

Terminal Value: Terminal value considers cash flows that are expected to occur beyond the explicit forecast period. Terminal value = (Cashflow at the end of the explicit forecast period * (1 + growth rate)) / (Discount rate - Growth rate)

Mergers & Acquisitions

INR in lakhs	Company A Based on FCFF	Company B Based on FCFE
EBIT	500	500
Add: Depreciation	100	100
Less: Tax paid	(120)	(120)
Less: Increase in net working capital	(50)	(50)
Less: Capex	(70)	(70)
Free cash flow to firm	360	360
Less: Debt payment including interest	-	(60)
Free cash flow to equity	-	300
Discount rate (WACC)	0.15	-
Cost of equity (Ke)	-	0.18
Terminal value based on 5% growth rate	3,780	2,423

Growth Rate: Represents the projected growth rate of cash flows beyond the explicit forecast period which is the perpetual growth rate used in the terminal value calculation. The growth rate can be influenced by factors such as industry growth rate, long-term inflationary expectations, market conditions and competitive position of the business / project being valued.

Mergers & Acquisitions

INR in lakhs	Company A Growth Rate @5%	Discount rate @15%	Company B Growth Rate @4%	Discount rate @15%
Year 1	500	0.870	500	0.870
Year 2	570	0.756	570	0.756
Year 3	680	0.658	680	0.658
Terminal Year	7140	0.658	6429	0.658
Enterprise Value	6,008		5,540	

Conclusion

To summarize, Discounted Cash Flow model is a detailed valuation approach that necessitates careful evaluation of multiple critical drivers of a business or project which impacts the resultant cash flows expected therefrom. An effective valuation analysis requires critical assessment of the projected cash flows, discount rates underlying the cashflows, growth assumptions, and other criteria explained above. Sensitivity analysis and market validation also assists in improving robustness of a DCF model and the resultant valuation.

Contributed by

Mr. Chinmay Naik, Ms. Riddhi Patel, and Mr. Vivek Soni.

*For detailed understanding or more information, send your queries to **knowledge@kcmehta.com.***

Settlement consideration received in lieu of relinquishment of right to seek registration of shares taxable as capital gains and not salary income

Akash Poddar v ACIT ITA No. 270 of 2023 (Delhi High Court)

The Taxpayer an individual resident of India who in terms of his employment agreement received sweat equity shares and received share certificates. Post termination of the employment, the employer refused to record the name of the Taxpayer in the Register of Members. The Taxpayer challenged the action of the employer before the Company Law Board ("CLB") and consequently received lump sum consideration for full and final settlement of the dispute. The Taxpayer offered the settlement amount as long term capital gain in the return of income. However, the AO taxed the settlement consideration as salary u/s 17(3) of the ITA on the ground that the sum was received for settlement of dispute and in lieu of employer-employee relationship. Also, tax was deducted by employer u/s 192 being tax on salary.

The CIT(A) accepted the contention of the Taxpayer that the right in shares is a capital asset covered within the provision of section 2(14) of ITA and further as per section 2(47) extinguishment of rights shall be treated as transfer. Accordingly, the CIT(A) held that the settlement consideration received for relinquishment of rights in shares is taxable as capital gain and not salary though tax was deducted u/s 192 of ITA. The ITAT gave a mixed finding and held that Taxpayer was eligible for lesser sweat equity shares and consideration received to that extent was taxable as capital gain and balance was in lieu of employment therefore taxable as salary income.

The High Court rejected the bifurcation of consideration as capital gain and salary income by holding that there was no dispute with respect to the fact that the Taxpayer had received sweat equity shares in pursuance to the employment agreement which was further supported with the valid share certificates. The HC further observed that the litigation before the CLB was only in respect of non-registration of name as shareholder and not for termination of employment. Therefore, the compensation received by the Taxpayer was for settlement and to relinquish his rights in the shares. The HC held that as per section 17(3) of ITA, compensation received in connection with termination of employment would be taxable as profits in lieu of salary and thereby the sum received for releasing rights in sweat shares would be taxable as capital gain and not as salary.

Taxation of shares held during lock-in period

Ravi Kumar Sinha v CIT ITA No. 281 of 2008 (Delhi High Court)

The Taxpayer received equity shares under Employee Stock Purchase Scheme ("ESPS") which was subject to lock in period as per the terms mentioned in the scheme. During the lock-in period the shares were not-transferable. The Taxpayer purchased shares for Rs. 10.50 each whose issue price was Rs. 15 per share. As per the valuation report, the value of shares was determined at Rs. 22.50 on which the employer deducted tax by considering the differential amount as perquisites. In the return of income appreciating the fact that shares are not transferable in open market, the face value was considered as its Fair market value and thereby deemed income on difference in value of shares as per valuation report and issue price was not offered to tax. The AO treated the shares at par with quoted shares and accordingly, difference between market value of Rs. 49.45 per share and issue price of Rs. 15 per share was taxed as perquisite u/s 17(2)(iiia) of ITA.

The First Appellate Authority, by placing reliance on the decision of Bangalore Tribunal in case of Infosys Technologies Ltd v DCIT [ITA No. 818 to 820 of 2000] held that there is no room of shares during the lock-in period as tradeable in the open market and therefore market value cannot be assigned to such shares. The CIT(A) further relied on the decision of Bangalore ITAT in case of Wipro Ltd v DCIT [ITA No. 294 to 296 of 2001] and held that as the employee cannot sell shares in the open market, the actual cost should be considered as the market value. However, as the employer had arrived at the fair market value of shares after taking into account all the relevant factors, the value as per valuation report was treated as the fair value and accordingly, differential amount was taxed as perquisite.

Before the Hon'ble HC, the Taxpayer contended that as the shares could not be sold, notional income by treating the market value as fair market value cannot be taxed in the hands of the employee Taxpayer. Reliance was placed on the decision of Bangalore Tribunal in case of Infosys Technologies Ltd (supra) which was further confirmed by Karnataka HC in ITA No. 430, 432, & 433 of 2002 and Supreme Court in Civil Appeal No. 3725 of 2007 wherein it is held that during lock in period shares cannot be transferred, also the possession of such shares remains with Trust and if the employee resigns during lock-in period, the shares are to be retransferred. Therefore, such shares do not have any realizable value and there is no benefit to the employee during such lock-in period. Lastly, the Hon'ble HC observed that Apex Court in case of State Bank of Travancore, held that only real income is chargeable to tax. Based on the above, it was held that shares held as non-transferable do not have value over and above its face value.

Taxation of income of Association of Person where shares are determinate

JV of Tata Projects Ltd & Chint Electric Co Ltd v ITO ITA No. 1140/Del/2024 (ITAT Delhi)

The Taxpayer is a Joint Venture between Tata Projects Ltd (Resident member) and Chint Electric Co Ltd (Foreign member) assessed as Association of Person ("AOP"). The AOP offered income to tax at the rate of 30% whereas while processing the return, the income was taxed at 40%. The Taxpayer contended that only income to the extent of share of foreign member would be chargeable to tax at higher rate of 40% and balance income would be taxed as Maximum Marginal Rate ("MMR") of 30%. The Taxpayer further relying on the decision of Rajasthan HC in case of JK Employees Welfare Fund v ITO S.B. Civil Writ Petition No. 6999 of 1991 challenged the application of higher tax rate while processing the return of income.

The Tribunal while adjudicating the issue referred to the provisions of ITA and held that where shares are indeterminate, income of AOP is charged to tax at MMR whereas if shares are determinate, AOP's income is taxed at MMR, if

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member's income exceeds maximum amount not chargeable to tax, if income of members is below taxable limit then income of AOP is taxed at slab rate and where member's income is chargeable to tax at rate higher than MMR, then income of AOP to the extent of share of such member shall be taxed at rate higher than MMR while balance income would be taxed at MMR. In view of the provisions of ITA, the Hon'ble Tribunal held that since share of members is determinate, the income of AOP to the extent of share of foreign member would be taxed at rate at which such foreign member's income is taxable and balance income of AOP shall be chargeable to tax at MMR.

Benefit of New Tax Regime in case requisite form is filed within extended due date

Makevale Acrylics Pvt Ltd v ADIT ITA No. 566/Ahd/2023 (Ahmedabad ITAT)

The Taxpayer is a manufacturing entity and for AY 2021-22 opted for new tax regime u/s 115BAA of ITA. All the provisions of section 115BAA of ITA were complied with, however, the mandatory requirement of e-filing of Form 10IC was not complied with. The Taxpayer before CIT(A) contended that no benefits or deductions as denied in section 115BAA were claimed in the return of income. Also, Form 10IC was filed before CIT(A) and it was contended that at the most it can be construed as procedural lapse. Accordingly, the Taxpayer requested the CIT(A) to tax its income under new tax regime. CIT(A) denied the appeal of the Taxpayer.

During the pendency of appeal before ITAT, the CBDT issued circular no. 19 of 2023 dated 23-10-2023 for condoning delay in filing form 10IC for AY 2021-22 on satisfaction of conditions stipulated therein. In accordance with the said circular, the Taxpayer e-filed Form 10IC within such extended period. The Hon'ble Tribunal took note of the fact that the legislative intention of the circular is to overlook the procedural lapse and allow the substantive benefits of new tax regime. Accordingly, the ITAT condoned the delay in e-filing the form and directed to allow the Taxpayer the benefit of new tax regime.

Contributed by

Mr. Bhavin Marfatia, Ms. Amrin Pathan, and Mr. Ayush Kasera.

For detailed understanding or more information, send your queries to ***knowledge@kcmehta.com.***

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Indian Rulings

Situs of rights in shares of Indian company not in India, capital gain not taxable in India

(Nikesh Arora [ITA No. 1008/Del/2022 – Order dated 18 July 2024 (Delhi ITAT)]

The ITAT Delhi ruled in favour of the taxpayer, an individual US resident, concerning the tax treatment of capital gains from the sale of rights in the Compulsory Convertible Preference Shares (CCPS) of the Indian companies. The taxpayer, being the employee of US company was provided rights in the CCPS of the Indian companies by its employer. Pursuant to termination of the employment agreement, the taxpayer was paid in cash amount equivalent to the value of rights granted in the CCPS of the Indian companies by its employer. The taxpayer offered long-term capital gains from extinguishment of his rights in the CCPS of Indian companies whereas the revenue had disputed the period of holding and the nature of the capital asset, treating the gains as short-term. Revenue had also challenged the deduction for cost of acquisition considering the same was not taxable in India as perquisites u/s 17(2)(vi) of the ITA at the time of grant of such rights.

The ITAT, after analyzing the facts of the case determined that since the taxpayer acquired rights to the shares through an assignment agreement (dated December 2014) and not through an employment agreement (dated May 2015), as contended by the revenue, the taxpayer held the capital asset in the given case for more than 24 months. However, the ITAT noted that what was being transferred by the taxpayer was certain rights and interests in CCPS and not a share or security since the shares were not registered in the name of the taxpayer. As a result, the ITAT concluded that the taxpayer would not be entitled to the benefit of a 24-month holding period. Instead, the applicable holding period would be 36 months for the asset to qualify as a long-term capital asset.

However, setting a precedent for similar cases, the ITAT ruled that since the actual asset transferred was a right rather than shares and the fact that agreement for acquisition of such rights was executed outside India, the situs of the capital assets being the rights in the CCPS of the Indian company was also situated outside India and accordingly, the capital gains were deemed non-taxable in India.

