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A Monthly Journal of
THE CHAMBER OF TAX CONSULTANTS

Estd. 1926
ज्ञानं परमं बलम्

THE CHAMBER'S JOURNAL

Your Monthly Companion on Tax & Allied Subjects

Vol. XIII | No. 4 | January 2025

Directors - Role, Responsibilities & Risks

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Glimpses of the 3rd RRC on FEMA 2024 held on 20th – 22nd December 2024 at Novotel, Ahmedabad, Gujarat organised by the International Taxation Committee

Dignitaries at the Inaugural Function

Release of Publication "Doing Business outside India"

CA Vijay Bhatt (President) giving his opening remark

CA Karishma Phatarphekar (Chairperson) welcoming the speakers and the delegates

Dr. Anup Shah addressing the Delegates

CA Atul Mittal addressing the Delegates

Mr. Moin Ladha, Solicitor addressing the Delegates

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THE CHAMBER'S JOURNAL

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From the Editor's Desk

My Brothers and Sisters,

At the outset, my best wishes to all of you for a happy, prosperous, successful and tranquil 2025. As the celebrated management guru, **Tom Peters** has said:

"Celebrate what you want to see more of."

We would like to see the world, and indeed our Motherland, achieve new highs in terms of growth (except population growth), happiness all around, no natural calamities, no outbreak of any diseases or viruses and tranquility in terms of no war between nations. Therefore, let us start this year with optimism, hope and a positive outlook and we hopefully will see what we want to see more of, this year.

As we look back on 2024, we would like to pay our tribute to two persons who significantly influenced their area of working and who left us in the month of December 2024, Dr. Manmohan Singh, noted economist, politician and former Prime Minister and Shri Zakir Hussain, renowned tabla player, composer, percussionist, music producer, and film actor who was known for bringing Indian classical music to a global audience. We deeply mourn their passing away and recognise the void that they have left behind.

Looking forward, at the Chamber also, we are geared up for the new year with a spate of activities and our preparation for ensuing centenary year are in full swing. The Journal also, in March 2025, will complete 50 glorious years, a milestone to be celebrated. Watch this space for more on these exciting initiatives.

Its less than a month to go for the Budget to be presented before Parliament, the second budget of this present Government, after the elections April – June 2024. The hope is we see the first steps towards ease of taxpayers' concerns, simple, clear provisions with detailed explanation as to their meaning in the Memorandum explaining the provisions of the Finance Bill. One peeve that I, in particular, have is the lack of precision when it comes to using language, in the explanatory memorandum and the use of incorrect grammar. Let's hope that, at least gets addressed this time around.

In recent times, the roles and indeed, the responsibilities of directors of companies have been in greater focus. Many of us professionals are also directors in companies, be it those who run these companies or those who hold independent director positions therein. This month's issue titled, "Directors – Role, Responsibilities and Risks" will be of help to them to understand these better, get an awareness of the laws they need to watch out for, for compliance as also for managing risk, give them a perspective of learned authors as well as for other readers, give them the right perspective on what to watch out for, if someone comes to them for guidance. An issue like this, which covers the complex subject with precision, will, I am sure be useful to one and all. My compliments to the Journal Committee for coming out with this insightful issue, particularly Ms Vinita Krishnan and Mr Simachal Mohanty. My grateful thanks to all the learned authors who provided their useful insights by way of excellent articles.

I would like to end this communication with a sentence that John Andrew Holmes, former US representative and senator, has said, and is one which we should always keep in mind.

> *"It is well to remember that the entire universe, with one trifling exception, is composed of others."*

Hope you will appreciate why this month's communication is short!

ANISH M. THACKER
Editor

From the President

Dear Members,

Wishing a very Happy New Year to each one of you and to your dear ones.

For the Chamber, the dawn of 1st January, 2025 was very special, as we are just six months from that magical moment of the commencement of the 100th Year.

The New Year always brings hope, determination & new ideas for future endeavors. The Foundation for 100th year celebration has already been laid down and we are fast moving in the direction of fulfilling our dream year.

The year ended on a high note for the Chamber as the 3rd FEMA RRC at Novotel, Ahmedabad was well attended by 155 Delegates from 19 cities across India. My gratitude to all the delegates for their interactive participation during the RRC. I express my sincere thanks to all the esteemed faculty members, who shared their vast knowledge and experience on FEMA for enriching our delegates. I take this opportunity to congratulate International Taxation Committee Chairperson, CA Karishma Phatarphekar & her team for meticulously organizing the FEMA RRC.

I congratulate the Research & Publication Committee Chairman, CA Ashok Mehta for a timely release of the Publication "Doing Business outside India" during the FEMA RRC at Ahmedabad. I also acknowledge the untiring efforts by the author CA Paresh P. Shah, the Chairman of International tax Journal Committee in preparing this publication within a short span of time.

The New Year 2025 has also started with a two day course on M & A by the Student Committee jointly with Pravin Gandhi College of Law at Vile Parle, Mumbai, wherein 81 participants enrolled, including a few from out of Mumbai. I am thankful to the Principal Dr. Navasikha Duara, Vice Principal Dr. Suman Kalani and their organizing team for their whole hearted support to the joint event. I congratulate Student Committee Chairperson Adv. Niyati Mankad and her team for the successfully executing the M & A Course.

The Student Committee has organized "Indirect Tax Moot Court Competition jointly with the ILS Law College, Pune, 2025. The preliminary rounds will be online in January,2025. The final round will be conducted physically on 8th February, 2025 at ILS Law College, Pune. I appeal to all the members to encourage their students to participate in this unique event.

The Membership & Public Relations Committee has organized Self Awareness Series for the first time jointly with the Bombay Chartered Accountants' Society on 22nd January, 2025 virtually on the topic "Managing Challenges in Profession today : Gita's Perspective". The Speaker will be Respected Swami Shri Swatmanand ji of Chinmaya Mission. The session will be moderated by CA Mukesh Trivedi, who is active member of Chinmaya Mission. I encourage all the members, their families and the students to attend this unique session for self awareness.

Last month, the Direct Tax committee organized a Webinar Series on understanding Capital Gains from a Tax Lens. Also, the Commercial & Allied Law Study Circle, Hyderabad Study Circle, Pune Study Group & Delhi Chapter organized various study circle meeting for the benefit of the members.

I am sure you all must be eagerly awaiting the Finance Bill, 2025 in February, 2025. We hope to see simplified Income Tax Act as visualized by our Honorable Finance Minister Smt. Nirmala Sitharaman ji.

This month's Journal's Special Story is on the important subject "Directors – Role, Responsibilities and Risks". I thank the Editorial Board, the Journal Committee and CA Ameya Kunte, Chairman and his team for selecting this topic especially in view of growing responsibilities of Directors under the Companies Act. I thank all the authors for their efforts for our members with special mention of Ms Vinita Krishnan and Mr Simachal Mohanty for their hard efforts.

The Chamber's Journal is reaching the milestone of 50 years in March, 2025. I urge readers to spread the word about the Journal among their professional colleagues and help the CTC in spreading knowledge.

Before I conclude, let me offer my humble tribute to the two of the renowned personalities, who left this world for the eternal heavenly journey. Dr, Manmohan Singh, the Former Prime Minister of India & a great Economist, passed away on 26th December, leaving behind his marks of his vast contribution to the Indian Economy. Ustad Zakir Hussain, the legendary Tabla Maestro, who carried Indian Classical Music to the Global Audience, suddenly expired on 15th December at the age of only 73 years, with many bits of **"ताल" (Rhythm)** remaining unexplored within him. His ***"Waah Ustaad"*** brand will remain forever in the hearts of the music lovers. Both were held in very high esteem, not only in India, but also in the entire world.

Jai Hind !

VIJAY BHATT
President

An Overview of the Concept of Directors

Mr. Shridhar Kulkarni

Overview

Under the Companies Act, 2013, directors have an important role in managing a company with an additional responsibility of ensuring compliance with legal obligations. They perform the role as a fiduciary and at the same time have to protect the interest of the shareholders in the journey of taking the company's business to newer heights and directions.

This also brings up a variety in their roles and accordingly the Act has given flexibility in selecting various categories for appointment of persons as directors, including executive, non-executive, independent, alternate, and additional directors.

While there are varied ways of appointment of Directors, it is pertinent to note that shareholders are the supreme authority to approve or disapprove the appointment of directors.

Directors are entrusted with responsibilities, including acting in good faith, avoiding conflicts of interest, and exercising due diligence. While a director has rights, he has obligations to fulfill as well, which if not done, results in vacation of office, including removal of the director in certain circumstances.

The Act ensures directors' accountability while protecting their authority, balancing corporate governance and operational flexibility. The note explains all this in much detail.

1. Definition

Pursuant to Section 2 (34) of the Companies Act, 2013, a 'director' means a person appointed to the Board of a company to perform the duties and functions of a director in accordance with the provisions of the Companies Act, 2013.

2. Types of Directors

Sl. No.	***Particulars***	***Requirements/Conditions***	***Appointing authority***	***Tenure***
1.	Additional Director (AD)	• Appointment should be subject to approval of the Articles of Association (AOA). • Any person who has been appointed otherwise than at a general meeting is an Additional Director. • Person who fails to get appointed as a Director in the shareholders meeting cannot be appointed as an AD.	Board of Directors	Upto upcoming Annual General Meeting or last date on which AGM should have been held
2.	Alternate Director	• Appointment should be subject to approval of the Articles of Association (AOA). • Appointed to act as an alternate for a director during the original director's absence from India for a period of not less than three months. • Alternate Director for an Independent Director can be appointed only if he is qualified to be appointed as an Independent Director.	Board of Directors, subject to provisions of AOA or where AOA does not authorize Board, in a general meeting by ordinary resolution.	Till the director in whose place, he has been appointed returns to India or when the term of such director in whose place he is appointed expires, whichever earlier
3.	Nominee Director	• Nominated by an institution in pursuance of the provisions of any law for the time being in force or an agreement or by the Central Government or the State Government by virtue of its shareholding in a Government company.	Board of Directors, subject to provisions of AOA	Upto removal by the authority which appointed them.
4.	Independent Director (ID)	• An "independent director" means an independent director referred to in sub-section 149(6), which prescribes multiple conditions for such person to be eligible for appointment as ID.	Members through an ordinary resolution, subject to	Maximum 5 years

Sl. No.	**Particulars**	**Requirements/Conditions**	**Appointing authority**	**Tenure**
		• Reappointment – Special resolution by members and an explanatory statement of the meeting shall justify the reasons for choosing such person for appointment • Section 149 of the Companies Act, 2013 mentions multiple conditions for a person being eligible to be appointed as an ID from the perspective of such a person being an unrelated party. • Schedule IV of the Companies Act, 2013 prescribes a Code for Independent Directors, which provides guidelines for professional conduct, duties, roles and functions etc. • Company may select an independent director from a data bank maintained by the Indian Institute of Corporate Affairs (IICA) with details of persons who are eligible and willing to act as independent Directors.	provisions of AOA	
5.	Small shareholder Director (SSD)	• Applicable to listed Companies upon receipt of a request from a prescribed number of small shareholders of the Company or suo moto. • Small shareholders are those holding shares of nominal value of not more than twenty thousand rupees. • Appointment shall be proposed, upon receipt of notice from a minimum one thousand small shareholders or one-tenth of the total number of such shareholders, whichever is lower.	Board of Directors (where suo moto) Small shareholders (by ordinary resolution)	

Sl. No.	*Particulars*	*Requirements/Conditions*	*Appointing authority*	*Tenure*
6.	Managing Director (MD)	• A Director who is entrusted with substantial powers of management of the affairs of the company. • Minimum age – 21 years Maximum age – 70 years • Where the appointment is of a person who has attained the age of seventy years, it may be made by passing a special resolution and explanatory statement of meeting shall mention the justification for appointing such person.	Public Companies – by shareholders through an ordinary resolution Private Companies – by the Board of Directors	Maximum 5 years Can be reappointed within a maximum one year prior to the expiry of his term.
7.	Whole Time Director (WTD)	• "Whole-time director" includes a director in the whole-time employment of the company.	Board of Directors	Maximum 5 years Can be reappointed within a maximum one year prior to the expiry of his term.
8.	Executive Directors	• Participate in the day-to-day affairs of the Company and are entrusted with the responsibility of managing and running the company's business. • As per Rule 2(1)(k) of the Companies (Specification of definitions details) Rules, 2014 'Executive Director' means a Whole Time Director as defined in clause (94) of section 2 of the Act. The 'whole-time director' definition as per the said section states that a whole-time director includes a director in the whole-time employment of the company.	Dependent upon designation at the time of appointment	Dependent upon designation at the time of appointment

Sl. No.	*Particulars*	*Requirements/Conditions*	*Appointing authority*	*Tenure*
		• Are usually full-time employees of the company, also.		
9.	Non-executive director	• Director who is not part of the executive team. • Does not engage in the day-to-day management of the organization but is involved in policy making and planning exercises.	Depends on designation at the time of appointment	Dependent upon designation at the time of appointment
10.	Resident Director	• Who has stayed in India for a total period of not less than one hundred and eighty-two days during the financial year. • In case of a newly incorporated company, the number of days shall be calculated proportionately at the end of the financial year in which it is incorporated. Example: Date of incorporation of the company: December 1, 2023 Number of days from December 1, 2023 to March 31, 2024: 122 days Total number of days in the financial year: 366 days Number of days for determining residency shall be calculated as: 182*122/366 = 61 days Hence director should have resided in India for at least 61 days from December 1 , 2023 to March 31, 2024.	NA	NA

3. Rights of Directors

i. Responsible for the overall management of the Company.

ii. Receive notice of the Board Meeting.

iii. Participate and vote in the meeting of the Board of Directors

iv. Inspect the minutes of the Board Meeting.

v. Elect the Chairman of the Board Meeting.

vi. Recommend dividend to be paid to Shareholders.

vii. Sign Financial Statements of the Company.

viii. Issue notice of Board Meeting and General Meeting.

ix. Appoint Additional, Alternate Directors, Nominee Directors or Directors in casual vacancy.

x. Inspection of books of accounts.

xi. Undertake all actions mentioned in section 179 of the Companies Act, 2013 including but not limited to borrowing money, investing funds of the Company, approving financial statements and Board's report, issuing securities, subject to compliance with the respective provisions of the Companies Act, 2013.

4. Appointment/Reappointment of Directors

i. Requirement of Director Identification Number ("DIN") and consent in form DIR-2

ii. A person can be appointed as a director by two modes – initial appointment by the Board subject to the approval of members in general meeting or directly by the members.

a. Initial appointment by the Board - first appointed as Additional Director, whose term is till the next annual general meeting, and then appointed as a 'director' by the members in a general meeting.

b. The second mode is direct appointment as a 'director' by members.

iii. Board resolution is required in case of any change in designation Example - Change in executive to non-executive or vice versa.

5. Appointment of Managing Director (MD), Wholetime Director (WTD)

i. A Managing Director ("MD") is defined as, a director who, by virtue of the articles of a company or an agreement with the company or a resolution passed in its general meeting, or by its Board of Directors, is entrusted with substantial powers of management of the affairs of the company and includes a director occupying the position of managing director, by whatever name called.

ii. Since an MD is entrusted with whole and substantially whole of powers of the Management of affairs of the Company and a Manager cannot be entrusted with such powers simultaneously, a Company cannot appoint an MD and a *Manager at the same time.

(*The Companies Act, 2013 defines a Manager as, an individual who, subject to the superintendence, control and direction of the Board of Directors, has the management of the whole, or substantially the whole, of the affairs of a company, and includes a director or any other person occupying the position of a manager, by whatever name called, whether under a contract of service or not)

iii. Eligibility conditions for appointment of MD or WTD:

a. Minimum 21 years of age upto attainment of 70 years

b. Resident of India (for appointment as MD and WTD, resident in India includes a person who has been staying in India for a continuous period of not less than twelve months immediately preceding the date of such appointment and who has come to stay in India,

1. for taking up employment in India; or

2. for carrying on a business or vocation in India

and in case such person is a non-resident he shall enter India only after obtaining a proper Employment Visa for which he shall furnish along with the visa application form profile of the company, the principal employer and terms and conditions of such person's appointment.

c. A person who has attained the age of seventy years may be appointed as MD or WTD,

1. by passing a special resolution by the members and an explanatory statement of such meeting shall mention the justification for appointing such person OR

2. Where no special resolution can be passed but votes cast in favour of the motion exceed the votes, if any, cast against the motion and the Central Government is satisfied, on an application made by the Board, that such appointment is most beneficial to the company, the appointment of the person who has attained the age of seventy years may be made

3. not been sentenced to imprisonment for any period, or to a fine exceeding one thousand rupees, for the conviction of an offence under any of the Acts specified in Schedule V and Central government approval has been obtained for such initial appointment

4. had not been detained for any period under the Conservation of Foreign Exchange and Prevention of Smuggling Activities Act, 1974 and Central government approval has been obtained for such initial appointment

In case of conditions (3) and (4) above, no further approval of the Central Government shall be necessary for the subsequent appointment of that person if he had not been so convicted or detained subsequent to such approval.

iv. Conditions making a person ineligible for appointment as MD or WTD:

a. is an undischarged insolvent or has at any time been adjudged as an insolvent;

b. has at any time suspended payment to his creditors or makes, or has at any time made, a composition with them; or

c. has at any time been convicted by a court of an offence and sentenced for a period of more than six months.

6. Resignation/Removal/Retirement by Rotation/Vacation of Office of Director

a. Resignation

By giving a notice in writing to the company and resignation shall take effect from the date on which the notice is received by the company or the date, if any, specified by the director in the notice, whichever is later. The Company may provide an acknowledgement of receipt of notice, once received or take note of resignation in a Board meeting. The receipt of the notice of resignation by the Company, can be ensured by the Director, by sending the notice of resignation through official means of communication which can substantiate the receipt, for example, by way of registered post with an acknowledgement due, or by way of an email activating read receipt etc.

Where a director resigns from his office, he may within a period of thirty days from the date of resignation, forward to the Registrar a copy of his resignation along with reasons for the resignation in Form DIR-11.

b. Removal of Director

i. By Ordinary resolution in general meeting after giving reasonable opportunity to the respective director, of being heard, subject to provisions of Articles of Association.

ii. The process involves the furnishing of special notice by the members of the Company holding a specified minimum amount of share or voting power as on date of the notice.

iii. The director who was removed from office shall not be re-appointed as a director by the Board of Directors.

Exception: The Independent Director reappointed shall be removed by the company only by passing a special resolution by the members and after giving him a reasonable opportunity of being heard.

c. By Retirement by rotation – (Applicable only to Public Company)

i. Unless the articles provide for the retirement of all Directors at every annual general meeting, not less than 2/3rd directors are liable to retire by rotation and 1/3rd are liable to retire at every general meeting after the meeting. [excluding Independent Director, nominee directors and small shareholder director].

ii. The Directors to retire by rotation at every annual general meeting shall be those who have been longest in office since their last appointment.

iii. Such a person can be reappointed at the annual general meeting at which he/she retires

Example: No. of Directors on the Board = 9

Liable to retire by rotation: 2/3 of 9 = 6

Liable to retire at every AGM: 1/3 of 6 = 2

d. ***Vacation of office of Director***

The office of a director shall become vacant in case –

i. Any of the disqualifications detailed hereinafter, are incurred.

ii. Absent himself from all the meetings of the Board of Directors held during a period of immediately preceding twelve months.

iii. Contravenes provisions of section 184 relating to entering into contracts or arrangements in which he is directly or indirectly interested or fails to disclose his interest under the said section. – Refer Annexure A

iv. Is disqualified by an order of a court or the Tribunal

v. Is convicted by a court of any offence, whether involving moral turpitude or otherwise and sentenced in respect thereof to imprisonment for not less than six months

vi. A private company may, by its articles, provide any other ground for the vacation of the office of a director in addition to those specified above.