The ITAT directed the tax office to accept the capital gains as offered in the taxpayer's return and noted that any additional benefits beyond the return would not be allowed to the taxpayer pursuant to the above ruling considering that such gains were not taxable in India. While the Tribunal has clearly differentiated the rights in the shares capital vis-à-vis the actual shares, taxpayers should also analyze Explanation 5 to section 9(1) of the ITA dealing with transfer of assets or interest of the foreign company deriving its value from the shares of the Indian Company as facts may vary from case-to-case basis.

Services for online learning platform for certification courses not taxable as FTS

Coursera Inc. [ITA Nos.2416 & 3646/Del/2023 – Order dated 21 August 2024(Delhi ITAT)]

Taxpayer is a tax resident of USA engaged in the business of operating a global online learning platform offering access to online courses and degrees from leading universities and companies. The AO held that the taxpayer was providing ‘content services’ as well as a whole range of ‘user services’ which were user specific and involved a high degree of human intervention. The services involved providing a customized landing page, user engagement reports, access to courses and specialization certificate services etc. He further pointed out that the completion certificate had the logo of educational institution as well as the taxpayer and held that a training element was

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involved in the services provided by the taxpayer. AO argued that through the said services, specialized knowledge and skills were made available by the taxpayer to the customers. AO further argued that the taxpayer was not an educational institution, rather an aggregation service provider, which brings the educational institutions and learners on one platform by using special cutting-edge technology and services and hence was not eligible for exception provided under Article 12(5) of India-USA DTAA.

The taxpayer contended that it was merely an aggregator of various contents and certification courses offered by different universities and provided access through subscription. It was not involved in content creation and examinations were conducted by the concerned universities and certificates were also issued by them.

The Hon'ble ITAT observed that the contents of respective courses and degrees were created by the concerned universities and companies and not by the taxpayer who merely acted as a facilitator between the universities and the customers undertaking their courses. While providing access to various courses/degrees, the taxpayer did not provide services of technical nature to the customers. Accordingly, based on the facts of the case and available jurisprudence the ITAT accepted the taxpayer's contention.

The judgment reinforced the principle that for a service to be classified as FTS, it must entail significant human involvement and the application of specialized knowledge or skills. A platform provider offering access to a database or content through a subscription model does not meet the criteria for FTS taxation. A similar judgement was rendered by Delhi HC in the case of Relx Inc. The same has been captured in our insight for the month of March 2024.

Faceless assessment procedure mandatory for issuance of notice under section 148

Sri Venkataramana Reddy Patloola [WP No. 13353, 16141 and 16877 of 2024 – Order dated 24 July 2024 (Telangana HC)]

The only question raised in the writ petition filed under Article 226 of the Constitution is whether show cause notices issued u/s 148 of the ITA in matters relating to international tax are exempted to follow the statutory faceless procedure.

The taxpayer in the present case argued that the notices issued u/s 148 of the ITA were not in compliance with the faceless assessment procedures outlined in the gazette notification dated 29 March 2022. Conversely, the Revenue contended that the notices issued under section 148 of the ITA complied with the applicable procedures. This argument was based on a combined interpretation of the Scheme dated 29 March 2022, the language of section 144B(2), and the CBDT order dated 6 September 2021. The Revenue asserted that the gazette notification and section 151A did not mandate faceless procedures for all types of notices, particularly the notices related to international tax matters. Revenue further argued that section 144B(2) provided for undertaking faceless assessment as specified by the Board and that the Board vide CBDT order dated 6 September 2021 exempted assessment orders in case of international tax from the purview of faceless assessment. Revenue accordingly contended that since the taxpayer was non-resident Indian, the faceless scheme was not applicable to the case at hand.

The HC allowed the writ petition for the following reasons:

- Section 151A of the ITA enables permission to CG to make a scheme for issuance of notice under section 148. Accordingly, CBDT issued notification dated 29 March 2022 wherein as per clause 3(b) it has been

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specifically stated that "***issuance of notice under section 148 of the Act, shall be through automated allocation,*** *in accordance with risk management strategy formulated by the Board as referred to in section 148 of the Act for issuance of notice, and* ***in a faceless manner, to the extent provided in section 144B of the Act with reference to making assessment or reassessment of total income or loss of assessee.***"

- Further, as per section 144B(2) of the ITA the faceless assessment as per section 144B(1) shall be made as may be specified by the Board.
- CBDT issued an Order under section 119 of the ITA dated 06 September 2021 providing exclusions to section 144B of the ITA. The Order provided that all the assessment orders shall be passed by the National Faceless Assessment Centre except assessment orders in cases assigned to central charges and International Tax charges.
- Reliance was placed on the judgment of Bombay HC in case of Hexaware Technologies Ltd. wherein it had been concluded that, the expression 'to the extent provided in Section 144B of the Act' does not deal with the aspect of issuance of notice under section 148 of the ITA and it does not preclude the mandatory faceless procedure for issuance of notice under section 148 of the ITA.

Accordingly, the High Court held that failure to comply with the procedural requirements of the faceless assessment scheme would invalidate any notices issued in contravention of this procedure.

Notably, the Court meticulously examined the relevant CBDT communications and carefully interpreted the pertinent sections of the ITA applicable to this case. The judgment highlights the critical importance of ensuring that notices are issued by tax authorities possessing the appropriate jurisdiction, as this is a key factor in determining the overall validity of the assessment or reassessment proceedings.

MFN Review Petitions pursuant to case of Nestle SA dismissed by SC

Nestle SA [Review Petition (C) No. 77 of 2024 & Others - Order dated 06 August 2024 (Supreme Court)]

In October 2023, the Hon'ble Supreme Court, in the case of Nestle SA, ruled in favor of the Revenue, holding that a separate notification under Section 90 of the ITA was mandatory for invoking the Most Favored Nation (MFN) clause. Absent such a notification, taxpayers could not claim the benefits of the MFN clause. Following this judgment, KCM released a detailed analysis in its publication, KCM Spark, titled "India's MFN Controversy: Was India's Supreme Court Driven by 'Advaitha' to Apply 'Dvaitha'?" on February 7, 2024.

The taxpayers had filed a Review Petition before the Supreme Court, seeking a reconsideration of the judgment. However, the Supreme Court has recently dismissed these review petitions, thus rendering the original decision final. Based on this Supreme Court ruling, the Revenue had initiated reassessment proceedings in multiple cases. Given the Supreme Court's refusal to revisit its decision, it would now be challenging to contest similar cases before lower authorities.

The Supreme Court, though unconvincingly, appears to have accepted the rehearing of the matter due to the unavailability of Sr. Adv. Harish Salve, without showing any inclination to change its stance. Furthermore, since the reasons for rejecting the review petitions are not publicly available, it remains to be seen how the Supreme

Court's interpretation will be received in international tax forums, where treaty terms are typically negotiated and agreed upon through mutual consensus between contracting states. The response of other treaty partners to this unilateral stance by the Indian judiciary is yet to unfold, raising concerns about its broader implications for international tax relations.

SC stays Karnataka HC decision barring retrospective application of Black Money Act

Dhanashree Ravindra Pandit [(Supreme Court)]

The Supreme Court has granted leave on the Special Leave Petition (SLP) filed by the Revenue against the Karnataka High Court's judgment, which held the retrospective applicability of Section 72(c) of the Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015, as unconstitutional.

The Black Money Act (BMA) was enacted in 2015 to deal with undisclosed foreign income and assets held outside India by Indian residents. Taxpayers were required to report their foreign assets and income in income tax returns. In one case, the Deputy Director of Income Tax filed a complaint against the taxpayer/petitioner for failure to furnish in return of income, information about an asset (including financial interest in any entity) located outside India (i.e., offenses punishable under section 50-52 of the BMA).

In this case, the petitioners were alleged to be the office bearers of corporations incorporated in British Virgin Island and beneficial owners of bank accounts of such corporations. Such corporations were struck off and bank accounts were closed prior to 2011. Thereafter show cause notice was issued on petitioners under BMA for such bank accounts (held prior to 2011). Recourse to section 72 of BMA was taken for issuing such notices, which provides that if no declaration is made by an assessee under the BMA even if the asset was acquired or made prior to coming into force of the BMA, it shall be deemed to be an offence under the BMA. Section 59 of the BMA provides that any person could declare undisclosed foreign assets acquired from taxable income for assessment years before April 1, 2016, if they failed to file or disclose them in their tax returns, provided the declaration is made within notified date (i.e., 30 September 2015).

The Karnataka High Court observed that section 72 of the BMA creates criminal liability for offenses alleged to have been committed five years before the enactment of the BMA. The court held that this violates Article 20 of the Constitution of India, which makes it a fundamental right of a person to be convicted only for violating the law in force at the time of commission of the act. The court ruled that the prosecution initiated against the petitioners did not pass constitutional muster under Article 20.

By granting leave on the SLP, the Supreme Court will now review the constitutional validity of section 72(c) of the BMA. The outcome of this case will have far-reaching implications for the interpretation and enforcement of the BMA, particularly concerning the retrospective application of its provisions.

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Foreign Rulings

French Supreme Court prioritize economic substance over form for income classification

BNP Paribas (SA) [ECLI:FR:CECHR:2023:434441.20230503 – Order dated May 3, 2023 (French Supreme Court)]

Taxpayer, a tax resident of France was engaged in the business of leasing operations. Two German companies entered into a contract of sale (for right to use asset) and lease back with the Taxpayer. The German companies transferred the right to use the buildings and subsequently took the same on lease from the Taxpayer. Under the said leasing contract, the German companies paid rent to the Taxpayer, which was calculated as depreciable loan, the principal being the transfer price of right to use the buildings and the interest rate an interbank rate reduced by 45 and 50 basis points, respectively.

Since the taxpayer received 'rent receipts' from lease of building, it classified the same as "Income from Real Estate" under Article 3 of the DTAA between France and Germany ('Franco-German DTAA'). As per Article 3 of the DTAA, the income would be taxable in Germany (i.e., where the property is located). However, the German tax authorities determined that the transactions constituted an artificial arrangement designed to conceal the true nature of the financial transactions and avoid taxation. Consequently, they ruled that the income should be categorized under Article 10 ("Interest") of the Franco-German DTAA, subjecting the income to taxation in France.

The French tax authorities concurred with the German authorities' view and taxed the receipts from the above contract as interest income under Article 10 of the France-German DTAA. Aggrieved by this decision, the taxpayer filed an appeal before the administrative courts requesting non-levy of additional corporate tax in France, however it didn't get any relief.

Subsequently, the Taxpayer filed an appeal with the Supreme Administrative Court of France (SC) to determine whether the receipts from the leaseback contract should be covered under Article 10 of the Franco-German DTAA. SC observed that various clauses in the lease contract indicated that the Taxpayer had no actual rights over the property such as further transfer of usage rights, economic use remained with the lessee, and restrictions on modifications without lessee authorization.

Based on these observations, the SC upheld the lower courts' ruling that the receipts from the aforementioned contract should be taxed as interest income under Article 10 of the Franco-German DTAA.

Doctrine of substance over form is a well-established principle in Indian jurisprudence for evaluating taxability. Internationally, Principal Purpose Test (PPT) is a key anti-avoidance measure, aimed at preventing the misuse of tax treaties. French SC has well recognized said principles while delivering the above judgement.

Hague Court grants higher tax sparing credit for interest on net equity, treating it as a dividend

[SGR 22/7556 and SGR 22/7733 – Order dated 30 April 2024 (Hague District Court)]

In a recent ruling, Hague court determined that "interest on net equity" (IoNE) should be classified as a dividend under the tax treaty between Brazil and the Netherlands. IoNE is a remuneration paid by a company organized under Brazilian law to its shareholders on the basis of the net equity of the company. The Netherlands- Brazil DTAA provide for tax sparing credit of 25% in case of dividend and 20% in case of interest. The dispute pertained to whether IoNE would be considered as 'dividend' or 'interest' for purpose of claiming tax sparing credit in Netherlands.