In case of point (iv) and (v) above, the office shall not be vacated:

a. for thirty days from the date of conviction or order of disqualification;

b. where an appeal or petition is preferred within thirty days as aforesaid against the conviction resulting in sentence or order, until expiry of seven days from the date on which such appeal or petition is disposed of; or

c. where any further appeal or petition is preferred against the order or sentence within seven days, until such further appeal or petition is disposed of.

e. ***Disqualification***

i. Less than 18 years of age

ii. Does not possess DIN

iii. Person of unsound mind, declared as such by the competent court

iv. Is an undischarged insolvent

v. Has been adjudicated or made an application to be adjudicated as an insolvent and such application is pending

vi. Convicted by a court of any offence and sentenced to imprisonment for not less than six months and a period of five years has not elapsed from the date of expiry of the sentence.

vii. In case of a sentence of imprisonment of seven years or more, such person shall not be eligible to be appointed as a director in any company;

viii. An order disqualifying him for appointment as a director has been passed by a court or Tribunal and the order is in force;

ix. Has not paid any calls in respect of any shares of the company held by him, whether alone or jointly, and six months have elapsed from the last day fixed for the payment of the call;

x. Is convicted of the offence dealing with related party transactions under section 188 at any time during the preceding five years; or

xi. He is already a Director in 20 companies, including alternate directorship but excluding directorships in dormant companies, of which maximum 10 companies can be public,

xii. Such person has been a director of a company which—

  a. has not filed financial statements or annual returns for any continuous period of three financial years; or

  b. has failed to repay the deposits accepted by it or pay interest thereon or to redeem any debentures on the due date or pay interest due thereon or pay any dividend declared and such failure to pay or redeem continues for one year or more,

  c. shall be eligible to be re-appointed as a director of that company or appointed in other company for a period of five years from the date on which the said company fails to do so.

xiii. In case the person seeking appointment is a national of a country which shares land border with India and has not obtained necessary security clearance from the Ministry of Home Affairs, Government of India.

xiv. A private company may by its AOA provide for any disqualifications for appointment as a director in addition to those specified above, which if not met disqualify the director from appointment.

7. Remuneration of Directors

Under the Companies Act, 2013, “remuneration” means any money or its equivalent given or passed to any person for services rendered by him and includes perquisites as defined under the Income-tax Act, 1961.

i. Private Companies -

In case of private companies, there is no cap on maximum remuneration payable to Directors and payment of remuneration shall be approved by the Board of Directors, subject to the monetary limits mentioned in the Articles of Association, if any.

ii. Public Companies -

Subject to the provisions of the Articles of Association,

a. Total managerial remuneration payable shall not exceed eleven percent of the net profits of that company for that financial year computed in the manner laid down in section 198 of the Companies Act, 2013, such 11% can be exceeded subject to the approval of members by ordinary resolution.

b. The act also caps maximum remuneration payable to any one managing director; or whole-time director or manager and to other Directors, the limit for which can be increased vide a special resolution.

c. Above remuneration shall exclude sitting fees paid to Directors for attending meetings of the Board or committees thereof and fees for services rendered in a professional capacity.

d. Where the Company has no profits or inadequate profits the remuneration shall be paid only in compliance with Part II of Schedule V of the Act, summarized in Annexure B.

e. In cases where Schedule V is applicable on grounds of no profits or inadequate profits, any provision relating to the remuneration of any director which purports to increase or has the effect of increasing the amount thereof, irrespective of the manner in which and authority by whom it is approved, shall not have any effect unless such increase is in accordance with the conditions specified in that Schedule.

f. Compliance with the relevant provisions above is to be reported in the auditor's report.

The Companies Act, 2013 provides significant powers to the shareholders in relation to the approval of Director remuneration beyond prescribed limits.

8. Procedural aspects under the Companies Act, 2013 and relevant rules thereunder:

i. DIR 3 – Application for Director Identification Number (DIN)

ii. DIR 12 – To be filed within 30 days of event, by the Company, for:

  a. Appointment (Director, Additional Director, Alternate Director, Nominee Director, Managing Director, Wholetime Director, Director appointed in casual vacancy)

  b. Cessation (Removal, Resignation, Death, Disqualification, Vacation of office)

  c. Change in Designation

  d. Appointment due to disqualification of all Directors – appointment of new director due to vacation of office by all existing Directors

iii. DIR 3 KYC (Form/Web) - This form is filed annually on or before September 30, to verify the personal details of Directors filed with the Ministry of Corporate Affairs (MCA) at the time of DIN application. Where there is a change in contact details of Directors (Mobile/Email) form DIR-3 KYC is filed, whereas where there is no change in details, DIR-3 KYC Web is filed.

iv. DIR 6 – Filed for reporting change in particulars excluding contact details i.e. mobile number and email ID of Directors, reported to MCA. within 30 days of such change.

v. DIR 11 (Optional) – To be filed within 30 days from date of resignation, by the Director, for reporting his/her resignation to the Registrar of Companies. In case of a foreign director, such director may authorise in writing a practicing chartered accountant or cost accountant in practice or company secretary in practice or any other resident director of the company to sign Form DIR-11 and file the same on his behalf intimating the reasons for the resignation.

vi. MR-1 - (Public Company) – Within sixty days of the appointment of Managing Director, Whole Time Director or Manager.

vii. MGT-14 – Board resolution or agreement executed by a company, relating to the appointment, re-appointment, or variation of the terms of appointment, of a managing director;

Annexure A
Provision of disclosure of interest by Director under Section 184 of the Companies Act, 2013

1. Every director shall:

   a. at the first meeting of the Board in which he participates as a director and

   b. at the first meeting of the Board in every financial year or

   c. whenever there is any change in the disclosures already made, then at the first Board meeting held after such change,

disclose his concern or interest in any company or companies or bodies corporate, firms, or other association of individuals which shall include the shareholding, in Form MBP-1.

2. Every director of a company who is in any way, whether directly or indirectly, concerned or interested in a contract or arrangement or proposed contract or arrangement entered into or to be entered into—

   a. with a body corporate in which such director or such director in association with any other director, holds more than two percent shareholding of that body corporate, or is a promoter, manager, Chief Executive Officer of that body corporate; or

   b. with a firm or other entity in which, such director is a partner, owner or member, as the case may be,

shall disclose the nature of his concern or interest at the meeting of the Board in which the contract or arrangement is discussed and shall not participate in such meeting. (in the case of a private company, such director may participate in the meeting after disclosure of interest)

Where any director becomes concerned or interested after the contract or arrangement is entered into, he shall disclose his concern or interest forthwith when he becomes concerned or interested or at the first meeting of the Board held after he becomes so concerned or interested.

3. A contract or arrangement entered into by the company without disclosure or with participation by a director who is concerned or interested in any way, directly or indirectly, in the contract or arrangement, shall be voidable at the option of the company.

Annexure B
Provisions of Part II of Schedule V
of the Companies Act, 2013

Remuneration payable by companies having profits:

1. A public company having profits in a financial year may pay remuneration to a managerial person or persons or other director not exceeding the limits specified, as illustrated above in Point 7 relating to remuneration.

2. For the purpose of this schedule, other director shall mean a non-executive director or an independent director.

Remuneration payable by companies having no profit or inadequate profit:

1. Where in any financial year during the tenure of a managerial person, or other director, a company has no profits or its profits are inadequate, it may, pay remuneration to the managerial person or other director not exceeding the limits below: -

Sl. No.	***Where the effective capital (in rupees) is***	***Limit of yearly remuneration payable shall not exceed (in Rupees) in case of a managerial person***	***Limit of yearly remuneration payable shall not exceed (in rupees) in case of other director***
1.	Negative or less than 5 crores.	60 lakhs	12 lakhs
2.	5 crores and above but less than 100 crores.	84 lakhs	17 lakh
3.	100 crores and above but less than 250 crores.	120 lakhs	24 lakh
4.	250 crores and above.	120 lakhs plus 0.01% of the effective capital in excess of Rs.250 crores	24 Lakhs plus 0.01% of the effective capital in excess of Rs.250 crores:

2. Effective Capital is calculated (as on the last date of the financial year preceding the financial year in which the appointment of the managerial person is made) as, the aggregate of:

   i. Paid-up share capital (excluding share application money or advances against shares);

   ii. Any credit balance in the share premium account;

   iii. reserves and surplus (excluding revaluation reserve);

   iv. long-term loans and deposits repayable after one year (excluding working capital loans, overdrafts, interest due on loans unless funded, bank guarantee, etc., and other short-term arrangements) as reduced by the aggregate of any investments (except in case of investment by an investment company whose principal business is the acquisition of shares, stock, debentures or other securities),

   v. accumulated losses and preliminary expenses not written off.

3. Remuneration in excess of above Iimits may be paid, if the resolution passed by the shareholders is a special resolution.

4. In case of a managerial person or other director, who is functioning in a professional capacity, remuneration as above may be paid if such managerial person or other directors is not having any interest in the capital of:

   i. the company

   ii. its holding company

   iii. any of its subsidiaries directly or indirectly or any other statutory structure

   and not having any, direct or indirect interest or related to the Directors or promoters of

   i. the company

   ii. its holding company

   iii. any of its subsidiaries

   at any time during the last two years before or on or after the date of appointment and possesses graduate level qualification with expertise and specialised knowledge in the field in which the company operates.

   Further, any employee of a company holding shares of the company not exceeding 0.5% of its paid-up share capital under any scheme formulated for allotment of shares to such employees including Employees Stock Option Plan or by way of qualification shall be deemed to be a person not having any interest in the capital of the company;

5. The remuneration as prescribed above shall be paid subject to the fulfillment of the following conditions:

   i. Approval by the Board through a Board resolution (and by the Nomination and Remuneration committee, wherever applicable)

   ii. No default by the Company in payment of dues to any bank or public financial institution or non-convertible debenture holders or any other secured creditor, and in case of default Company has obtained prior approval of such party before obtaining the approval in the general meeting.

   iii. An ordinary resolution or a special resolution, as the case may be, has been passed for payment of remuneration at the general meeting of the company for a period not exceeding three years.

   iv. A statement along with a notice calling the general meeting referred to in clause (iii) is given to the shareholders containing all the points mentioned in the Schedule.

6. Certain special circumstances have been prescribed where, a company may, pay remuneration to a managerial person or other director in excess of the amounts provided above, as follows:

   1. where the remuneration in excess of the limits specified above is paid by any other company and that other company is:

      i. a foreign company or

      ii. has got the approval of its shareholders to make such payment, and treats this amount as managerial remuneration under section 197 and such total managerial remuneration payable is within permissible limits under section 197.

   2. where the company

      i. is a newly incorporated company, for a period of seven years from the date of its incorporation, or

      ii. is a sick company, for whom a scheme of revival or rehabilitation has been ordered by the Board for Industrial and Financial Reconstruction for a period of five years from the date of sanction of the scheme of revival, or

      iii. is a company in relation to which a resolution plan has been approved by the National Company Law Tribunal under the Insolvency and Bankruptcy Code, 2016 for a period of five years from the date of such approval.

   3. Where remuneration has been fixed by the Board for the National Company Law Tribunal.

   The limits under this Section shall be applicable subject to meeting all the conditions specified earlier and the following additional conditions:

   i. The managerial person is not receiving remuneration from any other company except as mentioned in point (b) (1) above;

   ii. Obtain a certificate from the auditor or Company Secretary of the company or where the company has not appointed a Secretary, a Secretary in whole-time practice,

   iii. that all secured creditors and term lenders have stated in writing that they have no objection for the appointment of the managerial person or other director as well as the quantum of remuneration.

   iv. that, there is no default on payments to any creditors, and all dues to deposit holders are being settled on time.

The Schedule also mentions certain perquisites which have been exempted from being included under the head remuneration.

■●■

Navigating Directorship: Legal Duties and Responsibilities

CA Rajen H Gada

Overview

The role of a corporate director is multifaceted, requiring adherence to a complex web of legal and regulatory frameworks. This article examines the statutory and fiduciary duties of directors under the Companies Act and Indian securities laws, emphasizing compliance, transparency, and ethical governance. Key responsibilities include acting in good faith, exercising due diligence, and protecting shareholders' interests.

For directors of listed companies, the article highlights enhanced obligations such as compliance with securities regulations and stock exchange norms. It also delves into the roles of essential board committees, including the Audit, Nomination and Remuneration, Stakeholders' Relationship, and Corporate Social Responsibility Committees.

A critical discussion on piercing the corporate veil explores scenarios where directors may face personal liability despite corporate limited liability. Additionally, the article underscores the importance of director independence in avoiding conflicts of interest and ensuring unbiased decision-making under SEBI and Companies Act guidelines.

The article concludes with insights into Directors' and Officers' Insurance (D&O Insurance), a key safeguard against potential liabilities. By addressing these core aspects, the article equips current and aspiring directors with the knowledge to navigate their roles while upholding the highest standards of corporate governance and mitigating associated risks.

Duty of Directors under the Companies Act, 2013: A Comprehensive WRI

The role of directors in a company is pivotal to its governance, management, and long-term success. The Companies Act, 2013, codifies directors' duties in India, integrating statutory obligations with principles derived from common law. This article provides a detailed analytical perspective on directors' duties under the Act, emphasizing statutory provisions, judicial interpretations, and comparative analysis with international standards.

1. Introduction: Role of Directors in Corporate Governance

Directors are fiduciaries of the company, managing its affairs and safeguarding its interests. Their duties stem from the principle that a company is a separate legal entity, requiring human representatives to function. The Companies Act, 2013, consolidates these responsibilities through well-defined statutory provisions while reflecting global governance standards like the UK's Companies Act, 2006.

2. Statutory Duties under the Companies Act, 2013

Section 166 of the Companies Act, 2013 is a central provision outlining directors' statutory duties, ensuring accountability, transparency, and fairness.

2.1. Duty to Act in Good Faith (Section 166(2))

Directors must act in good faith, promoting the company's objectives while considering the interests of shareholders, employees, and the community. This duty aligns with the stakeholder theory of corporate governance.

Case Law Reference:

Gopal Jalan vs. Calcutta Stock Exchange Association Ltd. (1964): The court held that directors should not act for ulterior motives but for the company's best interests.

Comparative Insight:

The UK Companies Act, 2006, imposes a similar duty under Section 172, emphasizing "promoting the success of the company."

2.2. Duty of Care, Skill, and Diligence (Section 166(3))

Directors must exercise reasonable care, skill, and diligence. This duty includes applying their expertise and acting as a prudent person managing their own affairs.

Judicial Interpretation:

Official Liquidator vs. P.A. Tendolkar (1973): The Supreme Court of India emphasized that directors must be vigilant and cannot claim ignorance of mismanagement.

Key Elements:

- ***Subjective Test:*** Considering the director's expertise and experience.
- ***Objective Test***: Evaluating actions against what a reasonable person would do in similar circumstances.

2.3. Duty to Avoid Conflicts of Interest (Section 166(4))

Directors must avoid direct or indirect conflicts of interest between personal and corporate objectives. Disclosure of such interests is mandatory under Section 184 of the Act.

Relevant Case Law:

Hindustan Lever Employees' Union vs. Hindustan Lever Ltd. (1995): The court emphasized the importance of transparent disclosure to avoid unfair transactions.

2.4. Prohibition Against Making Undue Gains (Section 166(5))

Directors should not profit from their position. Any undue gains must be refunded to the company, with penalties imposed for violations.

Example:

Insider trading penalties under SEBI regulations complement this provision, ensuring directors cannot exploit confidential company information.

2.5. Duty Not to Assign Office (Section 166(6))

Directors cannot transfer or assign their responsibilities to another person, ensuring accountability remains personal.

Judicial Context:

Directors delegating essential tasks without oversight can be held liable under the "non-delegation" principle established in UK common law cases like ***Re City Equitable Fire Insurance Co Ltd (1925)***.

3. Special Duties of Directors in Listed Companies

For listed companies, directors have additional obligations under SEBI's Listing Obligations and Disclosure Requirements (LODR) Regulations, 2015, including maintaining corporate governance standards, audit committee responsibilities, and ensuring accurate public disclosures.

4. Fiduciary Duties Derived from Common Law

Indian courts have reinforced fiduciary principles through various judgments:

- Duty of Loyalty: Directors must avoid personal gains at the company's expense.
- Duty of Disclosure: Material facts must be disclosed in a timely manner.
- Duty of Fairness: Directors must treat all shareholders equally and fairly.

Leading Cases:

Percival vs. Wright (1902) established that directors owe duties to the company, not individual shareholders.

5. Key Judicial Precedents in India

1. ***Dale & Carrington Investment Co. vs. P.K. Prathapan (2004)***:
2. The Supreme Court imposed liability on directors acting dishonestly, emphasizing good faith and transparency.
3. ***Satyam Scandal (2009):***
4. This landmark fraud case underlined the critical need for directors' accountability, leading to corporate governance reforms.
5. ***Tata Sons vs. Cyrus Mistry (2020)***:
6. India's apex court clarified directors' roles and the boundaries of board decisions vis-à-vis controlling shareholders.

6. Piercing the Corporate Veil: Personal Liability of Directors

While a company enjoys separate legal status, courts can pierce the corporate veil in cases of fraud, misconduct, or tax evasion, holding directors personally liable.

Key Case Law:

Standard Chartered Bank vs. Directorate of Enforcement (2006): The Supreme Court held that directors could be personally liable if found guilty of deliberate fraud.

7. Conclusion

The Companies Act, 2013 integrates statutory provisions, judicial interpretations, and fiduciary duties to build a comprehensive framework of directors' duties. By balancing business realities with corporate governance standards, the law ensures that directors act responsibly, promoting the company's growth while safeguarding the rights of stakeholders. Future reforms could enhance this framework, aligning Indian corporate law more closely with evolving global best practices.

Special Duties Assigned to Directors and Boards of Listed Companies under Securities Laws and Stock Exchange Regulations

Corporate governance in listed companies is heavily regulated due to their exposure to public investors. In India, the legal framework governing directors and boards of listed companies stems from the Companies Act, 2013, SEBI's Listing Obligations and Disclosure Requirements (LODR) Regulations, 2015, and various securities laws. This article offers a detailed analytical perspective on these special duties, including statutory provisions, regulatory guidelines, and judicial interpretations.

1. Introduction: The Governance Imperative in Listed Companies

Directors and boards of listed companies have fiduciary, statutory, and regulatory obligations that ensure transparency, accountability, and investor protection. The regulatory landscape for listed entities primarily involves:

- **The Companies Act, 2013**
- **SEBI Act, 1992**
- **Securities Contracts (Regulation) Act, 1956**
- **SEBI (LODR) Regulations, 2015**
- **Stock Exchange Listing Agreements**

2. Key Special Duties of Directors and Boards in Listed Companies

2.1. Corporate Governance Requirements under SEBI (LODR) Regulations, 2015

The SEBI LODR Regulations set detailed corporate governance norms, placing several responsibilities on the board of directors.

2.1.1. Board Composition (Regulation 17)

- ***Minimum Directors:*** At least six directors.
- ***Independent Directors:*** At least 50% of the board if the chairman is non-independent, or 33% if the chairman is independent.
- ***Woman Director:*** At least one woman director on the board.

Key Case Law:

Tata Sons vs. Cyrus Mistry (2020): The Supreme Court reaffirmed that corporate governance norms should ensure board independence and transparency in board decisions.

2.1.2. Code of Conduct and Ethics (Regulation 17(5))

- Boards must adopt a Code of Conduct for directors and senior management.
- Annual declarations confirming compliance are mandatory.

Example:

Several Indian companies faced penalties for non-disclosure of directors' compliance with the Code of Conduct, emphasizing its significance in governance.

2.1.3. Roles of Chairperson, CEO, and MD (Regulation 17(10))

- The roles of chairperson and CEO/MD should ideally be separated to avoid concentration of power.

Judicial Precedent:

The Satyam fraud case revealed the consequences of poor role separation, resulting in tighter governance regulations.

2.2. Disclosure and Transparency Obligations

2.2.1. Financial Disclosures (Regulation 33)

- Quarterly and annual financial results must be published within stipulated timelines.

- Disclosures must comply with Indian Accounting Standards (Ind-AS).

Case Reference:

SEBI vs. Reliance Industries Ltd. (2020): SEBI fined Reliance for misrepresenting financial data, stressing accurate reporting duties.

2.2.2. Material Event Disclosures (Regulation 30)

- Material events such as acquisitions, mergers, and board changes must be disclosed within 24 hours.
- "Materiality" is defined based on the company's size and potential market impact.

Key Example:

Infosys Ltd. vs. SEBI (2017): Infosys was scrutinized for delayed disclosure of CEO resignations, highlighting disclosure importance.

2.2.3. Related Party Transactions (Regulation 23)

- Boards must approve and disclose related-party transactions to prevent conflicts of interest.
- Audit committees must ensure compliance.

Case Reference:

Fortis Healthcare Case (2018): SEBI imposed fines for non-disclosure of related-party transactions with controlling shareholders.

2.3. Risk Management and Internal Controls (Regulation 21)

The board must establish a risk management committee, particularly in the top 1,000 listed companies by market capitalization. Its responsibilities include:

- Identifying, evaluating, and mitigating risks.
- Reviewing internal control systems.

Key Precedent: IL&FS Crisis (2018): The lack of adequate risk management practices led to IL&FS's financial collapse, prompting regulatory reforms.

2.4. Corporate Social Responsibility (CSR) Duties

Section 135 of the Companies Act, 2013 mandates CSR activities for certain companies. Listed companies must ensure CSR compliance, overseen by a CSR committee.

Example:

Tata Group's CSR Model: Recognized globally for its exemplary CSR policies, reflecting board-level CSR accountability.

2.5. Compliance with Insider Trading Laws (SEBI (PIT) Regulations, 2015)

Duties under Insider Trading Regulations:

- Prohibition on trading based on unpublished price-sensitive information (UPSI).
- Disclosure of trading plans by insiders.

Relevant Case Law:

SEBI vs. RIL Insider Trading Case (2017): SEBI penalized Reliance for insider trading, underlining the responsibility of directors to ensure compliance.

3. Committees of the Board: Special Oversight Roles

Several board committees ensure specialized governance:

1. Audit Committee: Financial oversight, internal control monitoring (Reg. 18).

2. Nomination and Remuneration Committee: Executive appointments and remuneration policies (Reg. 19).

3. Stakeholders' Relationship Committee: Redressing investor grievances (Reg. 20).

4. Risk Management Committee: Evaluating and mitigating risks (Reg. 21).

4. Judicial Precedents: Governance Failures and Accountability

4.1. Satyam Scam (2009):

The board's failure to detect accounting fraud resulted in tighter SEBI regulations.

4.2. Kingfisher Airlines Case (2013):

Board negligence in financial management led to bankruptcy and regulatory scrutiny.

4.3. PNB Scam (2018):

Poor internal controls and risk management triggered one of India's largest financial frauds, reinforcing directors' duty to ensure adequate oversight.

5. Conclusion

The duties of directors and boards of listed companies under securities laws and stock exchange regulations reflect a comprehensive governance framework. These obligations ensure accountability, investor protection, and market transparency. Future reforms must continue aligning Indian laws with global best practices, strengthening India's capital markets.

Committees of Directors: A Detailed Analytical Review

The functioning of a company's board is streamlined through specialized committees that handle critical aspects of governance, compliance, and stakeholder management. Under the Companies Act, 2013, and SEBI's Listing Obligations and Disclosure Requirements (LODR) Regulations, 2015, Indian listed companies must establish key board committees: Audit Committee, Nomination and Remuneration Committee, Stakeholders' Relationship Committee, and Corporate Social Responsibility Committee. These committees ensure that essential tasks are managed effectively while enabling accountability, transparency, and strategic decision-making.

1. Introduction: Role of Board Committees in Corporate Governance

Board committees are formed to manage complex governance functions, ensuring directors fulfill their fiduciary duties effectively. Each committee has distinct roles, defined responsibilities, and statutory obligations outlined under various sections of the Companies Act, 2013, and SEBI regulations. These specialized bodies strengthen oversight and improve corporate governance.

2. Key Board Committees and Their Roles

2.1. Audit Committee

Legal Framework:

- **Companies Act, 2013**: Sections 177, 134(3), and 143
- **SEBI (LODR) Regulations, 2015:** Regulation 18

2.1.1. Composition:

- Minimum of three directors, with two-thirds being independent directors.
- The chairperson must be an independent director.
- At least one member should have financial and accounting expertise.

2.1.2. Responsibilities:

1. **Financial Reporting:**
   - o Overseeing the company's financial statements and disclosures.
   - o Ensuring compliance with Ind-AS and other accounting standards.
2. **Internal Controls and Audits:**
   - o Reviewing the internal audit process.
   - o Ensuring the implementation of recommendations.
3. **Fraud and Compliance Monitoring:**
   - o Investigating suspected fraud or non-compliance issues.
4. **Whistleblower Mechanism:**
   - o Establishing a vigil mechanism for employees and directors.

Case Study: Satyam Computers Scandal (2009)

The absence of effective oversight by the audit committee led to one of India's largest accounting frauds, emphasizing the need for stronger audit mechanisms.

2.2. Nomination and Remuneration Committee (NRC)

Legal Framework:

- **Companies Act, 2013**: Section 178(1)
- **SEBI (LODR) Regulations, 2015**: Regulation 19

2.2.1. Composition:

- Minimum of three non-executive directors, with at least half being independent directors.
- Chairperson must be an independent director.

2.2.2. Responsibilities:

1. Board Composition and Appointments:
   - o Identifying and recommending qualified individuals for board positions.
   - o Ensuring a balanced mix of executive, non-executive, and independent directors.
2. Performance Evaluation:
   - o Evaluating board and director performance annually.
   - o Establishing performance evaluation criteria based on best governance practices.
3. **Remuneration Policy:**
   - o Designing a transparent, fair remuneration policy aligned with company goals.
   - o Ensuring executive remuneration is performance-linked.

Judicial Precedent: *Tata Sons vs. Cyrus Mistry (2020*

The NRC's role came under scrutiny in the Tata-Mistry dispute, stressing the importance of transparent appointment and evaluation processes.

2.3. Stakeholders' Relationship Committee (SRC)

Legal Framework:

- Companies Act, 2013: Section 178(5)
- SEBI (LODR) Regulations, 2015: Regulation 20

2.3.1. Composition:

- The committee should consist of at least three directors, with at least one independent director as chairperson.

2.3.2. Responsibilities:

1. **Investor Grievance Redressal:**
    - o Addressing shareholder grievances related to dividends, share transfers, and dematerialization.
2. **Policy Framework:**
    - o Developing policies for investor relations and shareholder communications.
3. **Shareholder Engagement:**
    - o Ensuring timely and transparent communications with shareholders.

Case Study: Reliance Industries Ltd. v. SEBI (2020)

Inadequate grievance redressal mechanisms led to penalties, highlighting the committee's role in investor protection and engagement.

2.4. Corporate Social Responsibility (CSR) Committee

Legal Framework:

- **Companies Act, 2013**: Section 135
- **CSR Rules, 2014** (Amended in 2021)

2.4.1. Composition:

- At least three directors, with at least one independent director.
- Chairperson can be any board member.

2.4.2. Responsibilities:

1. **CSR Policy Formulation:**
    - o Developing and recommending CSR policies aligned with company goals and legal requirements.
2. **Project Implementation and Monitoring:**
    - o Approving CSR activities/projects and ensuring their effective implementation.
3. **Annual CSR Reporting:**
    - o Disclosing CSR activities in the board's annual report.
    - o Ensuring expenditure compliance with the mandatory 2% net profit CSR allocation.

Case Study: ***ITC Ltd. - CSR Leadership***

ITC's CSR initiatives in sustainability and rural development serve as a model for how CSR committees can contribute to business and community welfare.

3. Key Judicial Precedents and Regulatory Actions

3.1. Satyam Computers Scandal (2009):

Highlighted audit committee failures, leading to stricter SEBI regulations on financial disclosures.

3.2. IL&FS Crisis (2018):

Failures in risk management and board oversight underscored the importance of active board committees.

3.3. Fortis Healthcare Case (2018):

SEBI imposed fines for related-party transactions, emphasizing the need for robust audit and NRC functions.

4. Conclusion

Board committees play a crucial role in strengthening corporate governance by fostering transparency, accountability, and stakeholder confidence. Indian regulatory frameworks, aligned with global standards, have imposed clear mandates on board committees, ensuring specialized oversight and compliance. Strengthening these frameworks with stricter enforcement mechanisms will enhance India's corporate governance ecosystem.

Piercing the Corporate Veil: A Detailed Analytical Perspective

The concept of Piercing the Corporate Veil (PCV) disrupts the foundational principle of corporate law: the separate legal entity doctrine established in ***Salomon vs. A Salomon & Co. Ltd. (1897).*** Under this doctrine, a company is considered a legal entity separate from its shareholders, directors, and promoters, shielding them from personal liability. However, courts may disregard this separateness when the company structure is misused, holding individuals personally liable. This article explores the origins, legal basis, judicial interpretations, statutory provisions, and circumstances under which courts pierce the corporate veil, with a focus on Indian and global legal perspectives.

1. Origin and Legal Doctrine of Corporate Personality

1.1. Corporate Personality and Limited Liability

The principle of corporate personality means that a company:

- Has a distinct legal identity separate from its owners.
- Can own property, enter contracts, and sue or be sued.
- Provides limited liability protection to its shareholders.

Key Case: ***Salomon vs. A Salomon & Co. Ltd. (1897)***

The House of Lords held that the company was a separate legal entity, protecting Mr. Salomon from personal liability. This case established the cornerstone of modern corporate law.

2. Legal Basis for Piercing the Corporate Veil

Courts may pierce the corporate veil when the company is used as a facade for illegal or unethical purposes. This concept is not explicitly defined in Indian law but is recognized through judicial interpretations, primarily under:

- **Companies Act, 2013**: Sections 34, 35, 36, 45, 251, 339
- **Indian Contract Act, 1872**
- **Income Tax Act, 1961**
- **Prevention of Money Laundering Act, 2002**
- **Securities Law (SEBI Regulations)**

3. Circumstances Leading to Piercing the Corporate Veil

Courts apply this doctrine when the corporate entity is misused to commit fraud, evade legal obligations, or perpetrate misconduct. Common grounds include:

3.1. *Fraud or Improper Conduct*

When individuals use the corporate structure to deceive creditors, courts may pierce the veil.

Case: ***Delhi Development Authority vs. Skipper Construction Co. (1996)***

The Supreme Court of India lifted the veil, holding the company's directors personally liable for defrauding homebuyers.

3.2. *Avoidance of Legal Obligations*

When a company is formed to bypass statutory obligations, courts may disregard its separate existence.

Case: *Gilford Motor Co. Ltd. vs. Horne (1933)*

Mr. Horne set up a company to circumvent a restrictive trade clause. The court pierced the veil, holding him liable.

3.3. *Tax Evasion and Fiscal Misconduct*

Tax authorities may lift the veil if companies are used as vehicles for tax evasion.

Case: ***Juggilal Kamlapat vs. CIT (1969)***

The Supreme Court of India pierced the corporate veil to address tax evasion through a complex web of companies.

3.4. *Misrepresentation and False Prospectus*

If promoters issue fraudulent prospectuses, they can be held personally liable under the Companies Act.

Relevant Provision:

- Section 34 & 35 of the Companies Act, 2013: Imposes personal liability for misleading prospectus issuance.

Case: ***DDA vs. Skipper Construction (1996)***

The court held the company's directors personally accountable for misrepresentation.

3.5. *Agency Relationship*

When a company acts as an agent or alter ego of its shareholders, courts may pierce the veil to prevent misuse.

Case: ***Lennard's Carrying Co. Ltd. vs. Asiatic Petroleum Co. Ltd. (1915)***

The directors were held liable as the company acted as their agent in breach of maritime regulations.

3.6. *Public Policy and Statutory Violations*

When companies violate public policy or statutory duties, courts may intervene to enforce accountability.

Example:

Under SEBI regulations, directors can be held personally liable for securities fraud.

4. Statutory Provisions in India

4.1. *Companies Act, 2013*

Relevant sections enabling veil piercing:

- **Section 34 & 35:** Liability for false statements in the prospectus.
- **Section 45**: Liability for carrying on business with reduced membership.
- **Section 251**: Liability for fraudulent application for company removal.
- **Section 339**: Personal liability for fraudulent trading during company liquidation.

4.2. *Income Tax Act, 1961*

The Income Tax Department may disregard corporate separateness when companies are used to evade taxes (McDowell & Co. Ltd. v. CTO (1985)).

4.3. Insolvency and Bankruptcy Code, 2016

Sections dealing with fraudulent transactions and wrongful trading can trigger personal liability.

5. Judicial Precedents in India

5.1. Life Insurance Corporation of India vs. Escorts Ltd. (1986)

The Supreme Court affirmed that courts should pierce the veil only in exceptional circumstances.

5.2. Tata Engineering and Locomotive Co. Ltd. vs. State of Bihar (1964)

The veil was lifted to determine the company's residency for taxation purposes.

6. Criticism and Limitations of the Doctrine

While piercing the corporate veil is essential, its application has faced criticism:

1. Uncertainty and Judicial Discretion: Inconsistent application creates unpredictability.
2. Abuse of Power: Judicial overreach may conflict with corporate autonomy.
3. Investor Confidence Impact: Frequent application can deter investments.

7. Conclusion

Piercing the corporate veil remains a crucial tool in corporate governance, ensuring accountability, transparency, and legal compliance. While the Companies Act, 2013, and related laws provide a robust framework, courts must balance this doctrine carefully to maintain investor confidence and the sanctity of the corporate structure. Future reforms could codify specific PCV triggers, reducing judicial ambiguity.

Independence of Directors: Conflict of Interest under SEBI and the Companies Act, 2013

The independence of directors is a cornerstone of corporate governance, ensuring unbiased oversight and protecting stakeholder interests. The concept is intricately linked to the principle of Conflict of Interest, where personal or financial interests of directors could interfere with their fiduciary duties. Indian corporate law, primarily through the **Companies Act, 2013** and **SEBI (LODR) Regulations, 2015**, prescribes stringent guidelines to ensure independence and minimize conflicts. This article examines the legal framework, statutory provisions, key case laws, and regulatory developments governing independent directors in India.

1. Introduction: Role and Importance of Independent Directors

Independent directors act as watchdogs, ensuring the board's actions align with corporate governance standards and shareholder interests. They contribute to:

- Enhancing accountability and transparency.
- Preventing dominance by promoters or majority shareholders.
- Monitoring managerial performance.
- Overseeing financial reporting and audit processes.

2. Legal Framework for Independence of Directors

The Companies Act, 2013, and SEBI (LODR) Regulations provide a comprehensive legal framework for the appointment, duties, and conflict-of-interest management of independent directors.

2.1. Definition and Qualification of Independent Directors

2.1.1. Companies Act, 2013 - Section 149(6):
An independent director must:

- Not be a promoter or related to promoters.
- Have no material pecuniary relationship with the company.
- Not have held key managerial positions in the last two financial years.
- Possess relevant expertise, skills, and experience.

2.1.2. SEBI (LODR) Regulations, 2015 - Regulation 16(1)(b):
Defines similar qualifications and emphasizes disclosure of relationships with promoters, directors, and significant shareholders.

2.2. Appointment and Tenure

Criteria	Companies Act, 2013	SEBI (LODR) Regulations
Minimum Requirement	At least 1/3 of board (listed)	50% if chairman is executive
Tenure	Two terms of 5 years each	Same as Companies Act
Cooling-off Period	Three years after two terms	Three years post-termination

3. Conflict of Interest: Legal Provisions

A conflict of interest arises when a director's personal interests clash with the company's interests, jeopardizing their ability to act independently.

3.1. Statutory Provisions under the Companies Act, 2013

3.1.1. Section 166: Duties of Directors
Directors must act in good faith, avoid conflicts, and disclose personal interests.

3.1.2. Section 184: Disclosure of Interest

- Mandatory disclosure of direct or indirect interests in any company, body corporate, or arrangement involving the company.
- Interested directors cannot participate in discussions or voting.

Example:
If a director holds shares in a supplier company bidding for a contract, they must disclose this interest and abstain from board discussions.

3.1.3. Section 188: Related Party Transactions (RPTs)

- Contracts between the company and related parties must be approved by the board or shareholders (depending on transaction value).
- Independent directors ensure RPTs are conducted at arm's length and in the company's best interest.

3.2. SEBI (LODR) Regulations, 2015

3.2.1. Regulation 17(10): Board Composition

- Requires balanced representation of executive and non-executive directors.
- Independent directors must approve critical decisions involving conflicts, such as mergers, acquisitions, and RPTs.

3.2.2. Regulation 23: Related Party Transactions

- Mandatory approval from the audit committee (comprising a majority of independent directors).
- Shareholder approval is required if the transaction value exceeds specified thresholds.

3.2.3. *Regulation 25: Obligations of Independent Directors*

- They must ensure policies are free from bias and conflicts.
- No directorships beyond seven listed entities (three if holding executive roles).

4. Judicial Precedents and Case Studies

4.1. Tata Sons vs. Cyrus Mistry (2020)

The case involved allegations of corporate mismanagement and conflicts of interest concerning RPTs and board appointments. The Supreme Court highlighted the need for transparent corporate governance and an active role of independent directors.

4.2. Satyam Computers Scandal (2009)

Independent directors failed to detect financial irregularities due to passive oversight. This case led to regulatory reforms under the Companies Act, 2013, and SEBI guidelines emphasizing stronger roles for independent directors.

4.3. Fortis Healthcare Case (2018)

SEBI imposed penalties for lapses in monitoring RPTs involving the company's promoters. The case reinforced the audit committee's role in conflict management.

5. Criticism and Challenges

1. **Board Capture:**
2. Promoters may influence the appointment of 'friendly' independent directors.
3. **Insufficient Oversight:**
4. Passive oversight may result from limited engagement or lack of financial literacy.
5. **Regulatory Ambiguity:**
6. Despite clear mandates, implementation varies due to vague definitions of independence.
7. **Confidential Information Access:**
8. Independent directors often face restricted access to key company data.

6. Recent Developments and Regulatory Reforms

1. **SEBI Amendments (2021):**
   - o Stricter RPT disclosure rules.
   - o Enhanced approval thresholds for RPTs.
2. **Companies (Amendment) Act, 2020:**
   - o Strengthened provisions for director disqualification and removal.

7. Conclusion and Way Forward

The independence of directors is essential for maintaining investor trust, promoting accountability, and ensuring ethical corporate conduct. However, achieving true independence requires robust regulatory oversight, transparent appointment processes, and continuous monitoring of board activities. Future reforms could address existing gaps, ensuring that independent directors play a proactive, well-informed, and unbiased role in Indian corporate governance.

Director Insurance: A Comprehensive Analytical Overview

Directors of companies face increasing personal liability risks due to evolving regulatory frameworks, corporate scandals, and heightened corporate governance standards. Director Insurance, specifically Directors and Officers (D&O) Liability Insurance, serves as a critical risk management tool to protect directors, officers, and the corporation itself from financial losses arising from claims alleging wrongful acts, breaches of duty, negligence, and other legal liabilities. This article provides an in-depth analysis of the legal framework, coverage scope, exclusions, regulatory mandates, global trends, and emerging challenges related to director insurance.

1. Introduction: Why Director Insurance Matters

Directors assume significant responsibilities, making them vulnerable to legal actions from shareholders, regulators, competitors, and other stakeholders. Director Insurance ensures that personal assets of directors are protected, enabling them to perform their duties without fear of personal financial ruin.

Key Purposes:

- Mitigating personal liability risk.
- Encouraging competent professionals to accept board positions.
- Ensuring business continuity during legal proceedings.

2. Legal Framework Governing Director Insurance in India

Director Insurance is not explicitly mandated by Indian corporate law but is recommended as a good corporate governance practice. Relevant legal provisions include:

2.1. Companies Act, 2013

Section 197(13): Indemnity for Directors

A company may indemnify directors against liabilities, except for those arising from:

- Willful misconduct.
- Gross negligence.
- Breach of trust or fiduciary duties.

Section 149(8): Independent Directors' Code of Conduct

- Independent directors are protected if they act in good faith.
- The company may obtain insurance on their behalf.

Schedule IV:

- Encourages indemnification of independent directors for acts done in good faith and within legal boundaries.

2.2. SEBI (LODR) Regulations, 2015

- **Regulation 25(10):**

Mandates director insurance for top 1,000 listed entities by market capitalization, covering independent directors.

2.3. Companies (Corporate Social Responsibility Policy) Rules, 2014

- Directors are responsible for CSR compliance. Insurance can mitigate risks stemming from non-compliance allegations.

3. Key Features and Coverage Scope of Director Insurance

3.1. Coverage Components

Director Insurance typically includes the following components:

1. **Side A Coverage (Personal Liability Protection):**
   - o Covers directors' personal assets when the company cannot indemnify them due to insolvency or legal restrictions.
2. **Side B Coverage (Company Reimbursement):**
   - o Reimburses the company when it indemnifies directors for covered claims.
3. **Side C Coverage (Entity Coverage):**
   - o Extends coverage to the company itself for securities-related claims, including shareholder lawsuits.