The tax authorities had contended that IoNE should be treated as interest, based on a 2020 Netherlands policy decree and a 2022 Mutual Agreement Procedure (MAP) decision with Brazilian authorities. However, the court found that following reasons supported treating IoNE as a dividend under the treaty:

- IoNE is related to equity and not debt
- It is related to size of profit reserves
- It should be agreed at shareholder's general meeting
- It can be distributed only in proportion to shareholder's interest

The Court further held that any uncertainty in interpreting the treaty's wordings should not be disadvantageous to the taxpayer. The court acknowledged the MAP Decision but deemed it less relevant for the 2019 and 2020 payment in question. This ruling followed a similar case, where the Dutch court also sided with the taxpayer who argued for a 25% tax sparing credit (rate applicable to dividend) on the IoNE, as opposed to the 20% credit applicable to interest.

The ruling implies that Netherlands taxpayers have a defensible position in claiming a 25% tax sparing credit for IoNE from Brazilian subsidiaries. Pending any further case law or changes in judicial interpretations, Netherlands taxpayers should be shielded from penalties if their position is ultimately reversed.

FTC allowed despite inconsistency in income characterization or timing difference

AA [Case no. 49-22/D- Order dated 28 August 2023 (Sweden Supreme Court)]

The Taxpayer, though a Swedish citizen and managing director of a Swedish Company, worked in Italy and thus was a tax resident of Italy. He was offered a pension insurance plan wherein monthly contributions were made by his Swedish employer. As per 'Article 15 – Dependent Personal Services' of Sweden-Italy tax treaty, income from employment shall be taxed in the country of residence and accordingly, tax was charged in Italy on the provisions made for the pension insurance plan. However, when the pension will be paid, the taxpayer would move to Sweden & become tax resident of Sweden. Thus, as per 'Article 19 – Pensions and other similar remuneration' of Sweden-Italy tax treaty, Sweden would tax such pension income in the year of receipt.

Accordingly, the issue under consideration was whether the taxpayer would be eligible for the credit of the taxes paid in Italy on contribution to the plan against the tax that will be payable in Sweden on disbursement of pension even if such income is taxed under different Articles of the treaty and in different tax years in Sweden and Italy.

The Sweden Supreme Court after observing the facts of the case noted that although the income would be taxed under different Articles of the treaty, however, the same income would be subject to tax in both the countries. The court held that the treaty only provides that credit of taxes should be given by the resident country for the same income which got taxed in the

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other country and it does not require that income should be taxed under the same Article or in the same year in both the contracting states. In the given case, the foreign court has upheld the principle that foreign tax credit cannot be restricted in case income has been characterized differently by the contracting states.

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Indian Updates

CBDT Clarifies ITCC Requirements for Indian Citizens

Section 230 of the ITA requires non-domiciled individuals and domiciled individuals in specific circumstances to obtain an Income Tax Clearance Certificate (ITCC) before departing India.

The Finance (No.2) Act, 2024, amended Section 230(1A) to include liabilities under the Black Money Act, sparking confusion that all citizens needed an ITCC before departing India. Consequently, on August 20, 2024, the CBDT clarified that the said position is incorrect and reiterated that domiciled individuals were required to obtain an ITCC in following specific circumstances after recording reasons and approval of appropriate authority:

- Serious financial irregularity or
- Direct tax arrears exceeding INR 10 lakhs (not stayed by any authority)

The clarification reiterates that ITCC is not a blanket requirement but applies only in specific situations involving serious financial irregularities or significant tax arrears. The amendment aims to ensure liabilities under the Black Money Act are treated similarly to other direct tax liabilities, without imposing unnecessary burdens on the taxpayers.

Foreign Updates

Third G20 Finance Ministers and Central Bank Governors Meeting

The Finance Ministers and Central Bank Governors of the G20, met on July 25 and 26 in Rio de Janeiro, Brazil. Prior to the meeting, the OECD published the Secretary-General Tax Report to the G20 Finance Ministers and Central Bank Governors. The report described some of the key developments in international tax reform since February 2024, including on the Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalization of the Economy and on the implementation of the BEPS minimum standards. It also covered progress made in tax transparency and on tax and development, tax administration and consumption taxes, as well as dedicated segments on tax and inequality and tax policy developments. It released four other reports as follows:

- Beneficial Ownership and Tax Transparency – Implementation and Remaining Challenges
- Strengthening International Tax Transparency on Real Estate – From Concept to Reality
- Taxation and Inequality

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- Bringing Tax Transparency to Crypto-Assets – An Update

A communique was released at the conclusion of the meeting. A discussion was made on international tax cooperation and the members appreciated the on-going work to finalize and implement the Two-Pillar Solution. The G-20 Finance Ministers also agreed on a Tax-Declaration with a particular focus on Minimum Effective Taxation Standard for Ultra-High-Net-Worth Individuals. They took note of the following documents commissioned by the Brazilian G20 Presidency:

- IMF's G20 Note on Alternative Options for Revenue Mobilization;
- The Blueprint for a Coordinated Minimum Effective Taxation Standard for Ultra-High-Net Worth Individuals; and
- The OECD Report to G20 Finance Ministers and Central Bank Governors on Taxation and Inequality.

Blueprint for a coordinated Minimum Effective Taxation Standard for Ultra-High-Net-Worth Individuals

The blueprint (dated 25 June 2024) for a coordinated Minimum Effective Taxation Standard for Ultra-High-Net-Worth Individuals has been prepared by French economist Gabriel Zucman. This report had been commissioned by the G20 Brazilian Presidency post a meeting held in February 2024 during which the taxation of ultra-high-net-worth-individuals and its lack of effectiveness were discussed. The report highlights the importance of international collaboration to avoid tax evasion, as well as the obstacles to implementing an international taxation standard. As per the report, individuals with more than $1 billion in wealth would be required to pay a minimum amount of tax annually, equal to 2% of their wealth. The individual taxes taken into account to compute this minimum would be individual income taxes, wealth taxes, and economically equivalent levies. Payroll taxes, property taxes, corporate taxes, consumption taxes, or other business-level and indirect levies would not be considered.

The idea is that a billionaire who reports little taxable income and as a result pays little income tax must be presumed to earn economic income that is not being captured by the tax code. Billionaires earn large amounts of economic income through their share of the profits made by the businesses they own but can report no taxable income by avoiding dividend distributions and capital gains realization. Only billionaires who currently pay less than 2% of their wealth in tax would have to pay more through this regime. Their individual income tax payments would be topped up to reach 2% of wealth.

This standard could be flexibly implemented by participating countries through a variety of domestic instruments, including a presumptive income tax, an income tax on a broad notion of income, or a wealth tax. The minimum tax on billionaires would raise $200-$250 billion per year globally from about 3,000 taxpayers; extending the tax to centimillionaires would add $100-$140 billion.

Hong Kong enacted Patent Box Regime

On July 5, 2024, the Government of the Hong Kong Special Administrative Region enacted the Inland Revenue (Amendment) (Tax Concessions for Intellectual Property Income) Ordinance 2024, commonly known as the "Patent Box Regime." This tax regime offers tax concessions for qualifying profits sourced in Hong Kong and generated from eligible intellectual properties (IP) developed through research and development (R&D) activities.

The key components of the regime are:

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- Patent Box Regime covers patents, copyrighted software, and new plant variety rights.
- Eligible IPs registered worldwide can benefit from this incentive provided their related profits are sourced in Hong Kong.
- Eligible IP income includes income derived from the exhibition or use of an eligible IP, income from sale of eligible IP, income embedded in sales of products or services attributable to eligible IP, insurance, damages, or compensation derived in relation to an eligible IP
- Taxpayers can apply for the patent box tax incentive starting from the year of assessment 2023/24.
- The applicable tax rate is 5%, which is substantially lower than the existing standard profits tax rate in Hong Kong (i.e., 16.5%).
- Eligible IPs must be developed by taxpayers themselves. If the R&D process involves acquisition of other IPs, or outsourcing part of the R&D activities, the amount of profits eligible for the concessional tax rate may be reduced proportionally.
- Enterprises must locally register their inventions or new plant varieties to enjoy the patent box tax incentive. This requirement would be effective two years after the incentive's implementation, i.e., July 5, 2026.

ATO releases guidance for withholding tax obligations on interest, dividend and royalty payments to non-residents

The Australian Taxation Office (ATO) has released guidance on withholding tax obligations on certain payments to non-residents. As per the guidance the taxpayers who pay interest, dividend or royalties to non-residents may need to meet certain withholding tax requirements as below.

- Filing of pay-as-you-go withholding from interest, dividend and royalty payments to non-residents - annual report by October 31 each year and/or
- Filing an Annual investment income report by October 31 each year if the taxpayer is an investment body making interest payments to non-resident investors (or lodge a nil return), and
- Payment of withholding tax

Additionally, the taxpayers may still have a withholding tax obligation even if the interest amount has not been actually paid.

Further, rate of withholding of tax will be 10% in case of interest payments and 30% in case for unfranked dividend and royalty payments subject to lower rate as may be specified in the Australia's DTAA with respective countries.

Australian government publishes consultation paper amending foreign resident capital gains tax regime

As a part of the 2024-25 budget, the Australian Government released two documents.

1) A consultation paper titled ***Strengthening the foreign resident capital gains tax regime***, which was open for consultation till 20 August 2024

Vide the said paper the Australian Government announced that it will strengthen the integrity of foreign resident Capital Gains tax regime to ensure foreign residents pay their fair share of tax in Australia and to provide greater certainty about the operation of the rules. This measure is not yet law. The amendments will apply to Capital Gains tax events starting or after 1 July 2025. The amendment will:

- Clarify the types of assets on which foreign residents are subject to CG tax
- Amend the point-in-time asset test to a 365-day testing period
- Require foreign residents disposing of shares and other membership interests

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exceeding $20 million in value to notify the ATO prior to execution of the transaction.

This measure will ensure that Australia can tax foreign residents on direct and indirect sale of assets with a close economic connection to Australian land, more in line with the tax treatment that already applies to Australian residents.

2) Exposure draft legislation titled ***Improving the foreign resident capital gains withholding (FRCGW) tax* regime** on which comments were invited up to 5 August 2024.

The FRCGW tax regime imposes a non-final withholding obligation on the purchaser of taxable Australian real property (TARP) and indirect Australian real property interests (IARPI) acquired from a foreign resident vendor. Currently, the FRCGW does not apply where the market value of TARP or IARPI is less than $750,000.

The measure would increase the withholding rate from 12.5% to 15% and remove the $ 750,000 threshold. These changes are expected to apply to acquisitions of relevant CG tax assets made on or after 1 January 2025.

UK HMRC Releases Policy Summary on Non-UK domiciled individuals confirming intention of residence-based taxation from 6th April 2025 (Published on 29 July 2024, Updated on 8 August 2024)

Presently, UK domiciled residents are taxed on worldwide income, however, non-domiciled UK residents are taxed on UK sourced incomes and foreign sourced incomes remitted to the UK. Inheritance taxes are also levied based on domicile tests. UK Government proposes to reform its preferential taxation of non-domiciled UK residents and proposes to tax all residents uniformly on foreign sourced incomes arising on or after 6th April 2025. This reform is proposed to be implemented along with a 4-year foreign income and gains (FIG) regime or a 100% relief on FIG for new arrivals for first 4 years of their residence, provided they have not been UK tax resident in any of the 10 years prior to their arrival in UK.