3.2. Types of Claims Covered

1. **Securities Litigation***:* Allegations of misleading investors.
2. **Breach of Fiduciary Duty***:* Failure to act in the company's best interest.
3. **Regulatory Investigations:** Non-compliance with legal and regulatory requirements.
4. **Employment Practices Liability:** Claims of discrimination or wrongful termination.
5. **Corporate Mismanagement:** Allegations of financial mismanagement.

3.3. Common Policy Inclusions

- Legal defense costs.
- Settlements and judgments.
- Crisis management expenses.
- Investigative costs in regulatory proceedings.

3.4. Exclusions and Limitations

Despite comprehensive coverage, director insurance policies typically exclude:

1. **Fraudulent Acts and Criminal Conduct:** Proven fraud or criminal behavior is not covered.
2. **Personal Profit and Gain**: Directors cannot claim if they unlawfully profit from company transactions.
3. **Intentional Wrongdoing**: Willful violations of the law are excluded.
4. **Prior Known Acts:** Claims arising from incidents before policy coverage began.
5. **Breach of Contract Claims**: Unless directly related to directors' duties.

4. Judicial Precedents and Case Studies

4.1. Satyam Computers Scandal (2009)

Directors faced claims of negligence and breach of fiduciary duty. The absence of director insurance resulted in significant personal liability exposure.

4.2. PNB Fraud Case (2018)

The PNB banking scandal highlighted the need for director insurance in financial institutions, where senior officials faced allegations of regulatory non-compliance.

4.3. IL&FS Crisis (2019)

The IL&FS default prompted significant claims against directors. Without comprehensive D&O

insurance, directors faced personal financial risks during legal proceedings.

5. Emerging Trends and Challenges in Director Insurance

5.1. Rising Regulatory Scrutiny

Governments and regulators worldwide are tightening compliance standards, leading to increased claims.

5.2. Environmental, Social, and Governance (ESG) Risks

Directors face mounting legal risks related to ESG compliance failures, driving demand for enhanced insurance coverage.

5.3. Cybersecurity Breaches

Cyber-attacks targeting corporations can trigger liability claims against directors, requiring expanded D&O policies.

5.4. COVID-19-Driven Litigation

Pandemic-related business disruptions triggered lawsuits against directors for operational failures and workforce mismanagement.

5.5. Mergers and Acquisitions (M&A) Litigation

Disputes related to M&A deals often lead to director liability claims, increasing insurance premiums.

6. Criticism and Limitations of Director Insurance

1. Moral Hazard: Directors may engage in risky behavior if they feel protected by insurance.
2. Premium Costs: Rising premiums can strain corporate budgets.
3. Coverage Gaps: Exclusions for fraud, prior acts, and regulatory fines can leave directors exposed.

7. Conclusion and Recommendations

Director insurance is essential for corporate governance, ensuring that directors can perform their duties without fear of personal liability. However, companies must carefully structure policies, ensuring comprehensive coverage and minimizing exclusions. Future regulatory reforms should aim to:

- Expand mandatory coverage requirements.
- Ensure policy standardization across industries.
- Strengthen legal provisions related to indemnification.

By adopting best practices and aligning with international standards, Indian corporate governance can achieve greater resilience and accountability.

Legal References:

- Companies Act, 2013
- SEBI (LODR) Regulations, 2015
- Income Tax Act, 1961
- Insolvency and Bankruptcy Code, 2016
- Relevant Supreme Court Judgements, High Court Judgments and other Judicial Precedents

Director's Liabilities: Navigating Accountability and Corporate Governance Challenges*


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Overview

With questions being raised whether or not to be a director in a company, the article examines the evolving landscape of director liabilities in Indian corporate governance, highlighting the increasing scrutiny faced by both executive and non-executive directors. With over 2.6 million companies in India, the growing responsibilities of directors, particularly independent directors, demand attention. Highlighting key legal precedents and regulatory developments, the article examines statutory obligations under the Companies Act, SEBI regulations, and other corporate laws, shedding light on directors' roles in governance, compliance, and accountability.

It notes a significant contrast in regulatory approaches: while the SEBI order in LEEL Electricals Limited imposed substantial penalties on independent directors, the Supreme Court's decision in ***Suseela Padmavathy Amma vs. Bharti Airtel Limited*** *provided protection by establishing that mere directorship doesn't automatically translate to liability.*

The article also covers director obligations under other statutes, including FEMA, cybersecurity laws, and labour regulations. It emphasizes that while independent and non-executive directors generally have limited liability (only for acts done with their knowledge or consent), recent cases show increasing accountability on them for governance failures.

The authors conclude that directors must maintain active oversight and robust compliance mechanisms while suggesting that regulatory frameworks may need to evolve to balance effective oversight with protection from undue penalization.

In India, the liability of directors is a crucial aspect of corporate governance, shaped by both statutory provisions and judicial interpretations. Recently, a noticeable trend has emerged: individuals who are invited to serve as directors of Indian companies are increasingly concerned about their potential liabilities. This concern intensifies when the individual is nominated as an independent director or a nominee director for a private equity fund or investor. Much of this apprehension can be attributed to the actions of regulatory authorities and courts, as directors can be drawn into legal proceedings, and the process of clearing their name can take years. This has created a sense of discouragement within the corporate sector. Clearly, the government faces a critical challenge in ensuring the continued growth of India's corporate landscape. According to publicly available data, as of March 2024, India is home to 2,663,016 companies, highlighting the need for a targeted approach from the government.

The recent Securities and Exchange Board of India (**SEBI**) order in the case of LEEL Electricals Limited[1] brings to the forefront a critical and evolving issue: the expanding scope of directors' liability, with a particular emphasis on independent directors (**IDs**). Historically viewed as passive overseers, IDs are now facing increasing scrutiny from regulators for lapses in corporate governance. In this case, SEBI imposed a penalty of INR 10 lakh each on two IDs for failing to meet their statutory obligations as Audit Committee (**AC**) members and for not safeguarding shareholder interests amidst financial misconduct. Furthermore, significant penalties ranging from INR 2 crore to INR 5 crore were imposed on other whole-time directors (**WTDs**) and key company officers for their role in governance failures. This development sends a clear regulatory signal: liability now extends beyond executive directors, placing independent directors squarely in the spotlight for governance shortcomings.

On the other hand, the Supreme Court's (**SC**) through a recent decision in Suseela ***Padmavathy Amma vs. M/S Bharti Airtel Limited***[2] serves as a pivotal reference in determining director liability under the Negotiable Instruments Act, 1881 (**NI Act**). SC affirmed that **mere directorship does not automatically translate to liability,** emphasizing the need for clear and factual evidence that directly links directors to the operational aspects of a company's wrongful acts. This judgment provides much-needed protection to directors who are not actively involved in the day-to-day management of the company.

The above contrast highlights the evolving legal landscape surrounding directors' liability, necessitating a careful analysis of their roles and responsibilities under the Indian corporate laws. In this articles, authors take a closer look at director liability in India and the recent legal trends and corporate impacts vis-à-vis certain key corporate laws.

A. Companies Act, 2013 ("CA2013")

The evolution of directors' duties and liabilities in India reflects the nation's journey toward enhanced corporate governance. Corporate scandals like Satyam and Sahara have deeply influenced Indian corporate governance, leading to stronger emphasis on directors' fiduciary duties. CA2013 marked a watershed moment in corporate governance, introducing comprehensive provisions that govern director responsibilities and accountability. CA2013 outlines the duties and liabilities of directors, emphasizing their roles as fiduciaries and statutory overseers of corporate governance. Directors, whether executive, non-executive, or independent, are expected to discharge their responsibilities with due diligence, accountability, and care. Under CA2013, failure to meet statutory obligations or breaches in duties can expose directors to both civil and criminal liabilities.

Duties of Directors

Under Section 166 of CA2013, all directors, be executive or non-executive, are required to operate within clear parameters: adhering to company articles, acting in good faith, exercising due care and independent judgment, avoiding conflicts of interest, preventing undue

1. SEBI Final Order in the matter of LEEL Electricals Ltd. dated April 18, 2024.
2. SC order under Special Leave Petition (Criminal) No.12390-12391 of 2022 dated March 15, 2024.

personal gain, and maintaining their office without assignment.

- **Duties of IDs** - In addition to the above, core fiduciary duties that bind all directors, independent directors (being a director other than a managing director (**MD**) or a WTD or a nominee director), must also adhere to the code of conduct and ethical guidelines as outlined in Schedule IV of the CA2013. This code extends to safeguarding minority shareholder interests, balancing the diverse needs of various stakeholders, and serving as neutral arbitrators when conflicts arise among different corporate constituencies. These specific duties reflect their position as objective overseers meant to strengthen corporate governance mechanisms and ensure equitable business practices.

- **Officer who is in default** – In addition to above, an "officer who is in default"[3] under CA2013 includes key individuals responsible for company management and compliance, specifically whole-time directors, key managerial personnel, and other specified individuals who either actively participate in or knowingly permit defaults. The scope extends to those acting under the board of director's (**Board**) authority and individuals whose directions the Board typically follows, creating a comprehensive net of responsibility for corporate governance. The liability framework imposes penalties including fines and potential imprisonment on these officers for corporate violations.

Liabilities of Directors

- **Civil liabilities**: Civil liabilities primarily involve monetary fines imposed on directors for various non-compliance issues. These penalties are generally administrative in nature and do not involve imprisonment. Key civil penalties include:

i) *General non-compliance*: For contravening the provisions of Section 166 of CA2013, such director shall be punishable with fine which shall not be less than ₹ 1 lakh but which may extend to ₹ 5 lakh.

ii) *Financial reporting violations*: Under Section 134 of CA2013, if financial statements are improperly disclosed, the company faces a fine of ₹ 3 lakhs, while each officer in default (provided below) may incur a fine of ₹ 50,000.

iii) *Failure to appoint key managerial personnel (**KMP**)*: Under Section 203 of CA2013, the company and its directors can be fined a minimum of ₹ 1 lakh, with maximum penalties reaching up to ₹ 5 lakhs.

iv) *Breach of managerial remuneration limits*: Section 197 of CA2013 imposes fines on directors ranging from ₹ 1 lakh to ₹ 5 lakhs for breaching remuneration limits.

v) *Ultra vires acts*: SC has in ***Lakshmanaswami Mudaliar and Ors. vs LIC*** provided for the personal liability of directors for passing resolution which were ultra vires of the company–*"Appellants 2 and 4 were at the material time Directors of the Company and they took part in the meeting held under*

3. Section 2(59) of CA2013.

the Chairmanship of the fourth appellant in which the resolution, which we have held ultra vires, was passed. As office bearers of the Company who were responsible for passing the resolution ultra vires the Company, they will be personally liable to make good the amount belonging to the Company which was unlawfully disbursed in pursuance of the resolution."

These civil penalties aim to enforce compliance and maintain the integrity of corporate governance without resorting to criminal prosecution.

- **Criminal Penalties:** Criminal liabilities are more severe and can lead to imprisonment alongside substantial fines. Directors can be held criminally liable under various provisions of CA2013 as well as the Bharatiya Nyaya Sanhita, 2023 (**BNS**)[4]. Key aspects include:

  i) *Fraud (Section 447 of CA2013)*: CA2013 provides an inclusive definition of fraud which includes any act, omission, concealment of any fact or abuse of position committed by any person or any other person with the connivance in any manner, with intent to deceive, to gain undue advantage from, or to injure the interests of, the company or its shareholders or its creditors or any other person, whether or not there is any wrongful gain or wrongful loss. Directors found guilty of fraud can face imprisonment for a term ranging from 6 months to 10 years, along with fines that may extend to three times the amount involved in the fraud. In cases involving public interest, the minimum imprisonment term is 3 years.

  In P.A. Tendolkar case[5], SC aimed to establish an objective standard for duty of care, and also considered subjective elements in determining director liability. These subjective factors included the director's time commitment to the company and their management experience. This case established that directors cannot escape liability for fraud if they are closely associated with the management of the company and aware of the fraudulent activities.

  ii) *Mismanagement (Section 241 of CA2013)*: Directors can be penalized for mismanagement, which may result in their removal from office and other penalties deemed appropriate by the court.

  iii) *Criminal Breach of Trust (Section 316(1) of BNS[6])*: If directors misappropriate company assets, they can face imprisonment and fines.

  iv) *Cheating (Section 318(1) of BNS[7])*: Engaging in deceitful practices can lead to similar penalties as those under fraud, including imprisonment and fines.

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4. Replaced the Indian Penal Code, 1860 ("IPC") w.e.f. July 1, 2024.
5. *Official Liquidator, Supreme Bank Ltd. vs. P.A. Tendolkar (Dead) by Lrs. and Ors. [AIR 1973 SC 1104]*
6. Previously, Section 405 of IPC.
7. Previously, Section 415 of IPC.

v) *Forgery (Section 361(1) of BNS[8])*: Forging documents for financial gain can result in significant legal repercussions.

- **Exemption of liabilities for IDs and non-executive directors–**

  Under Section 149(12) of CA2013, a non-obstante provision provides for limited liability for IDs and non-executive directors (not being a promoter or a KMP). They can only be held liable, in respect of such acts of omission or commission by a company which had occurred with their knowledge, attributable through Board processes, and with their consent or connivance or where they had not acted diligently.

  Further, the Ministry of Corporate Affairs (**MCA**) vide its circular dated March 2, 2020[9], provided additional clarity stating that these directors/personnels cannot be involved in criminal or civil proceedings unless the above Section 149(12) criteria are met. In essence, these directors/personnels' liability is strictly limited to matters they knowingly participated in or negligently overlooked, rather than extending to all company actions or routine compliance matters.

- **Important judicial precedents on liabilities of directors -**

  i) *Criminal intent* – Under ***Sunil Bharti Mittal vs. CBI***[10] (2G Spectrum Case), SC held that directors can be prosecuted for offences committed by the company only if there is sufficient evidence of their active role coupled with criminal intent, or if a specific law provides for their vicarious liability. Since no specific charges were made against the MD, SC dismissed the case against him.

  ii) *Whether liability can be attached for acting on representation of managerial personnel* - On this question, the Allahabad High Court has in ***LIC vs. Hari Das Mundhra and Ors.***[11], held inter alia stating that directors must exercise reasonable care based on their experience and circumstances, with allowance for calculated risks and reliance on trusted colleagues. They aren't liable for errors in judgment or another director's misconduct (unless complicit or negligently passive), and their decisions should be evaluated from the perspective of a reasonable businessperson in the moment, not with hindsight.

  iii) *Role of director determining liability* – Under ***Lalankumar Singh and Ors. vs. State of Maharashtra***[12], SC distinguished between 'in charge of' (a factual test requiring overall control of day-to-day business) and 'responsible to' (a legal test), noting that both tests must be satisfied for vicarious criminal liability,

8. Previously, Section 463 of IPC.
9. MCA General Circular 1/2020 dated March 2, 2020.
10. 2015 INSC 18
11. [1966] 36 Comp Cas 371 (All)
12. 2022 (240) AIC 141

while acknowledging that certain directors like IDs or non-executive directors might not be in charge of company's business. Furthermore, in ***Pooja Ravinder Devidasani vs. State of Maharashtra and Ors.***[13], SC held that a non-executive director is no doubt a custodian of the governance of the company but simply because a person is a director of a company, he does not become liable for all the actions of the company.

iv) *Cheque dishonour under Section 141*[14] *of Negotiable Instruments Act, 1881(NI Act)* – On the offence by the company and vicarious liability of the director, SC held that for vicarious liability under Section 141, mere statements about being "in-charge" are insufficient - specific averments must show how the accused was responsible for the company's business conduct. MDs and cheque-signing officers may be automatically liable, for other directors/officers, the complainant must explicitly prove their direct involvement, consent, or negligence in the offense, as there is no presumption of knowledge or deemed liability.

The delineation of roles, particularly for IDs and non-executive directors, ensures they are held liable only for acts directly attributable to their knowledge or negligence. We now examine what other liabilities do directors of listed companies have to face, focusing on their governance mechanisms and the obligations imposed on directors to uphold investor protection and market integrity.

B. SEBI Act, 1992 ("SEBI Act") and Rules and Regulations

Under Section 27 of SEBI Act, 1992, when a company contravenes SEBI Act or any rules or regulation thereunder, every person in charge of and responsible for the company's business conduct at the time of contravention is deemed guilty alongside the company, unless they prove the violation occurred without their knowledge or despite their due diligence. SEBI has in ***Rahul H. Shah and Ors. vs. SEBI***, held that based on the SC's interpretation and Section 27 of the SEBI Act, there is no vicarious liability for directors who are not involved in the day-to-day affairs of a company under Section 11B[15] of SEBI Act read with Regulation 11 of SEBI (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Market) Regulations, 2003 (**SEBI PFUTP**)[16]. This principle aligns with similar provisions across various acts like the NI Act, where directors uninvolved in daily operations cannot be held liable for company offenses.

13. 2015 (1) CLJ (SC) 109

14. Section 141 outlines offences by companies under Section 138 of the NI Act. It states that every person responsible for the company's conduct of business, including the company itself, is liable for offences unless they prove lack of knowledge or due diligence to prevent it. Additionally, directors, managers, or officers are deemed guilty if the offence occurs due to their consent, connivance, or neglect.

15. Section 11B of SEBI Act gives the SEBI the power to issue directions and levy penalties to protect investors and regulate the securities market.

16. Regulation 11 of SEBI PFUTP gives broad powers to SEBI to issue various directions in the interest of investors and securities markets, including suspending trading, restraining market access, etc.

SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 ("SEBI LODR")

Under Regulation 4 of SEBI LODR, directors of listed entities have comprehensive responsibilities spanning disclosure obligations (including material interests in transactions), key governance functions (such as guiding corporate strategy, risk management, succession planning, and financial oversight), and broader duties to stakeholders amongst other responsibilities. Furthermore Regulation 98 of SEBI LODR provides that for contravention of SEBI LODR, a listed entity or any person may face multiple penalties including fines, trading suspension, freezing of promoter holdings, and other actions as specified by SEBI, in addition to consequences under securities laws.

Exemption of liabilities for IDs - Further, a clause similar to Section 149(12) of CA2013 has been provided under Regulation 25(2A)(5) of the LODR which provides that an ID shall be held liable, only in respect of such acts of omission or commission by a company which had occurred with his knowledge, attributable through Board processes, and with his consent or connivance or where he had not acted diligently.

However, SEBI has in some cases have even penalised the IDs who are not involved in day-today affairs of the Company. In the Adjudication Order of ***Bombay Dyeing and Manufacturing Company Limited***[17], penalised IDs (being part of AC) alongside executive directors and officials for failing to fulfil their fiduciary duties. Despite their non-executive role, the IDs were held equally accountable for not adequately overseeing and preventing these improper accounting practices that artificially inflated the company's sales and profits. Further, even in the matter of LEEL Electricals, as provided above, the ID being a part of AC was held liable and asked to fulfil their duties being part of the committee.

Liabilities of IDs and MDs for fraud - The Securities Appellate Tribunal (**SAT**) has in an interesting matter of ***Gurmeet Singh vs. SEBI***[18] provided that the only person liable was the MD since he was involved in the day-to-day affairs of the company and let go off the ID who was not involved in the day-to-day affairs. SAT also held that merely being signatories to a resolution is not sufficient to allege fraud. Hence, the directors who had signed the resolution were exonerated. Further, under ***Prafull Anubhai Shah vs. SEBI***[19], SAT held that the mere presence of the WTD in the board meeting does not make him liable for the alleged fraud that had been committed by the company.

The liability of directors under the SEBI Act, and related regulations largely depends on their role and involvement in the company's day-to-day affairs. While directors actively responsible for the company's operations may be held liable for violations, independent directors and non-executive directors are generally exempt unless the contravention occurred with their knowledge, consent, or lack of due diligence. However, SEBI has, in some cases, penalized independent directors for failing to fulfil their fiduciary duties, emphasizing the need for active oversight and adherence to governance standards.

17. Adjudication order in the matter of Bombay Dyeing and Manufacturing Company Limited.
18. *Gurmeet Singh vs. SEBI, Appeal No. 406 of 2020 decided on September 14, 2021.*
19. *Prafull Anubhai Shah vs. SEBI, Appeal No. 389 of 2021 decided on June 28, 2021.*

C. Insolvency and Bankrupcy Code, 2016 ("IBC")

The increase in non-performing assets and credit repayment issues in the country highlighted the need for directors to exercise greater diligence, prudence, and awareness in decision-making. Against this backdrop, IBC introduced specific duties for directors to fulfil toward creditors of financially distressed companies. Under the IBC, directors face significant liabilities during corporate insolvency, particularly during the "twilight zone" - the period when the director *"knew or ought to have known that there was no reasonable prospect of avoiding the commencement of corporate insolvency resolution".* Section 66(2) of IBC imposes a specific duty on directors to exercise due diligence and minimize potential losses to creditors when they knew or should have known that there was no reasonable prospect of avoiding insolvency. Failure to meet this obligation can make directors personally liable to contribute to the company's assets.

Shift of duties from shareholders to creditors - When a company enters financial distress, directors' responsibilities shift significantly. They must demonstrate heightened diligence and prudence in managing the company's affairs, with a primary focus on safeguarding creditors' interests. Their key obligation becomes preserving company assets to ensure creditors can recover their dues, rather than prioritizing shareholder interests. This fundamental change in duties reflects the increased risk to creditors when a company faces potential insolvency.

Section 69 of the IBC prescribes criminal penalties for directors who engage in fraudulent conduct, including imprisonment up to 5 years and/or fines up to ₹ 1 crore. Activities that can trigger liability include fraudulent trading, concealment of property, undervalued transactions prejudicial to creditors' interests, and falsification of company books.

SC on liability of directors during moratorium period – In the landmark case of ***Ansal Crown Heights Flat Buyers Association***[20], SC recently clarified that the moratorium imposed under Section 14 of IBC does not restrict the execution of a decree against the directors or officers of a company undergoing corporate insolvency resolution process.

D. Liabilities under Other Statutes

- **Under Foreign Exchange Management Act, 1999 ("FEMA"):**

  Under FEMA, director liability primarily stems from Section 42 of FEMA, which creates two distinct liability frameworks: Section 42(1) imposes deemed liability on persons controlling company operations regardless of direct involvement, while Section 42(2) extends liability to officers who enabled violations through consent, connivance, or neglect. The courts have time and again established that mere directorship is insufficient for liability - there must be a demonstrable nexus between the director and the contravention (as seen from above).

  In an important judgement under FEMA - ***Suborno Bose vs. Enforcement Directorate***[21], SC established that FEMA

20. Civil Appeal(s).4480-4481/2023.
21. AIR 2020 SC 4288

violations under Section 10(6)[22] are continuing offenses - directors who join after the initial violation remain liable if they fail to rectify known contraventions during their tenure. SC rejected the appellant's argument that he wasn't liable since he became MD after the violation, holding that his awareness of and failure to address the ongoing contravention made him liable under Section 42.

- **Under cyber-security and data privacy related laws**

  Directors play a crucial oversight role in cybersecurity governance by ensuring management implements effective risk management processes. While directors benefit from business judgment rule protection, their key responsibility is to actively oversee cybersecurity risk management to fulfil their fiduciary duties. These responsibilities are primarily governed by the Information Technology Act, 2000 (**IT Act**) and the soon to be enforced the Digital Personal Data Protection Act, 2023 (**DPDPA**). Under DPDPA, directors of companies may be classified as *"significant data fiduciaries"* or *"data fiduciaries"* having additional responsibilities. DPDPA specifies monetary penalties for breaches of its provisions. For instance, failing to take reasonable security safeguards can result in penalties of up to ₹ 250 crores. These penalties are imposed on the entity, which could indirectly affect directors if they are found to have neglected their duties in ensuring compliance. On the other hand, Section 43A of the IT Act holds companies liable for damages if they fail to implement reasonable security practices and procedures, leading to wrongful loss or damage. Directors may face consequences if the company is found negligent in this regard.

- **Under relevant labour laws**

  Under current Indian labour laws like the Industrial Disputes Act, 1947[23], directors of a company are presumed liable for any labour law violations committed by the company. The burden of proof lies on the directors to demonstrate that they had no knowledge of or did not consent to the non-compliance. This creates a stringent liability framework where directors must proactively prove their innocence to avoid being held responsible for company violations.

  The soon to be enforced new labour codes in India - The Code on Wages (2019), the Code on Social Security (2020), the Occupational Safety, Health and Working Conditions Code (2020), and the Industrial Relations Code (2020) (**NLC**) appear to shift this burden of proof onto the prosecuting labour authorities. While directors can still be held liable, the authorities must first prove that the violation occurred with the director's consent, connivance, or due to their neglect. However, some

22. Section 10(6) of FEMA makes it an offense if a person acquires foreign exchange for a declared purpose but either doesn't use it for that purpose, fails to surrender it within the specified period, or uses it for any non-permissible purpose under FEMA.
23. Section 32 of the Industrial Disputes Act, 1947.

ambiguity exists due to the two-part structure of the relevant NLC provisions - one part maintains general liability for persons-in-charge unless they prove lack of knowledge, while a separate overriding provision specifically addresses director liability based on proof of their involvement. The practical implementation and interpretation of these provisions will become clearer once the NLC takes effect.

Way forward

The expanding scope of liability under various statutes, from CA2013 and SEBI Act to the upcoming data protection and labour laws, creates a formidable web of responsibilities that directors must navigate carefully. The stakes are extraordinarily high, with penalties ranging from substantial fines to imprisonment, and personal liability for corporate misconduct. This evolving landscape demands that directors maintain active oversight; exercise heightened due diligence and stay vigilant about their statutory obligations across all applicable regulatory frameworks – or face severe consequences that could impact both their professional standing and personal freedom.

The way forward lies in enhancing director awareness and understanding of their responsibilities, ensuring robust compliance mechanisms within companies, and fostering a culture of proactive governance. Regulatory frameworks may also need to evolve, offering clearer guidelines on the scope of director liabilities while balancing the need for oversight with the protection of directors from undue penalization. Ultimately, strengthening corporate governance will not only protect directors from liability but will also contribute to the long-term growth and credibility of Indian businesses.

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ADDENDUM

The Supreme Court has recently delivered a ruling which is relevant for the topic. Hence a suitable addendum is included for readers' reference.

Under a recent criminal appeal, ***Sanjay Dutt & Ors. v. State of Haryana & Anr. (judgment dated January 2, 2025),*** the Supreme Court (SC) clarified that directors cannot be held vicariously liable for corporate offenses unless explicitly mandated by law. It quashed a complaint under the Punjab Land Preservation Act, 1900, against directors accused of environmental violations, stating that mere directorship is insufficient to establish personal culpability. SC emphasized that criminal liability requires specific allegations demonstrating active involvement or authorization of the offense. In absence of such evidence, directors cannot be prosecuted for acts committed by their companies. SC noted, "While a company may be held liable for the wrongful acts of its employees, the liability of its directors is not automatic."

This judgment underscores the need for liability to be grounded in clear statutory provisions and supported by substantive evidence, providing crucial clarity on director responsibilities and shielding them from undue prosecution for actions by the company.

Independent and Non-Executive Directors — Evolving role and liabilities under Indian law

Mr. Pranay Bagdi

Ms. Divya Shrivastava

Overview

This article discusses the evolving role, responsibilities, and liabilities of independent and non-executive directors under the Indian law, particularly in the context of corporate governance reforms that have been introduced in response to the corporate frauds that plagued India in the 2000s. Under the current regulatory regime, independent and non-executive directors have extensive duties and obligations including chairing critical board committees like the audit committee and the nomination and remuneration committee. As members of these committees, they are tasked with responsibilities such as, examining the financial statements, approving related party transactions, evaluating internal financial controls and risk management systems, etc. Independent directors are expected to maintain high standards of integrity and expertise while fulfilling statutory duties, but the regulatory burden often blurs their non-managerial status. Recent legal precedents highlight a stricter approach towards holding non-executive and independent directors accountable for corporate misconduct, underscoring their duty to remain informed and proactive. Liabilities under various laws, including tax, foreign exchange, and the Negotiable Instruments Act, often expose these directors to legal risks despite the 'safe harbour' provisions in the Companies Act and SEBI regulations. To empower the independent and non-executive directors and further strengthen their institution, the article advocates for reforms, such as clearer legal distinctions between executive and non-executive roles, better safeguards against unwarranted legal action and company level initiatives like director training, D&O insurance, and more robust corporate practices.

General overview

In recent decades, following the corporate frauds during the 2000[1], various reforms have been introduced by the government, regulators, companies, and stakeholders to improve the corporate governance standards in India. Central to these reforms are the boards of directors, who act as company

1. For instance, the Satyam Computers scam, where the promoters of one of India's largest IT companies fraudulently falsifies accounts and inflated share prices. These instances of corporate frauds highlighted a lack of corporate governance, auditing standards and regulatory monitoring in India which paved the way for enactment of the Companies Act, 2013 and the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 – Avantika Banerjee "Corporate Frauds in India from 1992-2019", published in the Indian Society for Legal Research (2021).

agents, performing authorized acts within the framework of laws and company rules, except for decisions requiring shareholder approval.

Under the Companies Act, 2013 (the ***Companies Act***), directors are categorized as either whole-time (who are effectively in whole-time employment, say executive director or managing director) or non-whole-time (which will include all categories of non-executive). Categories of non-executive directors include independent directors, promoter nominee directors, and investor nominee directors. The eligibility, roles and responsibilities of independent directors is clearly spelt out under law. The eligibility conditions includes objective criteria such as no significant financial ties to the company beyond remuneration (or shareholding) and no linkage to the promoter group, as well qualitative criteria such as being a person having integrity and relevant expertise[2]. Moreover, they are also expected to comply with the prescribed code of conduct[3], and there are stipulations on their roles as members of key board committees on an on-going basis. Unlike independent directors, the role and responsibilities of the other categories of non-executive directors is not specifically defined. These non-executive directors are essentially those directors who are not involved in daily operations but are meant to play a role on policy-making and overall strategy.

Over the last 5 to 7 years, several changes have been brought about in the context of listed public companies enhancing the role of non-executive directors as key players in ensuring good corporate governance. Among the top 50 NIFTY companies, 29 have non-executive directors as board chairpersons, with 11 being promoter nominee directors[4]. In 2024, a major shift occurred with generation of 47 independent director vacancies among 23 of the top 50 NIFTY companies, including Hindustan Unilever, ITC, L&T, and TCS, due to term completions[5]. Notably, 64% of the new independent directors appointed by 2,453 NSE-listed companies were first-timers with no prior board experience[6].

In this piece we delve into the (i) evolution of the roles and responsibilities of independent and other categories of non-executive directors; (ii) scope of their liabilities under corporate laws as well as other key laws; and (iii) share our suggestions for the key stakeholders to help ensure independent and non-executive directors are able to discharge their expected role in advancing corporate governance in a practical and effective manner.

Evolution of the role of independent and non-executive directors

The concept of non-executive directors in general and independent directors in particular have long existed under the common law. In the Indian context, the concept of independent

2. Section 149(6) of the Companies Act.
3. Schedule IV of the Companies Act.
4. Snapshot report (for NSE listed companies) published by PrimeInforbase, as on 24 December 2024, available at https://www.primeinfobase.com/indianboards/pages/snapshot-reports.aspx?snap=AN.
5. Rajesh Kurup, "India Inc boards set for major revamp; 23 Nifty50 firms need to add 47 new members this year", available at https://www.financialexpress.com/business/industry-india-inc-boards-set-for-major-revamp-23-nifty50-firms-need-to-add-47-new-members-this-year-3412207/.
6. Kiran Somvanshi, "Most independent directors of listed companies are first timers", available at https://economictimes.indiatimes.com/news/company/corporate-trends/most-independent-directors-of-listed-companies-are-first-timers/articleshow/113576759.cms?from=mdr.

director was first recognised by SEBI in the Listing Agreement[7]. Thereafter, basis the recommendation of the J.J. Irani committee[8], independent directors were given statutory recognition under the Companies Act. In context of listed entities, SEBI further strengthened the regime of non-executive and independent directors by introducing additional parameters under the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 (the ***LODR Regulations***), which have been amended from time-to-time basis suggestions from various committees. The latest amendments emanate from the committee constituted by SEBI in 2017 under the chairmanship of Uday Kotak (the ***Uday Kotak Committee***). The Uday Kotak Committee was constituted to recommend changes aimed at enhancing the overall independent director framework to ensure compliance in letter and spirit.

Over the years, the role of independent directors has transformed from merely bringing an element of objectivity to the board process to becoming crucial participants in the operations of the board and its committees that primarily oversee the company's financial transactions. The induction of independent directors on the board has progressed beyond simply checking of a box from a corporate governance standpoint, as they are now entrusted with significant statutory duties and responsibilities that reinforce their role as the watchdogs of corporate integrity. Some of the key duties and responsibilities of independent directors include:

(i) *Balancing interests of various stakeholders*: the independent directors are responsible for bringing about an independent judgment to board's deliberations on issues of strategy, performance, risk management, resources, etc., and for balancing the conflicting interests of all stakeholders, thereby safeguarding their interests, particularly those of the minority shareholders.

(ii) *Performance evaluation*: the independent directors are required to objectively evaluate the performance of board and management. In this regard, they are also expected to hold one meeting annually, without the presence of non-independent directors, to inter alia, (a) review the performance of non-independent directors, the board and the chairperson; and (b) assess the quality, quantity and timeliness of flow of information between the management and the board.

(iii) *Role as member and chairman of audit committee*: It is mandatory for the listed entities to constitute an audit committee such that at least 2/3rd of its members comprise of independent directors and its chairman is an independent director[9]. The audit committee is responsible for multifarious things ranging from examining the financial statements and auditor's reports, appointment of the chief financial officer and internal

7. SEBI circular bearing reference MDRP/POLICY/CIR-10/2000 dated 21 February 2000.
8. J.J. Irani Committee, Report of the Expert Committee on Company Law, established by Government of India (2005).
9. Regulation 18 of the LODR Regulations.

auditor, evaluating internal financial controls and risk management systems, monitoring the end use of funds raised through public offers, scrutinizing inter-corporate loans and investments and reviewing the functioning of whistle blower mechanism[10]. The independent directors on the audit committee are exclusively responsible for approving any related party transactions of the company[11]. Additionally, the audit committee has the authority to investigate into any finding of internal auditors with respect to suspected fraud or irregularity or a failure of internal control systems and reporting the matter to the board[12].

(iv) *Role as member and chairman of Nomination and Remuneration Committee (the **NRC**)*: Similar to the audit committee, it is mandatory for listed entities to constitute an NRC comprising of only non-executive directors. Earlier, it was prescribed that 50% of the members of the NRC should be independent directors. However, this requirement was later changed to 2/3rd of its strength, in line with the audit committee[13]. The primary role of the NRC is to devise a policy in relation to remuneration of the executive directors, key managerial personnel and other senior management.

In addition to the above, the fiduciary duties of directors prescribed under the Companies Act[14] and LODR Regulations[15] (including the duty to act in compliance with the company's articles of association, act in good faith, and exercise due and reasonable care, among others) are also applicable to all non-executive directors.

Given that independent directors are essentially non-executive directors, it is often debated whether the amount of regulatory burden placed on them under the scheme of the Companies Act LODR Regulations, amounts to delegating 'managerial responsibilities' to them. That said, the present scenario demands active participation from independent directors and fosters the expectation that they possess comprehensive understanding of governance principles, financial management, and legal obligations required to effectively discharge their statutory duties and responsibilities. In this context, the next obvious question is regarding the scope and extent of liability attributable to the non-executive directors and independent directors under Indian laws when an action is brought against the company.

10. Part C (Role of Audit Committee and Review of Information by Audit Committee) of Schedule II of LODR Regulations.
11. Regulation 23(2) of the LODR Regulations, amended by the SEBI (Listing Obligations and Disclosure Requirements) (Third Amendment) Regulations, 2021.
12. Paragraph 15 of Part C (Role of Audit Committee and Review of Information by Audit Committee) of Schedule II of LODR Regulations.
13. Regulation 19(1)(c) of the LODR Regulations, amended by the SEBI (Listing Obligations and Disclosure Requirements) (Third Amendment) Regulations, 2021.
14. Section 166 of the Companies Act.
15. Regulation 4 of the LODR Regulations.

Independent and Non-executive Director liability under Companies Act and SEBI regulations

Ordinarily, a director is expected to exercise his/her powers with such degree of skill and care as may be reasonably expected from a person of his/her knowledge and experience[16]. Although there is no formal distinction in the Companies Act and LODR Regulations regarding the standard of care expected from an executive director vis-à-vis a non-executive director, conceptually, it should not be the same since independent directors, being non-executive directors, are not directly engaged in the daily operations of the company. To mitigate the consequences and undue hardships faced by the non-executive directors when a legal proceeding is initiated against the company, the Companies Act and LODR Regulations stipulate specific a safe harbour provision which states that independent and non-executive directors are only liable in respect of such omission or commission by a company, which had occurred with their knowledge (attributable through board process), consent or connivance or where they had not acted diligently[17].

That said, in practice, these mitigating factors do not prevent the initiation of a prosecution or other legal proceedings against the non-executive and independent directors, and such directors will have to demonstrate that they have fulfilled the criteria for the safe harbour provision to be applicable. In this regard, it is key to delve into what constitutes knowledge 'attributable through board processes'. This phrase makes the concept of knowledge wider than actual knowledge implying that a director is deemed to have knowledge of all matters that have been taken up at the board level or discussed in board meetings. For example, if board papers are delivered to a director along with the agenda for a meeting, the director may be imputed with knowledge regarding the contents of those papers.

Hence, determination of knowledge 'attributable through board processes' is a fact-based analysis.

Indian courts and tribunals have, in a plethora of rulings, applied the principle that director liability cannot be imputed automatically based on designations or general averments regarding director's involvement in the affairs of the company[18]. Instead, a thorough examination of the facts and circumstances in each case is required to ascertain the role and involvement of the relevant director.

This was illustrated in the matter of ***Sayanti Sen vs. Securities and Exchange Board of India***[19], which dealt with improper issuance of non-convertible debentures that violated the Companies Act by Silicon Projects India Limited, where Sayanti Sen served as a non-executive director. In this matter, on the basis of the facts that Sayanti Sen had not attended

16. Re: City Equitable Fire Insurance Co., (1925) 1 Ch 407.
17. Section 149 (12) of the Companies Act and Regulation 25(5) of LODR Regulations.
18. Armaan Patkar and Abhipsita Kundu, "Director Liabilities – Recent Judicial Pronouncements", published on May 28, 2020 available at: https://www.azbpartners.com/bank/directors-liabilities-recent-judicial-pronouncements/
19. Appeal No. 163 of 2018, Order dated August 9, 2019.

any of the board meetings or signed any of the resolutions approving the issuance of non-convertible debentures, the Securities Appellate Tribunal (SAT) absolved her of all liabilities in relation to the same. The SAT examined the vicarious liability provisions under the Companies Act and SEBI Act and held that in order to attribute vicarious liability to any director for the acts of the company, it has to be specifically established that the director was responsible for the acts of the company and the mere fact that a person was holding the office/designation of a director would not be sufficient. Accordingly, in order to rely on the safe-harbour provision and ring-fence their liability, independent/non-executive directors are expected to act diligently, raise questions and/or mark their dissent.

Moreover, recently, there seems to be an emerging trend in the approach towards dealing with matters regarding independent directors' liability where more thrust is now being given to the duties, responsibilities and expectations from independent directors rather than their actual involvement. Few notable examples include:

- In the matter of *LEEL Electricals Ltd.*,[20] SEBI imposed a fine of INR 10 lakhs on the two independent directors for failing to fulfil their statutory responsibilities as audit committee members. The independent directors in question contended that they were approached by the erstwhile promoter to join the board on the assurance that their role would 'not require any specialized knowledge of law and finance' and that the audit committee meetings were 'routine' and 'actual decisions would be taken by the board in board meetings'. Despite the independent directors being a retired Air Force Marshal and a physical therapist, respectively, SEBI dismissed their claims regarding their lack of understanding of law and finance and found them accountable for breaching their statutory duty.

- In the matter of *Southern Ispat and Energy Ltd.*[21], independent directors of a company were subject to proceedings in relation to fraudulent issuance of global depository receipts (GDRs) by the company in violation of SEBI regulations. The Adjudicating Officer (AO) held the independent directors responsible, specifically calling out their duty under law to monitor the end use of the funds that were raised by issuing the GDRs and ensuring their transfer to the accounts of the company in India.