No transitional provisions are proposed to be provided on foreign sourced incomes to UK resident individuals not eligible for the 4 year FIG regime. However, it is proposed to rebase previously acquired foreign capital assets for computing capital gains. Government also proposes to work on Temporary Repatriation Facility (TRF) for individuals who have been taxed on the remittance basis and on Overseas Workday Relief (OWR). The proposed changes are likely to have significant impact on inheritance taxes and trust structures as well.

Contributed by

Mr. Dhaval Trivedi, Ms. Dhwani Shah, Ms. Shradha Khemka, Ms. Pranjal Borad, Ms. Pooja Shah, Mr. Vishal Sangtani, Mr. Varun Parekh , Mr. Karanraj Chaudhary , Mr. Maqbul Ahmed.

For detailed understanding or more information, send your queries to ***knowledge@kcmehta.com.***

Important Rulings

De-novo adjudication of comparable by Tribunal in case not explicitly examined at TPO / AO level

S & P Capital IQ (India) Private Limited [TS-363-ITAT-2024(HYD)-TP]

The taxpayer is engaged in provision of IT enabled services ('ITeS') to its associated enterprises. The taxpayer's case was selected by the TPO for scrutiny. The TPO made certain adjustments to the international transaction of provision of ITeS based on number of comparables. Aggrieved by the TPO's adjustment to the income, the taxpayer appealed before the DRP which also upheld the adjustment by the TPO.

As aggrieved by the DRP's directions, the taxpayer approached the Hon'ble Hyderabad ITAT. The taxpayer contended for the exclusion of 4 companies from the final set of comparable companies. Out of the above, 3 companies have already been taken cognizance of in the previous TP assessments and were outrightly regarded as non-comparable. The remaining company, i.e., MPS Limited was not objected to by the taxpayer during the proceedings before the TPO.

The TPO contended that MPS Ltd. has been considered by the taxpayer suo-moto and accordingly, shall not be rejected from the final set of comparable companies at the time when the subject matter is before the ITAT. The ITAT noted that the relevant information in relation to MPS Ltd. was not available at the time of examination by the TPO / AO and as a result, the comparability of MPS Ltd. could not be appraised at that point in time. Accordingly, the Hyderabad ITAT remitted the matter for de-novo consideration of MPS Ltd. whether the same should be considered as a part of the final set of comparable companies.

The aforesaid judgment was based on the ruling by the Special Bench of Chandigarh ITAT in case of Quark Systems Pvt. Ltd.[1]

Reader's Focus

In the present case, the disagreement needle oscillates around the inclusion / exclusion of one of the comparable which though not expressly examined at the time of preliminary scrutiny were pressed by the tax authorities to have attained finality at the time of further examination by appellate authorities.

Further, the present case also talks about whether the actions which have been taken by the taxpayer can be challenged at a later stage by the taxpayer on its own motion. The significant point to note is that the Tribunals, in addition to upholding the law, are also the fact-finding lords. Accordingly, if the facts point out to an anomaly which is apparent from the information or details available at that point in time, then the Tribunal may on the prayer of the either of parties to the dispute or on its motion may resort to use of its powers to establish the supreme truth.

Irrespective of the fact that a comparable has been accepted by the taxpayer which has not been expressly adjudged in the retrospective examinations may be rightly subjected to the wide powers of screening by Tribunal, which may shake the very foundations of the previous examinations and assessments in case found to be lacking.

[1] [2010] 38 SOT 307 (CHD.) (SB)

Important Rulings

Berry Ratio (G.P. / Val. Add. Exp) rendered infructuous in case of full-fledged marketers / distributors

Kubota Agricultural Machinery India Private Limited [TS-354-ITAT-2024(CHNY)-TP]

The taxpayer is engaged in distribution of agricultural machinery in the Indian market after procuring the same from its associated enterprises. The taxpayer benchmarked the transaction of import of agricultural machinery using the Resale Price Method ('RPM'). The taxpayer's case was selected for scrutiny.

The TPO adopted the use of Transactional Net Margin Method ('TNM method') employing the Berry Ratio as the appropriate profit level indicator ('PLI'). The TPO selected Berry Ratio as the PLI stating that the taxpayer is not a mere distributor but provides value added services, the cost of which is closely interlinked with the distribution function. The DRP upheld the addition by the TPO.

Aggrieved by the actions of the TPO and consequently, Ld. DRP, the taxpayer appealed before the Chennai ITAT. The Chennai ITAT noted that the taxpayer, being a full-fledged marketer, bore various risks such as marketing risk, pricing risk, inventory risk among many others. The expenditure emanating out of the risks borne above could not be said to be inbuilt / represented sufficiently in the operating expenses of the taxpayer. As a result, it would be prudent to establish that the use of Berry Ratio is not acceptable in the case of a full fledge distributor.

Reader's Focus

One of the PLIs which finds its application in the transfer pricing realm is the Berry Ratio which is computed by dividing the gross profit by operating expenses. OECD TP Guidelines advocate the use of Berry Ratio only in those cases wherein the profitability is affected and can be sufficiently represented by the elements of expenses in the profit and loss statement. As a result, any of the qualitative factors affecting the profitability of the tested party such as intangibles, marketing supply chains, etc which do not find any mention in the profit and loss statement would not be addressed by the use of Berry Ratio. Accordingly, use of the Berry Ratio in case of any of the full-fledged marketers / distributors which employ intangibles, marketing supply chains built over a period of time of operating in the Indian jurisdiction and bearing any other risk which are not reflected in their profit and loss statement is not appropriate.

Further, the OECD TP Guidelines have laid down the following parameters for the application of the Berry Ratio which are commensurate with the ruling laid by the Chennai ITAT in case of Kubota Agricultural Machinery (supra):

A. value of the functions performed (FAR analysis) in the controlled transaction is proportional to the operating expenses

B. value of the functions performed in the controlled transaction is not materially affected by the value of the products distributed, i.e., it is not proportional to sales

C. taxpayer does not perform, in the controlled transactions, any other significant function (e.g., manufacturing function) that should be remunerated using another method or financial indicator.

Important Rulings

Comparability triumphs over internal uncontrolled transactions: Supply of electricity by captive tax holiday unit to its industrial unit

Hindalco Industries Ltd [TS-335-ITAT-2024(Mum)-TP]

The taxpayer is engaged in the manufacture and production of aluminium and related products. The taxpayer operated a power generation plant enjoying the fiscal benefits u/s 80IA of the Income Tax Act. The power generated was mainly used by the aluminium processing unit ('APU') and the miniscule surplus power was sold to Grid Corporation of Orrisa Ltd. ('GCO'). The taxpayer considered the rate of Rs. 2.63 per unit for supplying the electricity to its APU which was the rate which Orissa Electricity Board ('OEB') charged to its industrial consumers. The taxpayer's case was subject to scrutiny by the Assessing Officer ('AO') which held that the rate of electricity to be charged to the APU shall be the rate charged by the taxpayer for supplying the surplus electricity to GCO i.e., Rs. 0.77 per unit.

On further appeal, the CIT(A), on the contrary pronounced in favour of the taxpayer, that the price charged by OEB (i.e., Rs. 2.63 p.u.) to its industrial consumers shall be the appropriate pricing. Aggrieved by the CIT(A) ruling, the tax authorities appealed before the Mumbai Tribunal. The Mumbai Tribunal held that the rate for supplying the electricity to a supplier itself (i.e., GCO in present case) cannot be considered to be appropriate rate as other industrial consumers do not have the option of procuring the electricity at that rate and the electricity can be procured only at the rate charged by the State Electricity Board (i.e., OEB in present case) to other industrial consumers.

Accordingly, the Mumbai Tribunal held that the taxpayer is correct in considering the rate of electricity charged by OEB to other industrial consumers as its rate of electricity to be charged for supplying power to its APU. The ITAT followed the Supreme Court's decision in the case of Jindal Steels & Power Ltd., which provided a precedent for considering the rate charged by SEB to industrial consumers as the market rate.

Reader's Focus

The Apex Court has tried to bring in the business mechanics, i.e., the right to choose in the hands of the buyer as well as the availability of choice provided by the supplier or in simple words the market economics of demand and supply. In the present case, the taxpayer does not have the option of supplying the excess electricity to any other person other than Orrisa Grid Corporation and which is also controlled since it forms the very basis of granting the option of generating power on its own by the taxpayer. Therefore, the price charged to Orrisa Grid Corporation suffers from the inherent limitation of freedom of choice and accordingly, cannot considered as a comparable price.

On the other hand, every power consumer either has to produce the power on its own or procure it from the nearby State Electricity Board authority. Therefore, electricity is available to any industrial consumer from the authorized electricity boards only and not from any other entity or organization. As a result, the rate charged by the State Electricity Boards to the other industrial consumers is the rate which can be considered as the rate at which the power can be made available.

On a different perspective, although it seems that the Apex Court has concluded in the right lines that the rate of electricity as charged by the respective State Electricity Board shall be considered as the comparable rate of electricity which can be compared with the controlled

Important Rulings

transaction but the recent trend in case of tax controversy involving the power rates the Indian tax authorities have been vehemently making additions considering different rates of electricity such as Open Exchange, internal transactions involving power supply under differing circumstances, etc. which might not be commensurate with the market forces of demand and supply.

Difference existing between the controlled and uncontrolled transactions to be eliminated to render them comparable

Swatch Group [India [Pvt Ltd [TS-341-HC-2024(DEL)-TP]

The taxpayer is an Indian subsidiary involved in the import of luxry watches from its associated enterprises and reselling in the Indian market. The taxpayer employed the use of foreign comparable companies to compare their profitability (gross / net level) with its own. The CIT(A) accepted the use of foreign comparables due to unavailability of sufficient comparable watch companies in the Indian market.

Further, the taxpayer contended before the CIT(A) that the customs duty on import of luxury watches in India amounted to 32% of the net sales or over 50% of the total cost of goods sold. The taxpayer had used the watch companies operating in Italy for the purpose of benchmarking the profitability of its own operations. The comparable companies operating in Italy that were used as benchmarks either faced negligible or no customs duties on similar imports of luxury watches. This discrepancy had a considerable impact on the profitability and financial performance of the taxpayer when compared to its Italian counterparts.

In India, luxury watches imported by the taxpayer attracted customs duties that accounted for a substantial portion of the total cost of goods sold. Specifically, it was noted that this heavy burden of customs duties was not a factor for the Italian comparables, leading to a significant disparity in the financial metrics between the two.

The CIT(A) and later the Delhi ITAT recognized the need to adjust for these differences. CIT(A) observed that without accounting for the customs duty differences, the comparability analysis between the Indian entity and its Italian counterparts would be skewed. As per Rule 10B(2)(d) of the Income Tax Rules, 1962, factors such as geographical location, market conditions, and government regulations (including customs duties) must be considered when assessing the comparability of international transactions.

CIT(A) concluded that the high customs duties paid by the taxpayer in India had a significant bearing on the company's margins and should be adjusted for to make a fair comparison. This adjustment was essential because the foreign comparables, operating in Italy, did not bear similar costs. The ITAT upheld this view, agreeing that the customs duties' impact was a material factor that justified an adjustment in the transfer pricing analysis. Later, The Delhi High Court endorsed the adjustments made by the CIT(A) and the ITAT.

Reader's Focus

Rule 10B of the Indian income tax rules basically deals with the selection of methods and adjudging the comparability of two transactions with one another. In this respect, it lays down that two transactions can be considered comparable in the following circumstances if it satisfies either of the two conditions:

1. that the differences in the two transactions would not lead to differences in prices in the open market. *For example, selling of bulk drugs or API by two different manufacturers which would be used in further productions of formulations wherein the constituents of the bulk drugs are same since bulk drugs would not command brand loyalty but rather quality specifications which would drive its price.*

OR

2. if there are differences affecting the prices in the open market, then there can be made certain adjustments which would substantially eliminate those differences affecting the prices. *For example, two similar products, one sold in loose packages containing the bare units just lying in the carton and similar products which is sold in neat and segregated packaging, in this respect, the additional cost of packaging in the later scenario can be quantified and eliminated from the final price to arrive at the price of loose units.*

It is not the intent of the transfer pricing regulations that every minor differences in product, economic circumstances, contractual agreements, etc. leading to variation in prices should be quantified and eliminated but only those affecting / driving the pricing difference in the products should be studied. As a result, there should be an earnest approach on behalf of the taxpayer to identify such substantial differences in the operational and economic circumstances within the industry or products or functional profiles or any other similar factors.

In the present case, the difference arises due to the quantum of taxes imposed by one jurisdiction when compared with another jurisdiction esp. the additional burden of the taxes and duties which would be ultimately passed on to the customers in their respective markets. As aforesaid, the duties imposed by the Indian authorities made up 50% of the total cost whereas the Italian authorities imposed almost negligible import. It can straightaway be concluded that a difference of 50% of the total cost would lead to reduction in the margin of the seller as well as the bargaining power in terms of affordability although the products under consideration are luxury watches.

Though there might be other factors such as market economics, transportation expenses, warehousing costs, etc. which are different in Italy and India but one of the major factors affecting the profitability that could be outrightly identified was the import duties and therefore an adjustment for the same was reasonable.

Entity Classification vs Functional Comparability: Government Company is a comparable as well

Corteva Agriscience Services India Private Limited [TS-326-ITAT-2024(HYD)-TP]

The taxpayer is a captive service provider engaged in providing administrative support services to its AEs. The taxpayer's case was selected for determining the arm's length price (ALP) of the support services provided by the

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taxpayer. The TPO determined the ALP of the charges towards support services based on a number of comparables including certain government companies which the taxpayer appealed against the inclusion of the same. The CIT(A) upheld the action of the TPO to include the comparables.

Aggrieved by the CIT(A) upholding the TPO's order, the taxpayer appealed before the Hyderabad ITAT contending that the government companies should be excluded as they are earning revenue from government contracts.

In this regard, though ITAT stated that Government companies are often considered functionally dissimilar to private companies, especially in cases involving the provision of services due to differences in objectives, regulatory environment, and operational dynamics yet the ITAT clarified that being a government undertaking alone does not automatically render a company incomparable with the taxpayer. The specific nature of the services offered by the government company must be evaluated to determine its comparability. Accordingly, considering that both the government companies and the taxpayer derived revenue from back-end consultancy services, the government companies ought to be considered comparable with the taxpayer.

Reader's Focus

The above case law discusses the fundamentals of the business operations which forms the very foundation of transfer pricing analysis. Functional analysis or comparability analysis is the cornerstone of the transfer pricing which iterates that it is the functions performed, assets employed, and risks undertaken which determines whether two transactions or entities are comparable or not.

In the present case law, the appellate authorities have discussed that it is not the ownership, customer profile, governance structure, laws, regulations, directing body, revenue model, etc. which determines the comparability but rather the business activities which are driving the revenue i.e., back-end consultancy services. As a result, even though the revenue is being derived from government contracts in one entity's case and from other customer (other than government) in taxpayer's case, both the government entity and the taxpayer have been held to be comparable.

Contributed by

Ms Stuti Trivedi, Mr. Nitin Chaudhary, and Ms Divvya Gupta.

For detailed understanding or more information, send your queries to ***knowledge@kcmehta.com***

Important Updates

Circular

Clarification regarding the manner of computing penalty under the IGST Act, 2017

[Circular No.12/2024-Kerala SGST Dated August 13, 2018]

The circular issued by the State GST department of Kerala State explains how penalties under the IGST Act, 2017, should be calculated when tax demands are issued under Sections 73(1) and 74(1) of the Kerala SGST Act, 2017. It highlights that the IGST Act does not have its own penalty structure but adopts the penalties from the CGST and SGST Acts, as stipulated by Section 20 of the IGST Act. Specifically, the fourth proviso of Section 20 states that penalties under the IGST Act are the sum total of penalties applicable under both the CGST and SGST Acts.

For instance, if a service is taxed at 18% on a taxable value of ₹2,00,000, and the penalties under both the CGST and SGST Acts are each 10% of the tax amount (i.e., ₹1,800 under each Act), the total penalty under the IGST Act would be ₹3,600 (₹1,800 from CGST + ₹1,800 from SGST). If the minimum penalty of ₹10,000 applies under both Acts, the IGST penalty would be ₹20,000 (₹10,000 from CGST + ₹10,000 from SGST).

Further, the said circular also clarifies that, when an adjudicating authority issues a notice under Section 73 of the IGST Act for unpaid taxes across multiple states, the penalty is calculated separately for each transaction based on the place of supply. The penalty is calculated at 10% of the tax amount or a minimum of ₹10,000, whichever is higher

Instruction

Guidelines issued for second special All-India drive against fake registrations

[Instruction No. 2/2024-GST Dated August 12,2024]

The Instruction No. 02/2024-GST, issued by the Ministry of Finance, launches a second special All-India Drive to combat fake GST registrations. Below are key elements of the guidelines:

This drive, taking place from 16th August to 15th October 2024, follows the success of a similar operation in 2023. The GSTN, in collaboration with the Directorate General of Analytics and Risk Management (DGARM), will identify high-risk and suspicious GSTINs using advanced data analytics. Additionally, Central and State Tax authorities can supplement this list with their own intelligence, leveraging tools like BIFA, GAIN, ADVAIT, and E-Way Bill Analytics.

The instruction requires jurisdictional tax officers to verify these suspicious registrations and take immediate action for suspension and cancellation where necessary. Furthermore, steps should be taken to block ITC for fake GSTINs, recover any wrongly availed ITC, and investigate the masterminds behind these fraudulent activities. Nodal officers are to be appointed in each zone to facilitate information sharing and ensure coordinated action across different tax jurisdictions.

The progress of this special drive will be closely monitored through weekly reports submitted by the nodal officers, detailing the number of GSTINs verified, tax amounts evaded and recovered, ITC blocked, and any arrests made. The GST Council Secretariat will compile these reports and share findings with all tax administrations to ensure consistent and effective enforcement. The document also highlights the need for identifying and sharing any unique modus operandi discovered during the drive to enhance the overall effectiveness of the GST system.

This coordinated effort aims to safeguard government revenue and ensure the integrity of the GST ecosystem.

Application of para 2(g) of Instruction No. 01/2023-24

[Instruction No. 3/2024-GST dated 14th August 2024]

The CBIC issued Instruction No. 03/2024-GST on August 14, 2024, emphasizing the application of para 2(g) from Instruction No. 01/2023-24-GST (Inv.), dated March 30, 2024, in audit matters.

This present instruction highlights the importance of maintaining uniformity and avoiding litigation when dealing with issues where taxpayers follow prevalent trade practices based on particular interpretations of the CGST Act, rules, or notifications. In such cases, the zonal Chief Commissioners are advised to refer the matter to the relevant policy wing of the Board before concluding the investigation, especially if there is potential for different interpretations. This procedure should be followed during ongoing audits to ensure consistency and reduce the likelihood of disputes.

GST Portal Updates

Introduction of FORM GSTR-1A: Optional Facility for Amending GSTR-1 before GSTR-3B Filing

The Government, through notification No. 12/2024 – Central Tax dated 10.07.2024, has introduced FORM GSTR-1A as an optional facility for taxpayers. This form allows taxpayers to amend or add supply details that were either missed or wrongly reported in FORM GSTR-1 for the current tax period, prior to filing the corresponding GSTR-3B return. The form can only be filed once for a specific tax period, and any changes made through it will automatically reflect in the GSTR-3B of the same period.

Form GSTR-1A is available based on taxpayer return filing frequency as below:

Taxpayer Category	Availability of GSTR-1A
Monthly GSTR-1 Filers	Available after the due date or actual filing of GSTR-1 and before the filing of GSTR-3B for the same period
Quarterly GSTR-1 Filers	Available quarterly after filing GSTR-1 or IFF (for M1 and M2) and before filing GSTR-3B for the same quarter

It should be noted that changes to the recipient's GSTIN can only be made in the subsequent tax period.

Mandatory bank account update in GST registration for filing GSTR-1/IFF starting September 2024

As per Rule 10A of the CGST Rules, 2017, taxpayers are required to furnish valid bank account details within 30 days of registration or before filing GSTR-1 or using the Invoice Furnishing Facility (IFF), whichever is earlier. This rule will be strictly enforced from September 1, 2024. From this date onwards, taxpayers will not be able to file GSTR-1 or IFF for the tax period of August 2024 onwards without updating their bank account details.

Important Updates

Taxpayers who have not complied with these requirements are advised to update their bank account information on the GST portal by navigating to *Services > Registration > Amendment of Registration Non - Core Fields.*

Introduction of RCM liability/ITC statement for accurate reporting of RCM transactions

The GST Portal has introduced a new "RCM Liability/ITC Statement" to help taxpayers accurately report RCM transactions.

This statement will be effective from the August 2024 tax period for monthly filers and the July-September 2024 quarter for quarterly filers,

This will capture captures RCM liabilities shown in Table 3.1(d) of GSTR-3B and the corresponding ITC claimed in Tables 4A(2) and 4A(3) of GSTR-3B. Taxpayers can access this statement via Services > Ledger > RCM Liability/ITC Statement.

Taxpayers must report the opening balance for RCM ITC by reconciling up to the July 2024 return period for monthly filers and the April-June 2024 period for quarterly filers. The opening balance can be declared until October 31, 2024, with amendments allowed until November 30, 2024. Taxpayers who have excess RCM liabilities or ITC from previous periods must adjust these in the new statement accordingly.

Important Rulings

Coverage

Interest, fines, and penalties cannot be levied in the absence of specific charging provisions

Chiripal Poly Films Ltd vs. Commissioner of Customs -Customs Ahmedabad

[*Final Order No.11628-11630/2024*]

The Taxpayer is a manufacturer and exporter of various products, including Bi-Axially Oriented Polypropylene (BOPP) Film, Aluminum Metallized BOPP Film, Polyester Metallized Film, Polyester Film, and Polyester (PET) Chips. To manufacture these goods, the Taxpayer imported raw materials such as plastic granules and additives under the Advance Authorization scheme. This scheme allows duty-free imports on the condition that the imported goods are used in the production of goods that are subsequently exported. The Taxpayer made these imports between October 13, 2017, and January 9, 2019, without paying the applicable IGST, relying on the exemption provided under Notification No. 18/2015-Cus dated April 1, 2015, as amended by Notification No. 79/2017-Cus dated October 13, 2017.

The Directorate of Revenue Intelligence (DRI), Kolkata, raised objections regarding the Taxpayer's compliance with the pre-import condition. As a result, SCNs were issued from various ports. These notices demanded the recovery of IGST, along with interest, fines, and penalties, under various sections of the Customs Act, 1962, including Sections 28(4), 111(o), 114A, and 125.

The Principal Commissioner of Customs adjudicated the SCNs and confirmed the demands for IGST, interest, redemption fines, and penalties, citing the violation of the pre-import condition.