- In the matter of *Fortis Healthcare Limited (FHL)*[22], the company was involved in aiding and abetting the routing of funds from FHL for the benefit of its promoter entities, which involved misrepresentation of the financial statements. The independent director alleged that he had relied on reports from his colleagues in the audit

20. Final order in the matter of LEEL Electricals Ltd. dated April 18, 2024.
21. Adjudication order in respect of Arun Panchariya in the matter of Southern Ispat and Energy Ltd. dated July 26, 2023.
22. Adjudication order in the matter of Fortis Healthcare Ltd. dated May 18, 2022.

committee as well as the representatives of FHL's subsidiaries, as being a medical professional, he had 'minimal knowledge of finance and financial statements'. Adopting a strict stance, the AO found the independent director accountable for aiding and abetting in the scheme of fraud perpetrated by FHL through their consistent inaction and mechanical approval of the financial statements, in addition to their failure to perform their duties as members of the audit committee. According to the AO, the independent director should have disclosed his inability to comprehend the subtleties of high-value financial transactions prior to becoming a member of the audit committee or should have refused to join the same.

These recent orders have highlighted the SEBI's efforts to tighten norms for independent directors emphasizing their accountability and responsibilities, particularly in cases involving financial misconduct within companies. Accordingly, under the existing legal framework of the Companies Act and LODR Regulations, independent directors are mandated to possess appropriate skills and knowledge in fields of finance, law, and corporate governance, reflecting the complexity of their roles.

Independent and Non-executive Director liability under other statutes

Unlike the Companies Act and SEBI Regulations, there is no specific recognition to the position of executive and non-executive/independent directors under other Indian laws and accordingly, the liability of directors under other Indian laws, such as, for dishonouring of cheques, offences under tax laws, violation of foreign exchange regulations and insolvency laws, may not always be limited to executive directors. These laws typically include 'vicarious liability' provisions, which hold individuals 'in charge of' and 'responsible for the conduct of the business' liable, and in the absence of a specific differentiation, independent/non-executive directors often face challenges like being summoned, investigated, or even prosecuted like executive directors. In cases of a default, usually, the warrants/summons is issued to all the directors (including non-executive directors), and obtaining a vacation of such warrants could be a time-consuming and arduous process. Moreover, whether the alleged commission or omission of the company was undertaken with the knowledge, consent, connivance, or negligence of the non-executive or independent directors is usually established at a later stage of the proceeding and, in the meantime the independent and non-executive directors remain exposed to the risk of reputational harm and protracted legal proceedings, despite the protections provided under Companies Act and LODR Regulations.

In this context, we have picked up examples of certain commercial laws and how the jurisprudence of 'vicarious liability' of directors has evolved under these laws. In connection with liability on account of dishonour of cheques under the Negotiable Instruments Act, 1881 (the ***NI Act***)[23], there

23. Section 141 of the NI Act provides that "every person who, at the time the offence was committed, was in charge of, and was responsible to the company for the conduct of the business of the company, as well as the company, shall be deemed to be guilty of the offence and shall be liable to be proceeded against and punished accordingly".

have been decisions of the Supreme Court recognising the need for additional safeguards to the non-executive and independent directors, preventing them from being dragged into legal actions for every breach committed by the company. The landmark decision of the supreme court in ***S.M.S. Pharmaceuticals Ltd. vs. Neeta Bhalla***[24], has largely settled the law under NI Act and effectively created a distinction in the treatment of executive versus non-executive directors in cases of cheque dishonour. To launch a prosecution against a director for cheque dishonour, specific averments/allegations are required to be made in the complaint, describing the role played by the director in connection with the transaction. Further, a director cannot simply be held liable by virtue of the office/designation he/she holds. It must be established how the concerned director was in charge of and responsible for the conduct of the business of the company at the time of committing the offence. It is to be noted that these requirements are not applicable to directors holding the office of 'Managing Director' or 'Joint Managing Director', who by virtue of the nature of their role, are deemed to be in charge of, and responsible for the conduct of the business of the company and can be made liable under the NI Act. In the aftermath of this judgement, courts were seen quashing the FIRs against independent directors based on their non-executive status[25], emphasizing that independent directors could not be held liable under the NI Act without specific averments of their involvement in the alleged offence.

However, the jurisprudence around independent/non-executive director's liability under majority of the statues is still evolving and therefore, the decisions of the courts in this regard remain inconsistent. For example, under Indian tax laws, directors of a private limited company may be held jointly and severally liable for taxes that cannot be recovered from the company unless the directors are able to prove that such non-recovery is not attributable to them. It has been held[26] that simply holding the office of a technical director will not, *ipso facto*, absolve a director of his liability. It is essential for the directors to establish that there was no gross neglect, misfeasance or neglect of duty on their part due to which the revenue department is unable to recover taxes from the company. Effectively, in cases of tax evasion by a private company, independent directors/ non-executive directors are likely to be issued warrants/summons and made party to the legal proceedings. While there are no corresponding provisions in relation to directors of a public companies, however, if it is shown that the company's affairs were willingly structured in way to defraud revenue, the income tax authorities would have the power to lift the corporate veil and treat the responsible directors of such a company liable for fraud.

Similarly, attribution of liability under foreign exchange laws focuses on conduct, act or

24. (2005) 8 SCC 89.

25. *Bhardwaj Thirvenkata Venkatavaraghavan vs. PVR Ltd (2019) 258 DLT (CN 17A) 17*; and *Satvinder Jeet Singh Sodhi vs. State of Maharashtra (2022) SCC OnLine Bom 2298*.

26. *Suresh Narain Bhatnagar vs. ITO [2014] 367 ITR 254 (Guj.)*

omission on the part of a person and not merely on account of holding an office or a position in a company. In ***Shashank Vyankatesh Manohar vs. Union of India***[27], the BCCI had allegedly violated the provisions of FEMA by remitting money without appropriate approvals. Thus, the enforcement directorate issued a show cause notice to the president of BCCI. However, the court took great care in assessing the president's accountability, regardless of his title, and instead carefully analysed the role of the president in the impugned contravention. The court found that the BCCI president had not only played no role in the operational matters of the contravention but had even told the persons in charge that appropriate approvals must be taken before any money is remitted. In the absence of active involvement in the contravention coupled with his exercise of diligence to prevent such contravention, the court dismissed any liability against him. It is pertinent to note that a detailed factual analysis drawing out distinction of the roles played ends up being examined only at the superior courts – accordingly, while practically liability and consequential penalty under the foreign exchange laws may not extend to non-executive directors, there exists a worrying trend where show cause notices are frequently issued to non-executive/independent directors notwithstanding their limited role in the functioning of the company[28].

Therefore, in the absence of clear 'safe-harbour' provisions in these laws, independent/non-executive directors have to defend their position by demonstrating how their position is different from an executive and the limited role they play in connection with the conduct of the business or operations to mitigate their liability. While judicial principles regarding the restricted exposure of non-executive directors continue to develop under various laws, in our view, insights and guidelines from rulings under the NI Act may be borrowed to give recognition to the fact that, unlike in the case of managing or whole time director, it is an abuse of the process of the court if proceedings are launched against non-executive directors without a *prima facie* examination of their role in default. The burden to establish *prima facie* involvement of non-executive directors should be on the complainant. In the long haul, however, it will be beneficial if the laws are amended to statutorily recognise the limitations of non-executive directors with respect to their role and liability in the offences prescribed under these laws. Such amendments will reduce court proceeding related nuisance value and encourage talented professionals to take up the role of independent directors. Additionally, some other recommendations for effective implementation of the non-executive/independent director framework are discussed below.

Recommendation and concluding remarks

Non-executive and independent directors play a vital role in shaping corporate strategy and

27. 2014(1) MahLJ 838.

28. Ryan Joseph, "Director's Liability under FEMA: Bridging the Gap Between Accountability and Investor Confidence", published by Business Law Review – National Law School (2023).

governance. Attracting talented, knowledgeable individuals to these roles is essential. However, they often face challenges related to their responsibilities and potential legal risks. In this section, we discuss certain reforms/ initiatives and tips for non-executive directors directed at empowering them to play a more impactful role in shaping the trajectory of modern corporations and protecting them from undue hardships associated with the inherent risks associated with occupying a position of director and/or becoming collateral damage for the wrongdoings of the management/executive directors.

(a) Legal reforms

(i) *Formalising the distinction between executive and non-executive directors in connection with vicarious liability*: As previously noted, there is a lack of uniformity in the current legal landscape in terms of the procedures followed by multiple investigating agencies when dealing with cases of director liability of non-executive directors. In this context, it is recommended that for effectively safeguarding the interests of the non-execute directors, specific guidelines should be formulated by authorities to address instances of non-executive director liability under various laws. These guidelines can take cue from the rulings under the NI Act and the investigating agencies should be instructed to issue summons to independent and non-executive directors only after arriving at the conclusion that there is a *prima face* case against them.

Perhaps, a specific amendment may be introduced to the Companies Act, clarifying how vicarious liability under any applicable law in relation to wrongdoings of a company vis-à-vis its directors should apply: (a) in the case of executive directors, by virtue of the nature of their role, the presumption should be in favour of their involvement, placing the onus on them to prove their lack of participation in the alleged offence; and (b) in the case of non-executive and independent directors, the assumption should be in favour of their non-involvement and the burden of proof should be on the person alleging that non-executive directors should be held liable to demonstrate their involvement in the relevant offence committed by the company.

(ii) *Setting out designations in the MCA Master Data*: Any intimation to the Registrar of Companies regarding appointment/cessation or change in designation of directors is filed via e-form DIR-12, which does not contemplate 'independent director' as a specific designation that can be chosen from the drop-down menu. Therefore, individuals serving as independent directors are categorized under the general designation of 'director' on the MCA portal. In this context, it is recommended that the e-form DIR-12 and the MCA portal should be updated to reflect designation of 'independent director' specifically.

In our view, as a practical matter, this may go a long way ensuring that regulatory action against any independent is taken only if there is sufficient reason to do so.

(b) Initiatives by the companies

To further strengthen the institution of independent directors and ensure enhancement of corporate governance to higher standards, the corporations may consider undertaking the following initiatives, which may also incentivise and attract talented professionals to take up the ever changing and complex role of independent directors in a company:

(i) *D&O Insurance:* While procurement of directors' and officers' liability insurance is mandatory only for the top 1,000 entities by market capitalization as per the LODR Regulations, it would be advisable for all listed and unlisted companies to consider this protection for their directors – especially for non-executive and independent directors.

(ii) *Training and Development*: Recognizing the need for a formal mechanism to evaluate the individuals who wish to serve as independent directors, the Ministry of Corporate Affairs introduced a mandatory self-assessment test for aspiring individuals designed to assess them on knowledge of corporate governance, legal frameworks, and financial management. However, a standardized proficiency test may not be enough to equip the individuals with the capability to discharge their roles as independent directors as the subject matter of this test seems to have very little regard for the type of company, nature of business or other specificities involving various boards. Therefore, the companies themselves should invest in induction and continuous training and development programs for independent directors to keep them updated on industry trends, best practices, and changing regulatory landscapes.

(c) Tips and good practice measures for non-executive and independent directors

Having regard to the duties, functions and responsibilities of the non-executive and independent directors, the individual occupying these positions should remain alert and diligent. Further, in order to invoke the safe harbour provisions and mitigate their liabilities, these directors should consider taking certain additional steps for good measure, such as:

(i) *Preparation and Diligence*: Upon receiving the notice, agenda and notes for a meeting, the director should thoroughly read though the same and determine if appropriate information has been shared for him to take an informed decision. If he feels that the information is lacking, then he should not hesitate in asking for relevant information and disclosures in advance to better prepare for the meeting.

(ii) *Engaging with Key Personnel*: A director, may as a good practice have a meeting with the management and any other relevant stakeholder such as internal auditors, statutory auditors, secretarial auditors and other key personnel prior to the meeting to understand any matter which is tabled for discussion as part of the agenda.

(iii) *Active Participation*: At the meeting, the director should not hesitate in asking questions to understand the basis of assumptions and strategy of the management to get full picture before taking a decision. Further, the directors must ensure that any questions raised by them in a board meeting or any dissent expressed is properly recorded in the minutes of the meeting so as to provide prima facie evidence of proceedings before the board in case the role of the director were to be called into question.

(iv) *Review meeting minutes*: It is also important for a director to review the minutes of the meeting to ensure that the minutes reflect accurate discussions at the meeting and their dissent or observations made (if any) at the meeting are specifically recorded.

As concluding thoughts, the role of independent directors is complex, with significant responsibilities and fragmented legal protections. Many directors join boards believing the role is minimal, only to discover they have statutory obligations beyond initial expectations. To bridge the gap between duties and risks, aspiring independent directors must understand their roles and stakeholder expectations deeply and mitigate exposure to liability by ensuring their eligibility to rely on safe harbour provisions, obtaining D&O insurance, and indemnities from the company.

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"A fool may buy all the books in the world, and they will be in his library; but he will be able to read only those that he deserves to; and this deserving is produced by Karma."

— *Swami Vivekananda*

Role & Responsibilities of Audit Committee and its Chairman

CA Nilesh Vikamsey CA Hasmukh Dedhia

Overview

Audit committees (AC) are often tasked with not only overseeing a company's financial reporting and internal control matters, but also a wide gamut of other responsibilities including oversight/monitoring of risks, compliance and operational governance matters (like fraud incidents, approving RPTs etc). Such important is the role, that AC is often described as 'gatekeeper of governance'.

Sectoral regulators like RBI, IRDAI, SEBI etc. also placed additional responsibilities on AC and its chair in the matters of compliance, risk, vigil and other important operational matters of the Companies; these requirements exhibit the confidence of Regulators for objectivity and independence in functioning of the AC.

The protection (from legal actions or show-cause notices etc.) to Independent Directors is not absolute but subject to their attributability (through Board process) or knowledge test evident from their exercise of diligence.

Considering vast role & responsibilities that AC and its Chairman are expected to perform ranging from financial reporting matters to evaluation of internal controls, auditors' findings, risk parameters, approving the related party transactions, participating in vigil mechanism & so on, it is critically essential that AC has control of its own agenda with objectivity and independence.

1. General

1.1 The concepts of "Audit Committee" and "Independent Directors" have their origin in the emergence of principles of Corporate Governance. The idea of separation of ownership and management in the case of corporate entities led to the principles of governance in managing corporate affairs. A Corporate body is a congregation of various stakeholders, namely shareholders, customers, employees, investors, vendors, lenders, government and society at large. It is imperative for a corporate business set-up to be fair and transparent to its stakeholders in its operations. These thoughts gained impetus in a sglobalised business world where corporations need to access global pools of funds, need to attract and retain the best human talent from various parts of the world, need to partner with vendors on mega collaborations and need to live in harmony with the global community. The ecological factors and perseverance of environmental resources (with low carbon emissions) made tenets of good governance more and more relevant over the last few decades.

1.2 The economic crisis and continued incidents of fraud and mismanagement the world over necessitated some framework, which would enable large corporates to instil self-discipline, checks and balances within processes of business decisions and governance of operations.

USA (market regulator, Securities & Exchange Commission) rolled out one such initial framework as part of new rules in federal law in 1975 to place importance on good governance; the UK was then the first to get to the nitty-gritty with detailed code of Corporate Governance (Cadbury Report in 1990)

1.3 In India, voluntary drafts of such code were attempted by the Confederation of Indian Industries (CII) and in 1998 'Desirable Corporate Governance Code' was issued by this industry body. The need for regulatory provisions for these matters was soon felt. The landmark development began with a committee set up by SEBI under the chairmanship of Shri Kumar Mangalam Birla (well-known Industrialist) in 1999. Based on its recommendations, SEBI issued such a code embodied in clause 49 of the Listing Agreements of the stock exchanges. Public debate and deliberations on the matter continued, and several task forces/committees set up by MCA & other authorities (e.g. Naresh Chandra committee, Narayan Murthy Committee, etc.) worked on ways and means to enhance the standards of Corporate Governance and towards raising the bar of Indian Industry for sharpening India's competitive edge in furtherance of governance culture.

1.4 Today, the laws and regulatory provisions (including the Companies Act, Regulations stipulated by SEBI, RBI, IRDAI and other relevant enactments) provide detailed rules and extensive guides to and actionable by the corporates in meeting the needs of good governance and up the ante of their compliance.

2 Summary of provisions pertaining to the Audit Committee of Directors:

The Companies Act, 2013 ('the Act') provide for the following committees to be set up by the Board of Directors of listed companies and other prescribed classes of companies:

2.1 ***Audit Committee***

[Section 177 read with Rule 6 of Companies (Meetings of Board and its Powers) Rules AND clause 49 of Listing Agreement]

The Board of Directors ('Board') of all listed Companies and Public Companies [having (a) paid up capital of ₹ 10 crores or more OR (b) turnover of ₹ 100 crores or more OR (c) aggregate outstanding loans, debentures and deposits of ₹ 50 crores or more] are required to constitute the "Audit Committee" ('AC') and "Nomination & Remuneration Committee" ('NRC').

AC should have a minimum of three members, with at least two-thirds of them being independent directors. Members of AC are expected to be financially literate and at least one of them an expert in matters of finance and accounting. AC, to be chaired by an Independent Director, is required to meet at least four times in a financial year. The terms of reference of the scope of work and responsibilities of AC as specified in writing by the Board shall, inter alia, include the matters narrated in Section 177(4) of the Act.

2.2 The other Committees of the Board of Directors, prescribed under the Act, include:

(i) Nomination and Remuneration Committee (NRC) [Section 178]

(ii) Corporate Social Responsibility (CSR) Committee [Section 135]

(iii) Stakeholders Relationship Committee [Section 178]

3 The Important duties/responsibilities of AC & its Chairman

3.1 Audit committees are often tasked with not only overseeing a company's financial reporting and internal control matters, but also a wide gamut of other responsibilities, which include oversight/ monitoring of risks, compliance and operational governance matters (like fraud incidents, approving RPTs, etc). AC and its Chairman occupy a place of prime importance under the Regulatory framework in the matters of ensuring compliance and constant betterment of governance within an organisation. Such important is the role that AC is often described as 'gatekeeper of governance'.

Some of the key regulatory responsibilities of the AC [inter alia, under provisions of (i) Section 177 & other applicable provisions of the Act, (ii) Regulation 18, 23(2), 9(A) of LODR (iii) Part C of Sch II of LODR] are summarised below:

- Examining the financial statements before submission thereof to the Board, which includes reviewing whether the financial statements present a true and fair view of the state of the company's affairs and comply with all the applicable accounting standards.
- Admitting matters in the Directors' Responsibility Statement prepared under Section 134(5) of the Act.
- Examining the auditors' report prepared in accordance with Section 143 of the Act, including the CARO report.
- Reviewing the quarterly financial statements before submission to the Board for approval & Auditors' review report thereon.
- Granting approval to Related Party Transactions ('RPTs'). (including omnibus approval)
- Scrutinising inter-corporate loans and investments, including review of utilisation of such loans & investments.
- Reviewing the application of funds raised through a public issue, rights issue, preferential issue, etc.
- Recommending Statutory Auditor's appointment, reviewing the Auditor's independence and performance, and effectiveness of the audit process.
- Reviewing the adequacy of the internal audit function, frequency of internal audits, Scope/coverage and discussing significant findings with Internal Auditors.

- Appointment of Registered Valuer and valuation of undertakings/assets of the listed entity, where necessary.
- Evaluating internal financial controls and risk management systems.
- Reviewing findings of any internal investigations by Internal Auditors into matters where there is suspected fraud/irregularity/failure of internal control systems of a material nature and steering towards better controls
- Reviewing the functioning of the whistle-blower mechanism.
- To consider the rationale, cost-benefit, and impact of schemes of arrangement on the listed entity and its shareholders.
- Reviewing information relating to management letters, letters of internal control weaknesses issued by Satutory Auditors, etc.
- Adhering to the requirements under the PIT Regulations, wherein Audit Committees have the responsibility to review compliance with the PIT Regulations at least once every financial year.
- Reviewing the reports/findings issues by the regulatory inspections (like RBI, IRDA, NHB etc.) and ensuring remediation of the reported issues.
- Reviewing the developments in critical litigations (including taxation) faced by the Company.

3.2 IRDAI, an authority that regulates and promotes the insurance industry in India, has also, under its Code of Governance for the Insurance Industry, provided all the above duties/responsibilities, *mutaties mutandies*, on the members of AC of the Insurance entities. Additionally, it provides for the following functions of Independent Director(s) and/or AC:

- Discussing compliance levels in the Company, identifying associated risks, and reporting significant compliance breaches to the Board.
- Reviewing compliance pertaining to disclosure of policy lapse ratio in the case of the life insurers.
- Reviewing compliance for disclosure of any pecuniary relationships or transactions between non-executive directors and the insurer in the Annual Report.
- Reviewing of the proceedings (to the extent its impact on financials) of regulatory committees like (i) Investment committee (ii) "with profit" committee or "Reversionary Bonus" committee (iii) risk management committee.
- Overviewing the process followed by the management to appoint an Investment Concurrent Auditor as well as an Information Risk Management Auditor in keeping with the regulatory requirements & review of reports of such auditors.
- Reviewing the regulatory mandates and/or inspection reports for ascertaining necessary actionables by the management.

Similarly, the regulatory requirements prescribed by RBI for Banks, NBFCs and

HFCs include, inter alia, the following matters to be dealt with by or reported to the AC of such entities (Ref. RBI Master Directions, RBIA, Scale Based Regulations, Circulars etc):

- Critical and significant matters in IS audit report which is to be done once in every two years by such lending entities.
- Periodical review of cases of wilful defaulters
- Detailed annual review of compliance function vis a-vis Risk assessment, including prompt deliberations on any material compliance failures
- Review the process of appointment of Chief Compliance Officer (CCO)
- Annual approval to Risk-based Internal audit (RBIA) plan and periodic review
- Monitoring of audit of outsourced activities
- Approval of any adjustments to ECL model output (i.e. Management overlay)
- Approval to classification of accounts over 90 DPD, but not treated as impaired, with the rationale for the same to be documented clearly.
- Reviewing notes on or findings from KYC guidelines, Money laundering or Terror Financing and such other regulatory sensitive matters.

Thus, sectoral regulators like RBI, IRDAI, SEBI, etc also have placed additional responsibilities on AC and its chair in the matters of compliance, risk, vigil and other important operational matters of the Companies; these requirements exhibit the confidence of Regulators in objectivity and independence in the functioning of the AC.

3.3 All the directors have a duty cast on them to act in the best interests of the company; but the Chairman and members of 'AC' have onerously specific roles to provide objective oversight in the areas of financial reporting, related party transactions and conflicts of interest, internal control environment, internal audit and external audit processes.

Such a need for objectivity is particularly imperative for the Chairman of the AC as the effectiveness of his committee is often dependent on his or her leadership. Chairman AC is responsible for ensuring that audit committee meetings run efficiently in a time-bound manner and all members of the committee thoroughly and thoughtfully discuss each agenda item. The AC Chairman is often the key contact between the committee members and members of the Board, as well as senior management and the Auditors and external experts as well as stakeholders. Noteworthy is that the presence of AC Chairman is mandatory at the Annual General Meeting of the Company.

The AC Chairman is expected to demonstrate courage to deal with tough issues and support other members to do the same, especially in probing management on areas where subjectivity is inherent (e.g. choice of accounting policies and estimates made in arriving at the figures recorded in the financial statements). Also expected from the AC Chairman, the traits of effective balancing and reconciling the differing views on the matters of financial reporting and compliance over RPT and like matters.

In view of the above, the attributes of an effective AC Chairman and AC Members are summarised as under:

- An independent, proactive, unassuming leader with confidence and integrity.
- A highly respected and experienced Board member who possesses strong financial literacy skills and has the time and inclination to develop competencies to grasp and closely monitor the agenda items.
- A person with an excellent working knowledge of audit committee practices.
- Hands on to the regulatory updates and requirements of audit processes.
- A good listener and communicator who can facilitate deliberations successfully and reconcile emerging different viewpoints in the proceedings to amicably resolve the issues.
- A person who is tenacious and when necessary prepared to ask the tough questions or take firm stand.
- Navigate the Company in matters of wrong/excessive actions against the Company by the Regulators.
- Key person in guiding the implementation and enhancement of systems, applications and processes and enhancing checks and balances in the Company.
- Driving sorganisational cultural change if required and instilling accountability.
- Good sounding Board to the senior management, auditors (statutory or internal)
- Demonstrating experience and wisdom in various matters tabled before the audit committee.
- Suggesting good resources in the role of key managerial personnel or senior management like CFO, CRO etc.
- Where required, improving Internal Audit effectiveness.
- Holistic Addressal of issues by going into root cause analysis and driving systemic changes as generally, the management tendency is to address only the immediate issue on hand and apply patchwork
- Based on the review of Business segments, question continuance of the segment in case of continuous bad performance or where further improvements are required
- Critically review the schemes of arrangements for Merger, demerger, etc and see whether the Tax & other Impacts have been considered properly.
- Verify whether valuation reports consider all relevant aspects of a transaction.

3.4 In recent years, advancements in technology and the increasing emphasis on Environmental and Social Governance (ESG) metrics have significantly introduced new dimensions of compliance and reporting, requiring the AC to oversee sustainability initiatives and ensure that disclosures align with applicable regulations and are benchmarked to global standards. These trends not only enhance governance but also position the sorganisations as forward-thinking entities in the eyes of stakeholders.

4. Practical issues and points for deliberation pertaining to AC & its Chairman

4.1 *Protection to ID's & NED's*

Amidst thoughts of collective responsibility of the Board members for any liability or claim arising in the course of Company's operations alleging contravention or non-compliance of law, a suitable protection is considered desirable to be accorded to Independent Directors ('IDs') or for that matter even to Non-executive Directors ('NEDs'), for the reason that IDs or NEDs do not have any role or do not engage in day-to-day operations of the Company.

Section 149(12) attempts to provide such protection to IDs and NEDs (other than promoters or KMP's). It provides that these directors shall be held liable only in respect of such acts of omission or commission by the Company, which had occurred with their knowledge, attributable through Board process and with their consent or connivance or where any of them had not acted diligently.

As can be noticed, the protection to ID's and NED's is not absolute but subject to their attributability (through the Board process) or knowledge test evident from their exercise of diligence.

In recent times, it is noticed that all the regulators, authorities often send notices to all Directors (including IDs & NEDs) for any alleged lapse, non-compliance etc, on the part of the Company without examining whether the said directors are involved or responsible for such matters of non-compliance. This practice needs to be re-examined in view of the protection accorded to IDs and NEDs who are not involved in the day-to-day affairs of the Company.

4.2 *Stringent time Schedules of AC & Board meetings*

To meet the stringent reporting timelines and other compliance requirements, many listed companies schedule their quarterly meetings of AC and Board on the same day, often with a minimal time gap of, say, half an hour or so. In the event that some interpretational or contentious issues are to be discussed and sorted out within such stringent timelines, the Chairman and members of AC face the challenges. Often, they are dependent on the views of the management and/or auditors.

Such challenges aggravate in cases where the financial results or other disclosures under LODR regulations are not shared in advance with members of AC, which usually happens. Such data or information are not shared too much in advance sometimes for the reasons of the provisions of regulations like "Prevention of Insider Trading" or concerns of unpublished price-sensitive information.

4.3 ***Pre-AC or Pre-Board informal meetings***

To counter the time related challenges mentioned above, a practice has evolved of informal pre-AC or pre-Board meetings, usually 2/3 days before the date of scheduled quarterly meetings of AC or Board.

In such informal meetings, the Chairman of AC and/or other IDs engage with the management and review the financial information for the quarter. They also overview significant developments affecting the results and get information on material developments in ongoing litigations, etc. Such meetings also assist in attempts to understand the views and rationale of the management on the interpretational or judgemental issues as also to evaluate the alternatives.

A couple of concerns on such otherwise useful pre-AC or pre-Board meetings need to be understood. Firstly, in such informal meetings, often, statutory or internal auditors are not there; AC Chair understands their presentations or views from the management of the Company. Secondly, since most of the reportable financial and other matters have been discussed in detail in such informal meetings, the tendency to run them over quickly at the meeting of AC or Board is sometimes noticed.

4.4 ***Separate Meetings of Independent Directors***

Schedule IV (para VII) to the Act provides that IDs of the Company shall hold one meeting of IDs in a year, inter alia to undertake followings:

- Review the performance of executive directors and of the Board as a whole.
- Review the performance of the Chairman of the Company from the views of executive and non-executive directors.
- Assess the quality, quantity and timelines of the flow of information between the management and Board (essential information to enable Board members to reasonably perform their duty and take informed decisions.
- Have informal interactions with statutory and internal audit heads/teams sans the management to understand their viewpoints or issues faced by them in carrying on their functions.

Despite such separate meeting of ID's being prescribed under Sch. IV, there is no specific requirement for any agenda or minutes of such meetings. Although, in the case of most well-governed Companies, proceedings or decisions of such meetings are noted, documented or even minuted by members of AC and handed over to the management for record-keeping and actionables. However, myriad practices are noted in the corporate arena about the outcome and/or documentation of proceedings of such separate meetings.

4.5 ***Vigil mechanism (whistleblower)***

Section 177(9) & (10), read with Rule 7 of Companies (Meetings of Board & its Power) Rules, 2014, require all listed companies & other companies (which accept deposits from the public or which have borrowed money from Banks & public financial institutions more than Rs. 50 crores) to establish vigil mechanism to report (by Directors & employees) genuine concerns or grievances.

AC Chairman is generally the direct access person in respect of the concerns or grievances reported under such vigil mechanism and must function in a role, which is quasi-investigative; reporting and guiding the management on corrective actions, including tackling frivolous complaints are part of the functions of AC Chairman.

4.6 ***Related Party Transactions [Section 177(4)(iv)]***

One of the onerous functions of AC is approving related party transactions and subsequent modifications to such RPTs. Gathering all the necessary and relevant information from management and other sources to be able to firm up the views on genuineness and arm's length rationale makes it a time consuming obligation, especially if the stakes involved are significant.

Even in the case of omnibus approvals, tracking the follow-up reports from the management becomes tedious.

AC's, in the case of many companies, hire the services of independent Chartered Accountants firms or other expert agencies to evaluate the subject matter requiring examination of 'Arm's Length' among related party transactions.

4.7 ***Internal Audit matters***

In most listed companies, reporting by the head of the Internal audit function is directly to the AC Chairman (other than for administrative matters). AC has a vital role in evaluating the scope, timelines and coverage of internal audit functions. Often, the AC Chairman is expected to perform the role of an umpire, overcoming subjectivity, in evaluating risk grading of the observations/findings by the internal auditors.

5. Wrap-up

Considering the vast role & responsibilities that AC and its Chairman are expected to perform, ranging from financial reporting matters to evaluation of internal controls, auditors' findings, risk parameters, approving the related party transactions, participating in vigil mechanism & so on, it is critically essential that AC has control of its own agenda with objectivity and independence.

Director's liability under the Income Tax Act, 1961

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Overview

In today's world, the role and responsibilities of Directors assumes significance. However, in recent times, a trend has been observed that the Indian tax authorities are imposing civil and criminal sanctions against the Directors for the tax defaults made by the Companies.

In this article, the author has discussed the various aspects relating to Director's Liability under the Income Tax Act, 1961, including a brief overview of the taxation related to remuneration earned by the Director. It has been emphasised that the Directors can be held liable jointly and severally for the default made by the company is payment of its tax dues. Similarly, the Act also provides for provisions relating to criminal prosecution of Directors. However, there are adequate safeguards embedded in the Act before the tax authorities imposes any such civil or criminal liability on the Director. Even the Courts, across the Country, have time and again indulged and issued necessary guidance interpreting these provisions of the Act.

A company being an artificial person cannot act on its own. The business of a company is managed and controlled by natural persons i.e. director(s) who act on behalf of the company. The role and responsibilities of a director in a company assumes accountability. In instances where a director contravenes his duties, the regulatory authorities are empowered to pierce the corporate veil and hold the director personally responsible for such contravention, subject to certain thresholds, conditions etc. In this article, an attempt has been made to summarily discuss about the civil and criminal liabilities of the directors as enshrined under the provisions of the Indian Income Tax Act, 1961 (**"the Act"**).

I. Taxation of Director' remuneration

There are difference classes of Directors. Executive Directors are whole-time director and are typically employees of the company, who are compensated in the form of Salary and other benefits. On the other hand, Non-executive Directors like independent directors are not the employees of the company and they only earn professional fees such as sitting fees for attending board meetings.

As regards taxability of such remuneration received by Directors, the same is dealt as under:

- Salary income is taxed under the head "Income from Salaries" or

- Professional fees is taxed under the head "Profits and Gains from Business and Profession".

The rate of taxation in the hands of the Directors depends on the applicable slab rates which ranges from 5% to 30% (plus applicable surcharge and cess).

Withholding tax implications on company

For the remuneration paid to Whole Time Directors which is taxable under the head salaries, the necessary withholding of taxes is performed by the Company under Section 192 of the Act. Further, tax is withheld under Section 194J of the Act in respect of the professional income of the Directors.

Tax treaty treatment

In case where an Indian company has availed services of a non-resident Director, then, for determination of taxability of the remuneration received by such Director, regard shall also be made to the provisions of the tax treaty, if any, which India have entered with the jurisdiction of which such director is tax resident. Generally under such tax treaties, under Article 17, the Director fees and similar payments derived by a non-resident Director are taxable in the source country where company (of which he is the director) is a resident. Thus, payments received by a non-resident director of an Indian company are taxable in India unless any specific tax benefit is available under a particular tax treaty.

II. Civil Liability of Directors

Under the provisions of the Act civil and criminal sanctions are provided for Directors, depending on the offences committed by them. While civil liability takes the form of damages or compensation, criminal liability can take the form of fine or imprisonment or both. The Halsbury Law of England[1] defines civil proceedings as proceedings that have for their object the recovery of money or other property, or the enforcement of a right or advantage on behalf of the plaintiff.

Section 179 of the Act deals with liability of Directors of a private company. To invoke the provisions of Section 179 of the Act, following conditions should be satisfied cumulatively:

(1) There should be taxes due from a private company and such tax dues cannot be recovered by the tax department from the company; and

(2) The concerned Director, *qua* whom tax recovery is sought, should be the Director of the Company at any time during the period for which such tax relates to; and

(3) Non-payment of such tax dues are attributable to gross negligence, misfeasance or breach of duty by the director.

The expression "tax dues" includes penalty, interest, fees or any other sum payable under the Act.

Following important aspects should be noted with respect to this provision:

- Section 179 of the Act specifically overrides the provisions of the Companies Act 2013 and thus, by implications, any protective clauses against personal liability of Directors under the Company law will not absolve the Directors from recovery of tax liability.

1. 4th edition, Volume 11, *Sachin Dogra vs. Anju Bala (20.11.2024 - HPHC) : MANU/HP/2575/2024*.

- This provision applies only on private limited company and not a public[2] company. Thus, the Directors of a public company cannot be made liable for receovery of the taxes. The Hon'ble Supreme Court, in the case of ***M. Rajamoni Amma vs. DIT***[3] held that even in instances when a formerly private company was converted into a public company, proceedings for recovery of tax due from the company cannot be taken against its directors for the assessment years when the company is a public company. Similar view has been taken by Hon'ble Gujarat High Court in the case of ***Radhe Mohan Sharma vs. DCIT***[4] . However, the Hon'ble Gujarat High Court in the case of ***Ajay Surendra Patel vs. DCIT***[5] noted that if the company is public but partakes the characteristics of a private company to defraud the revenue, the assessing officer can lift the corporate veil and hold the director liable by treating the company as a de facto private company. It is pertinent to note that this case does not reflect that Section 179 can be imposed on directors of public companies.

Notice from tax office should establish that tax dues cannot be recovered from the company

To initiate recovery under Section 179, the primary condition is that the authorities are unable to recover the dues from the company itself. When an assessee is in default in making payment of taxes, the provisions of the Act read with Schedule II provides procedure to be followed by a tax recovery officer to recover taxes. In this regard, the officer is broadly required to: -

(1) issue notice to the defaulter providing it time to pay the tax amount specified in the notice;

(2) attach and sell moveable and immovable properties of the defaulter, if the amount is not realised in step 1 above.

Tax recovery measures as per the provisions of the Act are a sine qua non before issuance of notice by a tax officer to a director under section 179 of the Act. Recently, the Hon'ble Supreme Court in the case of ***ITO vs. Jayesh Savjani:[2023] 154 taxmann.com 43 (SC)*** held that the show cause notice issued to the director should disclose the steps taken by the authorities to recover the amount from the delinquent company. Setting out particulars of efforts made by the authorities and the subsequent failure to recover tax are a sine qua non before issuance of notice under Section 179 of the Act, and failure to set these out will invalidate the proceedings. It has been similarly held in other cases[6] as well.

2. Except for a public company if the tax dues relates to a period when the company was a private company.
3. [1992] 195 ITR 873 (SC), [2014] 44 taxmann.com 211 (Gujarat)
4. [2014] 44 taxmann.com 66 (Gujarat)
5. [2017] 78 taxmann.com 339 (Gujarat)
6. *Kushal Vinodchandra Mehta vs. ITO [2023] 151 taxmann.com 204 (Gujarat); Bhailal Babubhai Patel vs. PCIT [2023] 156 taxmann.com 271 (Guj; Manjula D. Rita vs. PCIT [2023] 153 taxmann.com 468 (Bombay); Bhagwandas J Patel vs. Dy. CIT [1999] 238 ITR 127 (Guj), Indubhai T Vasa vs. ITO [2005]146 Taxman 163(Guj), Amit Suresh Bhatnagar vs. ITO [2009] 183 Taxman 287 (Guj), Mehul Jadavji Shah vs. Dy. CIT [2018] 92 taxmann.com 401 (Bombay), Ashita Nilesh Patel vs. ACIT [2020] 115 taxmann.com 37 (Guj), Devendra Babula Jain vs. ITO [2022] 145 Taxmann.com 553 (Guj) and Rajendra R Singh vs. ACIT [2022] 143 taxmann.com 34 (Bombay).*

Onus of proving that the non-recovery is not attributed to any gross neglect, misfeasance or breach of duty is on the Director

Once it is established that recovery cannot be made from the company, then the onus shifts to the Director to establish that the non-recovery was not due to any of the following factors on his part, i.e. gross neglect, misfeasance or breach of duty.

Recently, in the case of ***Geeta P. Kamat vs. PCIT***[7], the director brought on record material which suggested lack of financial control, lack of decision-making powers due to her limited role in the entire decision making which was held by the directors appointed by the investors of the company. Noting the same the Hon'ble Bombay High Court held that the director had sufficiently discharged her burden of proof under Section 179 of the Act and since the Revenue has not highlighted any single action of the director which could be treated as an act of gross negligence, breach of duty or misfeasance resulting in non-recovery of tax due, the order passed against the director is unsustainable. Similarly, in another case of ***Prakash B Kamat vs. PCIT***[8], the Hon'ble Bombay High Court passed the order in favour of the director holding that sufficient material was brought on record to prove that the non-recovery of tax was not attributable to the actions of the director.

Individual should be a director during the year for which the tax is due

One of the conditions to initiate proceedings under section 179 of the Act is that the director on whom tax recovery is sought should be a director of the company at any time during the period for which such tax is due and cannot be recovered from the company. Even if a director has resigned from the company, if he was a director at any time during the period for which such tax is due and cannot be recovered from the company, he can be held liable. The Punjab and Haryana High Court, in the case of ***Darshan Kumar vs. CIT [1998]99 Taxman 524 (P&H)***, held that resignation from directorship does not ipso facto absolve ex-director from all the liabilities which he incurred during the period he was a director of the company. Later, the Allahabad High Court[9] adopted the similar view and held that to initiate proceedings against a director, it is essential to prove that he was the director of the private company at the relevant point of time.

To summarise, the following principle(s) of law emerges with respect to the liability of a director under the Act:

1. The tax dues should not be recoverable from the defaulting company, and the tax authorities have to showcase all the efforts made to retrieve the same.

2. Once the authorities have sufficiently discharged their duties of trying to recover the dues, notice can be issued to the directors. At this point of time, the burden of proof shifts to the directors, and they may defend by showcasing that non-recovery of tax dues from the company cannot be attributed to his gross neglect, misfeasance and breach of duty.

3. The director must not just be a director in designation but must exercise the

7. [2023] 150 taxmann.com 490 (Bombay)
8. [2023] 151 taxmann.com 344 (Bombay)
9. [2001] 117 Taxman 611 (Allahabad)

power and functions of a director, especially with relation to the financial aspects of the company.

4. An ex-director may also be held responsible for offence if he was a director for any period during the year for which tax due is not recoverable.

III. Criminal Liability of Directors

For an offence committed under this Act by a company, Section 278B of the Act provides that every person who at the time the commissioning of such offence, was in charge of and was responsible for the conduct of the business of the company as well as the company shall be deemed to be guilty of the offence.