The Taxpayer contested the adjudication, arguing that all imported goods were used in the production of exported goods, thereby fulfilling the core requirements of the Advance Authorization scheme. They emphasized that the IGST paid by the Taxpayer following the Supreme Court's decision was eligible for input tax credit (ITC), making the situation revenue neutral. They also argued that there was no statutory provision under the Customs Tariff Act, 1975, specifically Sections 3(7) and 3(12), for charging interest, fines, or penalties on IGST. The Taxpayer claimed that the imposition of interest, fines, and penalties was unjustified and beyond the scope of the law, as these are separate financial levies that require specific charging provisions in the statute. Furthermore, the Taxpayer argued that the extended period for demanding duties was not justified because there was no intent to evade taxes, and all relevant information had been provided to customs authorities at the time of import.

The department contended that the Taxpayer had violated the pre-import condition and was therefore liable for the duties, interest, fines, and penalties as determined by the law.

The Tribunal recognized that while the Taxpayer had paid the IGST in compliance with the Supreme Court's ruling and had been granted ITC, the overall situation was revenue neutral. Therefore, the Tribunal decided not to issue a detailed order regarding the duty payment.

The Tribunal noted that the Customs Tariff Act, 1975, did not include specific provisions for charging interest, fines, or penalties on IGST under Sections 3(7) or 3(12). The Tribunal cited several judicial precedents that established that such financial levies could not be imposed without explicit charging provisions in the law. Consequently, the Tribunal set aside the orders of the Principal Commissioner of Customs regarding the recovery of interest, fines, and penalties.

The Tribunal also addressed the issue of confiscation and redemption fines, ruling that these were invalid as the goods were no longer available for confiscation, and there was no legal basis for imposing such fines under the Customs Tariff Act, 1975.

KCM Comment

This case underscores that interest, fines, and penalties cannot be imposed without a specific charging section in the law. The Tribunal ruled that such financial liabilities under the Customs Tariff Act, 1975, particularly concerning IGST on imports, require clear statutory authority. It highlights the necessity for explicit legal provisions when imposing these charges, protecting taxpayers' rights and reinforcing the principle that no tax or penalty can be levied without the authority of law. This decision is crucial for importers and legal practitioners navigating tax and customs regulations.

Furthermore, it should be noted that in the recent Union Budget, Section 3(12) of the Customs Tariff Act, 1975, was amended via Section 106 of the Finance Act, 2024, which became effective from August 16, 2024. The updated section aims to bridge the gap by extending the provisions of the Customs Act, including rules and regulations for the determination of the rate of duty, assessment, non-levy, short-levy, refunds, exemptions, interest, recovery, appeals, offences, and penalties.

Readers may refer to the detailed analysis in the KCM publication related to the Finance (No.2) Bill 2024 for a comprehensive understanding of these amendments.

The absence of BRCs should not be a ground for denying a refund of accumulated Input Tax Credit (ITC) on zero-rated supplies, particularly in the case of export of goods

Rajiv Sharma HUF (Proprietor of M/s Sagar Scooter Syndicate) vs The Union of India and Others (W.P. (C) No. 9381 of 2023)

The taxpayer engaged in the export of automotive spare parts through M/s Sagar Scooter Syndicate, sought a refund of accumulated ITC for November 2021. The

Important Rulings

refund claim was rejected by the Adjudicating Authority due to discrepancies in the documentation, specifically the non-furnishing of Bank Realization Certificates (BRCs) and incomplete bank statements and ledger accounts of suppliers.

The taxpayer argued that BRCs were not required to claim a refund under the CGST Act for export of goods. Additionally, the petitioner submitted BRCs during the appellate proceedings and contended that the rejection of the refund claim on these grounds was unjustified

The Department Argued that the refund claim was rightly rejected due to non-compliance with the documentation requirements, particularly concerning BRCs and supplier payment verification.

The Court held that the petitioner's refund claim should not have been rejected solely on the grounds of non-furnishing BRCs, especially given that BRCs were later provided. The Court found the appellate authority's reasoning flawed and remanded the case to the Adjudicating Authority for a fresh decision on whether the petitioner had made payments to the suppliers for the inward supplies in question. The previous orders were set aside, and the petitioner was allowed to submit additional documents

The judgment clarifies that ITC refunds on zero-rated supplies, particularly exports, cannot be denied solely due to missing Bank Realization Certificates (BRCs). It underscores the importance of following the CGST Act and relevant circulars, ensuring that refunds are processed fairly and providing essential guidance for businesses and tax authorities.

Orders passed by the Commissioner (Appeals) only in the Hindi language are not permissible for officers working in central government offices in region "C"

M/s Subodh Enterprises vs The Union of India and Others

[WRIT PETITION NOs: 13043, 13046 & 14904/2024[

The taxpayer approached the High Court of Andhra Pradesh challenging the orders passed by the Commissioner (Appeals) under Section 107 of the CGST Act, 2017. The primary issue raised was that the orders issued by the Commissioner (Appeals) were handwritten in Hindi, a language not understood by the petitioners. They requested copies of the orders in English, which were not provided. Aggrieved by this, the petitioners filed writ petitions before the High Court.

The Commissioner (Appeals) defended the issuance of orders in Hindi by citing various constitutional provisions and a Law Commission report, arguing that Hindi is an official language and that orders can be passed in Hindi. The Commissioner also noted that a significant portion of his orders were issued in English and that there was no legal requirement mandating that orders must be in English alone.

The taxpayer argued that the orders in Hindi violated their rights as they were not conversant with the language, and that official communication, especially in non-Hindi speaking regions like Andhra Pradesh, should be in English.

The High Court ruled in favour of the petitioners, directing the Commissioner (Appeals) to provide copies of the orders in English within three weeks. The Court held that in regions categorized under "C" (including Andhra

Important Rulings

Pradesh), communications from Central Government offices should normally be in English. The orders passed in Hindi were deemed non-permissible, and the Court ordered that the limitation period for taking further steps against these orders would commence only after the English copies were served. The Court also stated that the orders in question would not take effect until the English copies were provided.

This case emphasizes the need for government orders to be accessible in English in non-Hindi speaking regions like Andhra Pradesh. The High Court ruled that orders issued in Hindi alone are not permissible, ensuring fair legal processes by mandating that parties receive orders in a language they understand. This decision sets a precedent for language requirements in official communications across India.

No interest or penalty on wrongly availed ITC if reversed before issuance of notice

Kurian Tharayil Sabu vs State Tax Officer

(W.P. (C) No. 25595 of 2024)

The taxpayer filed a writ petition challenging an order issued by the State Tax Officer demanding payment of Rs. 43,37,212, which included interest and penalties. This demand was based on the alleged wrongful availing of Input Tax Credit (ITC) for the year 2017-18.

The taxpayer contended that the erroneous claim of ITC was a result of a mistake made shortly after the introduction of GST. Upon realizing the error, the petitioner reversed the entire ITC in the GSTR-3B return for July 2018, before any notice was issued. The petitioner argued that since the error was corrected within the time allowed under Section 39(9) of the CGST/SGST Acts, there was no basis for the demand made by the department.

The department argued that the petitioner failed to appear before the officer and respond to the notices issued prior to the order. They contended that the petitioner should have presented evidence to prove that the ITC was reversed within the prescribed time

The court observed that while the petitioner failed to respond to notices, it was clear that the error was rectified before any notice was served. Acknowledging the petitioner's honest mistake and the timely correction, the court set aside the original order and remitted the matter for fresh consideration by the department. The petitioner was directed to appear before the respondent on 23rd August 2024, and fresh orders were to be passed within three months. The court further stated that any new order would not be invalidated by time-bar provisions.

Contributed by

Mr. Bhadresh Vyas, Mr. Basavaraj M, Ms. Vidhi Mankad, Mr. Vimarsh Munsif and Ms. Misbah Khairadi.

For detailed understanding or more information, send your queries to ***knowledge@kcmehta.com.***

Important Updates - MCA

Limited Liability Partnership (Amendment) Rules, 2024

Notification dated August 5, 2024

"Centre for Processing Accelerated Corporate Exit" (CPACE) as a process has been introduced for the dissolution of LLPs vide amendment to Rule 37 of the Limited Liability Partnership (LLP) Rules, 2009.

CPACE was initially constituted by MCA under section 396 of the Companies Act, 2013 in April 2023 to strike off of the companies in such a manner so as to remove human intervention in the process of strike off and make it faceless, fast, and efficient.

By integrating the CPACE into the LLP dissolution process, the Government has now aimed to provide a more streamlined and accelerated approach in winding up LLPs, on lines similar to that for dissolution of companies.

Applicability:

August 27, 2024

Companies (Adjudication of Penalties) Amendment Rules, 2024

Notification dated August 05, 2024

MCA vide notification through Companies (Adjudication of Penalties) Amendment Rules, 2024, inserted Rule 3-A which addresses the "*Adjudication Platform*" as follows:

1. All proceedings (including of issue of notices, filing replies or documents, evidence, holding of hearing, attendance of witnesses, passing of orders and payment of penalty) conducted by adjudicating officers and Regional Directors will be carried out electronically via the e-adjudication platform;
2. E-adjudication platform to be developed by the Central Government;
3. The adjudication notice / summons will be as prescribed below to a person without an e-mail of physical address:
    - Any person to whom a notice/ summon is to be issued but who does not have an e-mail address, the Officer will send the notice by postal mail to the last intimated address available in records.
    - In case, no address is available, a copy of the notice will be electronically archived on the E-adjudication platform.
4. The Annexure has been updated, and Form No. ADJ has been revised to reflect changes in the Memorandum of Appeal.

The shifting of Adjudication to electronic adjudication platform is expected to streamline the whole Adjudication process by making it more efficient and less cumbersome for companies, leading to reduced physical interaction and overall enhanced compliance and transparency.

Applicability

September 16, 2024

Companies (Indian Accounting Standards) Amendment Rules, 2024

Notification dated August 12, 2024

Central Government in consultation with National Financial Reporting Authority, hereby

Important Updates - MCA

makes the following rules further to amend the Companies (Indian Accounting Standards) Rules, 2015.

The primary amendment vide the said Rules notifies Indian Accounting Standards (AS) Ind AS 117 – Insurance Contracts which supersedes the extant Ind AS 104 Insurance Contracts.

With the notification of Ind AS 117, specific amendments have been made in Ind AS 101, Ind AS 103, Ind AS 105, Ind AS 107, Ind AS 109 and Ind AS 115 to replace reference to the superseded Ind AS 104.

The detailed Circular can be referred with link: https://www.mca.gov.in/bin/dms/getdocument?mds=4iwngdxt9oFj%252Bpp05r1EZA%253D%253D&type=open

Applicability: An entity shall apply Ind AS 117 for annual reporting periods beginning on or after 1 April 2024. Early adoption is permitted.

Companies (Registration of Foreign Companies) Rules, 2014

Notification dated August 12, 2024

Ministry of Corporate Affairs (MCA) vide this notification amended Rule 3 and Rule 8 of the Companies (Registration of Foreign Companies) Rules, 2024.

Below is a summary of the amendments:

1. Rule 3 sub-rule (3): A foreign company shall, within a period of thirty days of the establishment of its place of business in India, file with the **Registrar, Central Registration Centre** Form FC-1, accompanied by a fee and documents as provided in Section 380 of Companies (Registration offices and Fees) Rules, 2014.
2. Proviso to Rule 8 sub-rule (1) inserted: Provided that the documents for registration by a foreign company referred to in sub-rule (3) of rule (3) shall be delivered in Form FC-1 to the Registrar, Central Registration Centre.

With this amendment the Form FC-1 will now be processed centrally at the Central Registration Centre ("CRC"). CRC is an initiative of Ministry of Corporate Affairs ("MCA"), developed keeping in mind the specific objective of providing speedy incorporation related services in line with global best practices. The amendment will result in streamlining of the registration process for foreign companies.

Applicability

September 09, 2024

Important Updates - RBI

Coverage

Master Direction on Treatment of Wilful Defaulters and Large Defaulters

RBI/DoR/2024-25/122 DoR. FIN. REC. No. 31/20.16.003/2024-25 dated July 30, 2024

Cases of wilful and large defaulters have grown manifold with the exponential increase in business activity and economic development in India over the past two decades. To tackle such malafide borrowers with loans turning Non-Performing Assets ("NPAs"), Reserve Bank of India released guidelines for handling such wilful defaulters, way back in Yr. 1999. Thereafter a review of the said guidelines was undertaken and revisions introduced in the form of Master Circular on Wilful Defaulters in Yr. 2015. Nearly a decade later, the RBI has again undertaken a review of the extant instructions based of various judgments / orders passed by the Hon'ble Supreme Court and Hon'ble High Courts along with representations and suggestions received from banks and other stakeholders in light of the increased financial irregularities and frauds.

The primary objective for introduction of the new guidelines is to provide a clear and transparent process for classifying a borrower as wilful defaulter by the lenders. Once a borrower is declared as a wilful defaulter, a process has to be there to ensure that such information is shared with other lenders so as to prevent any further institutional finance to such defaulters.

Some of the salient features of the Master Direction are provided below:

- Definitions have been increased from merely 3 in the Master Circular to 21 in the Master Direction, defining the terms All India Financial Institution ('AIFI'), Bank, Borrower, Credit facility, Diversion of Funds, Large defaulter, Wilful default etc.
- Mechanism of identification and then classification of a person as 'wilful defaulter' has been put in place along with detailed procedure for determining a borrower as wilful, including review of accounts.
- Guidelines also provide for what are the measures that can be taken by the lenders against wilful defaulters, including legal recourse, publishing photographs of such defaulters and any other penal measures that can be initiated.
- Detailed action against guarantors and their liability in case of wilful default has also been provided in the guidelines.
- In addition to determination and actionable measures, mechanism has also been prescribed to disseminate credit information of large defaulters to ensure that other lenders are aware of such defaulters. This dissemination of information includes reporting on guarantors as well Directors in cases where Companies are in default.
- In addition, preventive measures prescribed include proper credit appraisal, monitoring end use of funds by regulated entities, statutory auditors' role in case of negligence or deficiency identified in conducting audit as well as reviewing the role of third parties involved in sanction and disbursement of loans.

Effective date: Immediate effect

Important Updates - RBI

Master Directions on Cyber Resilience and Digital Payment Security Controls for nonbank Payment System Operators

RBI/DPSS/2024-25/123 CO. DPSS. OVRST. No. S447/06-26-002/2024-25 dated July 30, 2024

Digital and online payments introduced in India have expanded exponentially especially with the COVID-19 pandemic accelerating and furthering its growth. However, such digital and online payment systems have brought with them some negatives as well in the form of online frauds and digital scams. To ensure a robust and healthy development of online payment and settlement systems, Reserve Bank of India issued draft Master Direction on proper governance and monitoring of cybersecurity for non-bank Payment System Operators ("PSOs") in June 2023 for comments from various stakeholders. RBI has already prescribed the necessary security controls for digital payment products and services offered by banks and credit card issuing NBFCs in the past.

On the basis of comments received from stakeholders, Reserve Bank of India has introduced the Master Direction on non-bank Payment System Operators.

Categorization on non-bank Payment System Operators:

- Clearing Corporation of India Limited (CCIL), National Payments Corporation of India (NPCI), NPCI Bharat Bill Pay Limited, Card Payment Networks, Non-bank ATM Networks, White Label ATM Operators (WLAOs), Large PPI Issuers, Trade Receivables Discounting System (TReDS) Operators, Bharat Bill Payment Operating Units (BBPOUs) and Payment Aggregators (PAs) are considered as **large non-bank PSOs**.
- Cross-border (in-bound) Money Transfer Operators under Money Transfer Service Scheme (MTSS) and Medium PPI Issuers are considered as **medium non-bank PSOs**.
- Small PPI Issuers and Instant Money Transfer Operators are considered as **small non-bank PSOs**.

Key Guidelines:

- Board of Directors ("Board") of the PSO to be responsible for ensuring adequate oversight over information security risks, including framing of Information Security ("IS") Policy.
- A Board approved Cyber Crisis Management Plan (CCMP) will have to be put in place to detect, contain and respond to cyber threats and attacks.
- Appointment of Chief Information Security Officer ("CISO") by the Board for implementation and continuous assessment of the IS policy.
- Maintaining a record of the key roles, information assets (applications, data, infrastructure, personnel, services, etc.), critical functions, processes and third-party service providers as part of data management.
- Setting up a Security Operations Centre ("SOC") protect its network and systems from external threats.
- Developing a Business Continuity Plan ("BCP") which will be based on different cyber threat scenarios, including extreme but plausible events to which the PSO may be exposed.
- Facilitating its members / participants to have mechanisms for online alerts based

on various parameters such as failed transactions, transaction velocity etc.

- Framing of adequate security measures for mobile and card payments, including device binding / finger printing of mobile applications, notifications for failed log-in or authentication attempts and also ensuring the card terminals installed at vendor / Point of sale ("POS") locations have requisite approval programs.

Implementation Timelines:

Regulated Entity	Timeline
Large non-bank PSOs	April 1, 2025
Medium non-bank PSOs	April 1, 2026
Small non-bank PSOs	April 1, 2028

Review of regulatory framework for HFCs and harmonization of regulations applicable to HFCs and NBFCs

RBI/2024-25/61 DOR. FIN. REC. No. 34/03.10.136/2024-25 dated August 12, 2024

Housing Finance Companies ("HFCs") have been governed by the provisions of National Housing Bank Act, 1987, though their primary business activity is similar to that of a Non-Banking Financial Company ("NBFC"). Recognizing the fact that a separate set of Rules and Regulations was governing HFCs which were primarily a form of financial institutions, the Reserve Bank of India came out with a Circular in Yr. 2020 to harmonize and migrate HFCs to NBFCs, thus discontinuing the governance of HFCs from National Housing Board Act, 1987 to the Reserve Bank of India Act, 1934.

Further to the harmonization undertaken in 2020, Reserve Bank of India have come out with revised regulations for overseeing HFCs and aligning them in line with provisions applicable to NBFCs.

Salient Features

Sr. No.	Particulars	Existing Provisions	Revised Provisions
1	Acceptance of Public Deposits	Prudential parameters for acceptance of public deposits by HFCs was more relaxed as compared to NBFCs.	Parameters as prescribed under *Master Direction – Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 2016* to become applicable.
2	Maintenance of % in Liquid Assets	Deposit taking HFCs were required to maintain 13 per cent liquid assets against public deposits.	To maintain on an ongoing basis, liquid assets to the extent of 15 per cent of the public deposits.
3	Repayment of Public Deposits	To accept or renew public deposits repayable after a period of 12 months or more but not later than 120 months from the date of acceptance or renewal of such deposits.	Public deposits accepted or renewed by HFCs to be repayable after a period of 12 months or more but not later than 60 months.

Important Updates - RBI

Coverage

Sr. No.	Particulars	Existing Provisions	Revised Provisions
4	Branches and appointment of Agents to collect deposits	No such regulations for appointment or collection of deposits by Agents.	To be governed by para 30 of *Master Direction – Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 2016.*
5	Restrictions on investment in unquoted shares	No restrictions	Deposit taking HFCs to frame Board approved internal limits within the overall limit of direct investment specified in *Master Direction – Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 2016.*
6	Participation in Currency Futures, Options and Interest Rate futures	No specific guidelines	All HFCs permitted to participate in currency futures and interest rate futures whereas non-deposit taking HFCs having asset size of 1000 cr. or more can participate in currency options.
7	Accounting Year	No specific guidelines for finalizing balance sheet, hence governed by general provisions applicable to all companies.	HFCs will have to finalize their balance sheets within 3 months from the date to which it pertains (i.e.) March 31
8	Guidelines for Acceptance of Public Deposits	No specific provisions	RBI has prescribed procedural guidelines including nomination, premature payment of deposits to small depositors, maintaining of register of deposits as well as providing guidance on periodic IS audits.

Effective date: January 01, 2025

Important Updates - RBI

Processing of e-mandates for recurring transactions

RBI/2024-25/64 CO. DPSS. POLC. No. S528/02-14-003/2024-25 dated August 22, 2024

E-mandate was introduced by Reserve Bank of India in Yr. 2019 keeping in view the changing payment needs and the fast acceptance of online and digital payments. E-mandate was permitted for all types of cards – debit, credit and Prepaid Payment Instruments (PPIs), including wallets, subject to a maximum permissible limit of INR 2,000/- for a transaction.

To make the e-mandate framework more robust and capture greater number of transactions, the following areas have been addressed vide this Circular:

- Issuer will have to send a pre-debit notification to every customer at least 24 hours prior to the actual charge / debit to the account.
- Auto-replenishment of balances in FASTag and National Common Mobility Card (NCMC) would be covered under the e-mandate framework. However, payments for auto-replenishment under both FASTag and NCMC will be exempt from the requirement of pre-debit notification.

Effective date: Immediate effect

Important Updates - SEBI

Amendment to Circular for mandating additional disclosures by FPIs that fulfil certain objective criteria

SEBI/HO/AFD/AFD-POD-2/P/CIR/2024/104 dated August 01, 2024

SEBI vide Circular No. SEBI/ HO/ AFD/ AFD-PoD-2/CIR/P/2023/148 dated August 24, 2023 mandated additional disclosures for Foreign Portfolio Investors ("FPIs") Granular details of all entities holding any ownership, economic interest, or exercising control in the FPI, on a full look through basis, up to the level of all natural persons.

However, FPIs with broad based, pooled structure and widespread investor base, ownership interest by Government or Government related investors, etc. which did not pose significant systemic risk were exempted from the stringent disclosure guidelines. Government and Government related investors registered as FPIs, Public Retail Funds ('PRFs') and Exchange Traded Funds (with less than 50% exposure to India and India related equity securities) and Entities listed on specified Exchanges were exempt.

SEBI vide this circular has included University Funds and University related Endowments from the exempt list of FPIs from additional disclosures, subject to fulfilment of certain criteria.

Applicability: Immediate effect

Valuation of Additional Tier 1 Bonds ("AT1 Bonds")

SEBI / HO / IMD / PoD1 / CIR / P / 2024 / 106 dated August 05, 2024

Additional Tier 1 ("AT1") bonds, as these instruments are popularly known, are a type of perpetual debt instrument that Banks use to augment their core equity base and so as to comply with Basel III norms. These bonds were introduced by the Basel accord after the global financial crisis of 2008 to protect depositors and have been used across the world to spruce up their balance sheet from time to time. AT1 bonds do not have a maturity date but come with a call option that permits the Banks to redeem these bonds after a certain period with a minimum maturity period of five (5) years.

National Financial Reporting Authority (NFRA) had observed that AT1 bonds were generally trading at prices closer to their Yield to Call (YTC) basis, so on NFRA's recommendation for market-based measurement under Ind AS 113, SEBI has permitted Mutual Funds to value the AT1 Bonds on Yield to Call basis.

For all other purposes, the maturity of all perpetual bonds (AT1 Bonds having no maturity date are considered as perpetual bonds) shall be treated as 100 years from the date of issuance of the bond for the purpose of valuation.

Mutual Funds which are the primary investors in such AT1 issues have been at loggerheads since the incident of Yes Bank in March 2020 when the Bank wrote down ₹8,425 crore AT1 bonds, instead of taking a hit on its equity. SEBI has added fuel to fire by flip flopping on the valuation norms for such AT1 bond issues but hopefully NFRA's guidelines will put an end to this debate.

Institutional mechanism by Asset Management Companies ("AMCs') for identification and deterrence of potential market abuse including front-running and fraudulent transactions in securities

Important Updates - SEBI

SEBI/HO/IMD/IMD-PoD-1/P/CIR/2024/107 dated August 05, 2024

In order to address instances of market abuse including front running and fraudulent transactions in securities, consultations were held with stakeholders for setting up an institutional mechanism to proactively identify and deter such market abuse.

AMCs have agreed to put in place an institutional mechanism which shall consist of enhanced surveillance systems, internal control procedures, and escalation processes such that the overall mechanism is able to identify, monitor and address specific types of misconduct, including front running, insider trading, misuse of sensitive information etc.

The key management personnel will be in charge of implementation of such mechanism wherein the AMCs will develop surveillance systems, preparing standard operating procedures ("SOPs"), action plan once such market abuse is detected along with escalation mechanism and intimation to exchanges and SEBI.

Association of Mutual Funds of India ("AMFI") in consultation with SEBI, circulated the SOPs with the AMCs in the last week of August 2024.

Applicability: SOPs were to be drafted and released within 15 days from date of Circular. The same have been circulated by AMFI to all the AMCs as per the timeline.

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

SEBI/HO/AFD/AFD-POD-1/P/CIR/2024/111 dated August 19, 2024

Securities and Exchange Board of India (Alternative Investment Funds) Regulations, 2012 ("AIF Regulations") were amended vide notification dated July 20, 2024, so as to provide flexibility to Venture Capital Funds ('VCFs') registered under the erstwhile SEBI (Venture Capital Funds) Regulations, 1996 ("VCF Regulations") to migrate to AIF Regulations and to avail the facility of dealing with unliquidated investments of their schemes upon expiry of tenure.

"Migrated Venture Capital Fund" would be registered under the AIF Regulations as a sub-category of Venture Capital Fund under Category I - Alternative Investment Fund.

Upon migration to AIF Regulations, the investors on-boarded, investments held and units issued by the VCF or scheme(s) of the VCF registered under VCF Regulations would be deemed to be that of the Migrated VCF or its scheme(s), under the AIF Regulations.

Guidelines have also been provided with respect to continuance of VCFs registered under the erstwhile VCF Regulations and have not opted for migration to AIF Regulations.

Furthermore, VCFs whose all schemes have been wound up or no investments have been made by the schemes of VCF but have not been wound up will not have the flexibility to opt for migration.

Applicability: Immediate effect

Guidelines for borrowing by Category I and Category II AIFs and maximum permissible limit for extension of tenure by LVFs

SEBI/HO/AFD/AFD-POD-1/P/CIR/2024/112 dated August 19, 2024

Important Updates - SEBI

Securities and Exchange Board of India (Alternative Investment Funds) (Fourth Amendment) Regulations, 2024 notified vide SEBI/LAD-NRO/GN/2024/198 dated August 06, 2024 had prohibited Category I and Category II Alternative Investment Funds ("AIFs") to borrow funds directly or indirectly or engage in any leverage for the purpose of making investments or otherwise, except for borrowing funds to meet temporary funding requirements and day-to-day operational requirements for not more than thirty days, on not more than four occasions in a year and not more than ten percent of the investable funds.

In a short span of less than two weeks, SEBI has revised its borrowing guidelines for AIFs by permitting Category I and Category II AIFs to borrow for the purpose of meeting temporary shortfall in amount called from investors for making investments in investee companies ('drawdown amount'), subject to thirty days cooling off period between two periods of borrowing.

Large Value Fund for Accredited Investors ("LVF") may extend its tenure up to five years subject to the approval of two-thirds of the unit holders by value of their investment in the LVF and the extension in tenure of any existing LVF scheme shall be subject to such conditions as may be specified by SEBI from time to time.

Applicability: Immediate effect

Cybersecurity and Cyber Resilience Framework ("CSCRF") for SEBI Regulated Entities ("REs")

SEBI/HO/ ITD-1/ITD_CSC_EXT/P/CIR/2024/113 dated August 20, 2024

To strengthen the cybersecurity measures in Indian securities market, and to ensure adequate cyber resiliency against cybersecurity incidents/ attacks, Cybersecurity and Cyber Resilience Framework ("CSCRF") for Regulated Entities ("REs") has been formulated in consultation with various stakeholders.

The main objective of CSCRF is to strengthen the security framework of the REs and secure the operations of the REs so as to withstand and recover from the shocks of cyber incidents.

CSCRF mandates all REs to establish appropriate security monitoring mechanisms through Security Operation Centre (SOC). SOC can be inbuilt by the REs or outsourced and provides for continuous monitoring of security events and timely detection of anomalous activities. NSE and BSE will be mandated to set up a Market SOC (M-SOC) with the objective of providing cybersecurity solutions to smaller REs who do not have the wherewithal to have an inbuilt SOC.

Annexure I forming part of the aforesaid Circular provides detailed guidelines on Cybersecurity and Cyber Resilience Framework (CSCRF) for SEBI Regulated Entities (REs), including categorization of REs, setting up of IT Committees, Compliance, Audit reporting and submission timelines along with Objectives and Standards.

Contributed by

Ms. Darshana Mankad, Mr. Nitin Dingankar, and Ms. Kajol Babani

For detailed understanding or more information, send your queries to ***knowledge@kcmehta.com***

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For further analysis and discussion, you may please reach out to us.

Locations

Ahmedabad

Arpit Jain
Level 11, Tower B,
Ratnaakar Nine Square,
Vastrapur,
Ahmedabad - 380 015

Phone: + 91 79 4910 2200
arpit.jain@kcmehta.com

Bengaluru

Dhaval Trivedi
4/1, Rudra Chambers, First Floor, 4th Main, B/W 8th & 9th Cross Road, Malleshwaram,
Bengaluru - 560 003

Phone: +91 99983 24622
dhaval.trivedi@kcmehta.com

Mumbai

Bhadresh Vyas
315, The Summit Business Bay,
Nr. WEH Metro Station,
Gundavali, Andheri East,
Mumbai – 400 069

Phone: +91 22 2612 5834
bhadresh.vyas@kcmehta.com

Vadodara

Milin Mehta
Meghdhanush,
Race Course,
Vadodara - 390 007

Phone: +91 265 2440 400
milin.mehta@kcmehta.com

Independent Member kcm NETWORK

Abbreviations

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Abbreviation	Meaning
AA	Advance Authorisation
AAR	Authority of Advance Ruling
AAAR	Appellate Authority of Advance Ruling
AAC	Annual Activity Certificate
AD Bank	Authorized Dealer Bank
AE	Associated Enterprise
AGM	Annual General Meeting
AIR	Annual Information Return
ALP	Arm's length price
AMT	Alternate Minimum Tax
AO	Assessing Officer
AOP	Association of Person
APA	Advance Pricing Arrangements
AS	Accounting Standards
ASBA	Applications Supported by Blocked Amount
AY	Assessment Year
BAR	Board of Advance Ruling
BEAT	Base Erosion and Anti-Avoidance Tax
CBDT	Central Board of Direct Tax
CBIC	Central Board of Indirect Taxes and Customs
CCA	Cost Contribution Arrangements
CCR	Cenvat Credit Rules, 2004

Abbreviation	Meaning
CESTAT	Central Excise and Service Tax Appellate Tribunal
CGST Act	Central Goods and Service Tax Act, 2017
CIT(A)	Commissioner of Income Tax (Appeal)
COO	Certificate of Origin
Companies Act	The Companies Act, 2013
CPSE	Central Public Sector Enterprise
CSR	Corporate Social Responsibility
CTA	Covered Tax Agreement
CUP	Comparable Uncontrolled Price Method
Customs Act	The Customs Act, 1962
DFIA	Duty Free Import Authorization
DFTP	Duty Free Tariff Preference
DGFT	Directorate General of Foreign Trade
DPIIT	Department of Promotion of Investment and Internal Trade
DRP	Dispute Resolution Panel
DTAA	Double Tax Avoidance Agreement
ECB	External Commercial Borrowing
ECL	Electronic Credit Ledger
EO	Export Obligation
EODC	Export Obligation Discharge Certificate

Abbreviation	Meaning
EPCG	Export Promotion Capital Goods
FEMA	Foreign Exchange Management Act, 1999
FII	Foreign Institutional Investor
FIFP	Foreign Investment Facilitation Portal
FIRMS	Foreign Investment Reporting and Management System
FLAIR	Foreign Liabilities and Assets Information Reporting
FPI	Foreign Portfolio Investor
FOCC	Foreign Owned and Controlled Company
FTC	Foreign Tax Credit
FTP	Foreign Trade Policy 2015-20
FTS	Fees for Technical Service
FY	Financial Year
GAAR	General Anti-Avoidance Rules
GDR	Global Depository Receipts
GMT	Global Minimum Tax
GILTI	Global Intangible Low-Taxed Income
GSTN	Goods and Services Tax Network
GVAT Act	Gujarat VAT Act, 2006
HSN	Harmonized System of Nomenclature
IBC	Insolvency and Bankruptcy Code, 2016

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Abbreviation	Meaning
ICDS	Income Computation and Disclosure Standards
ICDR	Issue of Capital and Disclosure Requirements
IEC	Import Export Code
IIR	Income Inclusion Rule
IMF	International Monetary Fund
IRP	Invoice Registration Portal
IRN	Invoice Reference Number
ITC	Input Tax Credit
ITR	Income Tax Return
IT Rules	Income Tax Rules, 1962
ITAT	Income Tax Appellate Tribunal
ITR	Income Tax Return
ITSC	Income Tax Settlement Commission
JV	Joint Venture
LEO	Let Export Order
LIBOR	London Inter Bank Offered Rate
LLP	Limited Liability Partnership
LOB	Limitation of Benefit
LODR	Listing Obligations and Disclosure Requirements
LTA	Leave Travel Allowance
LTC	Lower TDS Certificate

Abbreviation	Meaning
LTCG	Long term capital gain
MAT	Minimum Alternate Tax
MCA	Ministry of Corporate Affairs
MeitY	Ministry of Electronics and Information Technology
MSF	Marginal Standing Facility
MSME	Micro, Small and Medium Enterprises
NCB	No claim Bonus
OECD	The Organization for Economic Co-operation and Development
OM	Other Methods prescribed by CBDT
PAN	Permanent Account Number
PE	Permanent establishment
PPT	Principle Purpose Test
PSM	Profit Split Method
PY	Previous Year
QDMTT	Qualified Domestic Minimum Top-up Tax
RA	Regional Authority
RMS	Risk Management System
ROR	Resident Ordinary Resident
ROSCTL	Rebate of State & Central Taxes and Levies
RoDTEP	Remission of Duties and Taxes on Exported Products

Abbreviation	Meaning
RPM	Resale Price Method
SC	Supreme Court of India
SCN	Show Cause Notice
SDS	Step Down Subsidiary
SE	Secondary adjustments
SEBI	Securities Exchange Board of India
SEP	Significant economic presence
SEZ	Special Economic Zone
SFT	Specified Financial statement
SION	Standard Input Output Norms
SOP	Standard Operating Procedure
ST	Securitization Trust
STCG	Short term capital gain
SVLDRS	Sabka Vishwas (Legacy Dispute Resolution Scheme) 2019
TCS	Tax collected at source
TDS	Tax Deducted at Source
TNMM	Transaction Net Margin Method
TP	Transfer pricing
TPO	Transfer Pricing Officer
TPR	Transfer Pricing Report
TRO	Tax Recovery Officer
UTPR	Undertaxed Profits Rules
u/s	Under Section
WOS	Wholly Owned Subsidiary