The phrase words 'as well as the company' used in section 278B(1) of the Act makes it unmistakably clear that even a company can be prosecuted and punished for an offence committed under the Act. Thus, an income tax officer can prosecute both, the company and its principal officers i.e. persons in charge/ persons responsible for the company but, the imprisonment will be levied only on persons-in-charge of the company and not on the company as company is a juristic person[10].

The Act further provides under Section 278AA that prosecution proceedings may not be initiated for certain offences if it is shown that there was a 'reasonable cause' for failure to perform certain actions. The term 'reasonable cause' has not been defined under the Act. Reference, can therefore be drawn to the case of ***Woodward Governor India P. Ltd vs. CIT [253 ITR 745 (Delhi)]*** wherein the Hon'ble Delhi High Court noted that 'reasonable cause' means an honest belief founded upon reasonable grounds, of the existence of a state of circumstances, which assuming them to be true, would reasonably lead any ordinarily prudent and cautious man, placed in the position of the person concerned, to come to the conclusion that the same was the right thing to do.

The proposition that prosecution proceedings should not be initiated if the company/ director is able to demonstrate that the failure was attributable to a reasonable cause has been upheld in various cases like ***Sequoia Construction Co. Ltd vs. ITO [1986] 158 ITR 496 (Delhi HC), ITO vs. Roshni Cold Storage P. Ltd [2000] 245 ITR 322 (mad)*** and ***S.G. Kale vs. UOI [2002] 256 ITR 148 (Raj.).***

Notice should be served on the Director for treating him as principal officer

The term 'principal officer' used with reference to a company is defined under the Act to inter alia mean any person connected with the management or administration of the company upon whom the Assessing Officer (**"AO"**) has served a notice of his intention of treating him as the principal officer thereof.

In order to treat an individual as a 'principal officer', the following two conditions must be satisfied: -

i) He must be a person connected with the management of or administration of the company; and

ii) The AO must be served a notice of his intention to treat him as the principal officer.

10. Sub-section (3) of Section 278B read with the underlying principle was laid down in *M.V. Javali vs. Mahajan Borewell & Co [1997] 95 Taxman 306 (SC).*

Therefore, merely on account of being a director, an individual will not become a principal officer[11]. The director should also be served with a notice mentioning that he is being treated as a principal officer.

Various judgements have been passed by Courts wherein it has been held that prosecution proceedings against a director cannot be initiated unless a notice under sub-clause (b) of Section 2(35) of the Act expressing AO's intention to treat the director as "principal officer" of the company has been issued[12].

In the case of ***Madhumilan Syntex Ltd. vs. UOI***[13], the Hon'ble Supreme Court held that to treat the directors of a company as "principal officers" there is no need to issue a separate notice or communication to them that they are to be treated as "principal officers", before the issuance of the show-cause notice under section 276B read with section 278B. It is sufficient that in the show-cause notice under section 276B read with Section 278B, it is stated that the directors are to be considered as principal officers of the company under the Act.

Recently, in the case of ***Anish Modi vs. UOI***[14], the company had failed to deposit the TDS amount. The petitioner, an independent, non-executive and nominee director, became aware of the default by the company only after receiving summons. The Hon'ble Bombay High Court held that since the petitioner was not served with a notice treating him as a principal officer, the criminal case qua the petitioner is quashed since such non-compliance of statutory requirements goes to the very roots of the matter and dents the prosecution against the petitioner.

Further, Section 278B(2) provides that a director can be deemed to guilty of an offence if it is proved that the offence has been committed with the consent, or connivance or any neglect on his part. In this regard, recently, in the case of ***Hemant Mahipatray Shah vs. Anand Upadhyay***[15], the Hon'ble Bombay High Court held that it is incumbent on the revenue to prove that the offence in question was committed with the consent, or connivance or was attributable to any neglect on part of the director.

New management cannot undergo criminal prosecution for actions by past management

In the case of ***Vasan Healthcare (P.) Ltd. vs. Dy. DIT (Investigation)***[16], the Hon'ble Madras High Court held that the criminal liability of a company cannot be transferred to another company or the new management ipso facto. Therefore, the new management apart from not taking over the criminal liability of the company, cannot also be made to undergo criminal prosecution for the offence conducted by persons who were in charge of the company during the relevant point of time.

11. *Varun Sood vs. ACIT: W.P.(C) 8577/2019: Judgment dated 12.02.2024 (Delhi HC)*
12. *ITO vs. Delhi Iron Works (P.) Ltd. [2010] 8 taxmann.com 61/195 Taxman 372 (Delhi), Sushil Suri vs. State [2007] 160 Taxman 31/[2008] 303 ITR 86 (Delhi), ITO vs. Roshini Cold Storage (P.) Ltd. [1999] 106 Taxman 318/[2000] 245 ITR 322 (Mad.), Greatway (P) Ltd. vs. Asstt. CIT [1992] 64 Taxman 421/[1993] 199 ITR 391 (Punj. & Har.)*
13. [2007] 160Taxman71 (SC)
14. [2023] 157 taxmann.com 597 (Bombay)
15. [2024] 165 taxmann.com 605 (Bombay) [12-08-2024]
16. [2024] 159taxmann.com135 (Madras)

Judicial review of sanction order is in a limited manner

Under Section 279(1) of the Act, initiating criminal proceedings against an assessee for a multitude of provisions requires prior sanction order of the appropriate tax authorities such as Principal Commissioner/Commissioner. Once the sanction order is passed by such appropriate authority, criminal prosecution can be initiated.

In the case of ***Indo Arya Central Transport Ltd. vs. CIT***[17], the company had delayed in depositing TDS amount. Show cause notice was issued to the company and its directors as to why they should not be prosecuted. In response, it was submitted that they shall opt for compounding. However, no compounding application was filed. The proceedings resumed and the petitioner accepted the default contesting that there was a reasonable cause of financial crunch for such failure. The sanction order for initiating criminal proceeding was passed by the appropriate authority. Magistrate had taken cognisance and issued summons for facing trial. A writ was filed challenging the sanction order on the ground that no punishment should be imposed for the offence as there was a reasonable cause for such failure. In this regard, the Hon'ble Delhi High Court noted that the grant of sanction could become a subject matter of judicial review albeit in a limited manner to ensure that the authority has acted fairly, and the Court cannot act as a forum to substitute the opinion. Questioning the validity of the sanction order on the grounds of reasonable cause would amount to pre-trial adjudication. Issues relating to sanction could be raised during trial. It was held that it would not be fair for the writ court to decide the question of validity of sanction order on merits of reasonable cause by acting as a fact-finding authority. Only in instances when the assessee could make out a case where cognizance was not justified, they could question the same by way of petition under Section 397 read with Section 401 of CrPC, or Section 482 of CrPC.

Defences for directors

In case the directors of a company are issued prosecution notice, following defences can be pleaded before the tax authorities based on the facts of the case: -

1. The director concerned is not the 'principal officer' of the company; or
2. The offence was committed by the company without his knowledge; or
3. Even if it was in his knowledge, he had exercised all due diligence to prevent commission of such offence.

Compounding of offence

Finally, the last resort for the directors is to compound the offence. Compounding is a mechanism whereby the directors can be prevented from prosecution by settling to pay certain sum of money. Section 279(2) of the Act provides that any offence may either before or after the institution of proceedings, be compounded by the Chief Commissioner or a Director General. CBDT has issued the compounding guidelines, which is revised from time to time. Thus, an application for compounding of an offence and the procedure for compounding should be made as per the new guidelines issued by the CBDT on 17 October 2024.

17. [2018] 92 taxmann.com 129 (Delhi)

Personal Liability of Directors under Customs and GST Laws

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Overview

Personal Liability of Directors under Customs and GST Laws

Under both Customs and GST laws, civil liability may be imposed on any person. This includes not only a corporate person, but also the natural persons in charge, such as Directors, KMP etc. For punishment/ prosecution, Section 137 of the CGST Act is pari materia to Section 140 of the Customs Act and creates a deeming fiction to fasten liability personally on Directors. In any case, such personal liability requires mens-rea and the active role of the directors in contraventions or offences committed by the company. The burden of proof will be on the directors and company to prove their bona-fides. Further, GST law categorically provides for recovery of dues from a director in cases where the company fails to discharge its liability during the normal course of business or during bankruptcy/liquidation. The executive and operational role of director may need examination to prove culpability.

Independent review of legal compliance and business models will help to prove bona-fides of the Company and the Director. As held by Apex Court, tax planning within the framework of law may be legitimate, being devoid of subterfuges or colourable devices.

Chapter 7 : Liability of Directors under Customs and GST and GST implications on Director's Remuneration

Introduction: Basis for personal liability for corporate entities with limited liability

The concept of 'limited liability' of a Company enables natural persons to assume business risks without personal property being at stake. That is, he is protected by a *corporate veil*. This principle largely applies, with some exceptions. These exceptions are rooted in the Common Law doctrine of *piercing the corporate veil,* as qualified by the doctrine of *attribution* personally to Directors. Directors of a Company have fiduciary responsibility for the operations of the Company, and a standard of care and diligence is expected in the performance of their duties.

This article discusses some relevant provisions regarding personal liability of Directors under Customs and GST laws. Some focal points are the Director's liability in relation to *(a)* contraventions committed by the Company, *(b)* tax dues of the Company, and *(c)* scenarios in case of liquidation, as interpreted by judicial pronouncements. There is reference to some practical steps that Directors can employ to mitigate risk and liability, in the conclusion.

Statutory basis for fastening liability on Directors – Customs & GST

For fiscal statutes such as GST and Customs laws, these Common Law doctrines must be statutorily incorporated before they can have effect. This is needed because fiscal statutes are interpreted "strictly" unlike other statutes which may accommodate a more purposive interpretation. Both Customs and GST[1] laws contemplate independent civil and criminal liabilities on Directors. Depending on the nature of the contravention in question, both may be attracted[2]. The difference lies in that while civil liability is monetary in nature, criminal liability attracts imprisonment in addition. In such a case, even if a person is acquitted of criminal proceedings, such acquittal by itself is no answer to the civil liability imposed ***[S.A. Thete vs. CC – 1989 (38) E.L.T. 98 (CEGAT – Bom.)]***.

The provisions pertaining to arrest and bail are similar under both the laws. The same are discussed below. The specific provisions fastening liability of Directors under both the laws are discussed thereafter.

Powers of the authority during Investigation : Arrest and bail

GST and Customs laws both provide power to various investigative authorities such as the Directorate of Revenue Intelligence, Anti-evasion, the Directorate General of GST Intelligence etc. to summon the officials and Key Managerial Personnel ("**KMP**") of a Company, including Directors for recording statements and ascertaining the facts of the matter. Arrest is also provided for in special circumstances. The general principles applicable in relation to Arrest and grant of bail as laid down by various Courts are discussed below.

For criminal liability, Bail is the rule and jail is the exception under both statutes

Pending the sentencing of a Director, it is settled that bail should be granted as a matter of rule, except in rare cases ***[Sanjay Chandra vs. CBI - [2012] 1 SCC 40; Gudikanti Narasimhulu vs. Public Prosecutor - (1978) 1 SCC 240]***.

Thus, when allegations recorded in the FIR were without considering evidence in detail, bail was granted to the Director accused. This is since there would be a violation of the right of personal liberty granted under Article 21 of the Constitution of India, where there is a time-consuming trial tantamounting to a pre-trial conviction. ***[Virbhadrasinh Pratapsinh Chauhan vs. State of Gujarat - 2024 (10) TMI 1613 (Guj HC.)]***.

Bail has also been granted where no incriminating evidence had been recovered directly linking the Director to the alleged offenses ***[Badal Gour vs. UOI - 2024 (12) TMI 134].*** So also is the case where the allegations were primarily based on witness statements without substantial corroboratory documentary evidence ***[Gyaan Chandra Jaiswal vs. Union of India, 2024 (9) TMI 1584]***.

- **Publication**: It is important to note that the department can publish the names of Companies and also its Directors who have committed any civil or criminal contraventions, if it is necessary in public interest[3].

1. Section 137 of the CGST Act, 2017
2. Section 127 of the Customs Act, 1962.
3. Section 154B of the Customs Act; Section 159 of the CGST Act.

- **Attachment**: Both statutes provide for power to effect attachment of properties, bank account and demat accounts.
- When the same offence is punishable under two legislations, there shall be criminal liability under only one of the legislations[4].

Having discussed in broad general principles of liability under Customs and GST laws including powers pertaining to investigation and arrest, we now discuss the nature and ingredients of these liabilities.

Customs law: Directors' civil and criminal liabilities

A gist of the Sections under the Customs Act, 1962 ("**Customs Act**"), under which civil and criminal liabilities can be imposed on the Director is as follows:

Civil liability provisions		Criminal liability provisions	
Section	**Provision**	**Section**	**Provision**
111	Confiscation of improperly imported goods, etc	132	False declaration, false documents
112	Penalty for improper importation of goods, etc	133	Obstruction of officer of customs
113	Confiscation of goods attempted to be improperly exported, etc	135	Evasion of duty or prohibitions
114	Penalty for attempt to export goods improperly, etc	135A	Preparation (to export goods in contravention to the Customs Act)
114A	Penalty for short-levy or non-levy of duty in certain cases	135B	Power of court to publish name, place of business, etc., of persons convicted under the Act
114AA	Penalty for use of false and incorrect material	137	Cognizance of offences
114AB	Penalty for obtaining instrument by fraud, etc.	138	Offences to be tried summarily
114AC	Penalty for fraudulent utilisation of input tax credit for claiming refund	138A	Presumption of culpable mental state
116	Penalty for not accounting for goods	139	Presumption as to documents in certain cases

4. Section 26 of the General Clauses Act.

Civil liability provisions		Criminal liability provisions	
Section	**Provision**	**Section**	**Provision**
117	Penalties for contravention, etc., not expressly mentioned	140	Offences by Companies
		140A	Application of section 562 of the Code of Criminal Procedure, 1898, and of the Probation of Offenders Act, 1958
154B	Publication of information respecting persons in certain cases		

The aforesaid sections are applicable to any "*person*" and thus includes natural as well as legal persons. However, none of the above provisions specifically refer to the Director, excepting Section 140 - on the contrary, Section 140 providing for offences by Companies specifically makes the provisions relating to offences, when committed by a Company, applicable to Directors.

Nature of acts which can attract Civil and criminal liabilities

A person may incur a civil penalty for *inter alia* doing anything that makes goods liable for confiscation[5]. Such an act may range from making an incorrect description of the goods or their value, to failure to fulfil export obligation using goods imported duty-free. Even if these acts are not intentional in nature, the fact that a contravention has rendered goods liable for confiscation is sufficient to attract penal provisions ***[Pine Chemical Suppliers vs. CC - 1993 (67) E.L.T. 25 (S.C.)].*** However, *bona-fides* greatly aid in lessening the quantum of penalty suffered.

The rationale for the Act being worded in such a manner as to impose such *"strict liability"* in certain cases, wherein there need not be any consideration as to the deliberateness of the act, lies in the purpose sought to be achieved by the Act: Its primary purpose, like customs legislations across the world, is to raise revenue for the country as goods cross the customs frontier ***[Saurer Textile Solutions vs. State of Maharashtra - 2024 (389) E.L.T. 328 (Bom.)].*** Public interest in the stated purpose significantly outweighs any justification that a contravention was committed without intent, and such liability serves as a deterrent measure.

Goods once confiscated for any contravention, vest with the Central Government and can be redeemed by payment of a "redemption fine"[6]. However, when a Company seeks to redeem the goods, there is no question of its Director personally bearing the redemption fine[7].

When there is wilful contravention, the quantum of penalty prescribed is several times higher[8], and criminal liability is invited.

5. Sections 112 and 114 of the Customs Act.
6. Section 125 of the Customs Act.
7. Ibid.
8. See for e.g., Sections 114AA, 114AB, 114AC of the Customs Act.

These include acts such as knowingly making false declarations or obtaining a license or scrip by fraud. It is crucial to note that while the language of criminal provisions such as Section 135 may be remarkably similar to civil penalty provisions, there is a *prosecution* by a magistrate when a criminal liability provision is invoked, as against *adjudicatory proceedings* by Customs authorities for civil penalties. It is for this reason that the protection under Article 20(2) of the Constitution of India against being punished twice for the same offence is not available ***[Amritlakshmi Machine Works vs. CC - 2016 (335) E.L.T. 225 (Bom.)].***

Attribution to Directors for corporate liability: Specific role in contravention to be attributed as a precondition for any liability

Attribution, simply stated, requires the Director's specific role in any contravention to be pointed out for imposing personal liability in addition to that imposed on the Company. For criminal offences, it must be further shown that he committed such contravention with a guilty mind. That is, it is necessary to ascertain whether the degree and control of the Director is so intense that a Company may be said to think and act through him ***[Iridium India Telecom vs. Motorola Incorporated - 2011 (1) SCC 74].***

To illustrate with an example, where a minor misdescription is made by the packing team, that is *per se* no reason to impose penalty on the Director of the Company, unless it is shown that the Director acted in gross negligence and facilitated the misdescription.

For criminal offences however, the sine-qua-non is a guilty state of mind. Thus, in addition to showing the specific involvement of the person in the contravention, it must be shown that he acted *wilfully* in that manner with the intention to commit such contravention. It is for this reason that the Customs Act ***presumes*** a guilty state of mind, to be rebutted by the person accused, before any liability is imposed[9]. The provisions relating to *offences* in the Act thus *always* require *mens-rea,* a guilty state of mind.

Judicial trend in confirming or setting aside penalty

Show Cause Notices are routinely issued seeking to impose penalty on the Director of an importing Company almost mechanically without pointing out the specific role of the Director in committing the contravention in question. This is especially worrisome for civil liability, given that the burden of proof is a mere preponderance of probabilities, and its strict nature as discussed above.

In practice however, the judiciary consistently insists on specific attribution before arriving at any finding as to whether such penalty is warranted. For instance:

- A person who was not an acting Director during the relevant period, cannot be held liable to penalty. So also is the case with a sleeping or a non-resident Director not involved in the day-to-day affairs of the Company, such as making declarations in import documents ***[Hemant Gogia vs. CCE - 2019 (367) E.L.T. 278 (Tri. - All.)].***
- There are also cases where penalty is confirmed only on the Directors found to be actively involved and set aside *qua* Directors not directly involved in the contravention ***[Tanya Diagnostic***

9. Section 138A and 139 of the Customs Act.

Centre vs. CC - 2002 (146) E.L.T. 198 (Tri. - Kolkata)].

- In cases where there is negligence so gross that it cannot be stated that the Directors acted with reasonably expected diligence, penalty may still be imposed on them for failure to monitor the transactions of the Company. For instance, it cannot be stated that the Director had no knowledge of the lack of factory facilities for fulfilling EO ***[CC vs. Adani Exports - 2010 (260) E.L.T. 125 (Tri. - Ahmd.)],*** and nor can it be stated that the use of the Company's IEC in fabricated import documents by employees was not within their knowledge until an investigation was commenced by the DRI ***[Danavarshini Exports - 2018 (363) E.L.T. 763 (Sett. Comm.)].*** In these cases, it is also no ground to state that penalty once imposed on the Company precludes imposition on the Directors ***[Pradeep Master Batches vs. CC - 2017 (348) E.L.T. 692 (Tri. - Mumbai)].***

- Where penalty is imposed on the Company alone, it cannot be recovered from the Directors, unless they stood as guarantors to discharge the Company's liability. The business carried out by a Company belongs to it as a juridical person and it is the Company alone which is duty-bound to discharge its debts and liabilities. If there is no penalty proposal on the Director personally, piercing of the corporate veil cannot be pressed to the extent of recovering it from the Directors in the absence of statutory provisions ***[Ved Kapoor vs. UOI - 2014 (299) ELT 385 (Del.); Anita Grover vs. CC - 2013 (288) ELT 63 (Del.)].***

- Assume that penalty is imposed on the Company, but the Company undergoes liquidation. Can Customs authorities proceed to personally demand penalty from the Directors? There is no specific section under the Customs Act dealing with this situation (unlike under GST law). Given the same, Customs authorities will have to subject themselves to the waterfall mechanism of the IBC, 2016 and lay a charge on the Company's estate (as a corporate entity) alone ***[Sundaresh Bhatt vs. CBIC - 2022 (381) E.L.T. 731 (SC)].***

GST law: Directors' civil and criminal liabilities

The Central Goods and Services Act, 2017 ("**CGST Act**") presumes that in the course of day-to-day operations of the Company, all actions of the Company are carried out with the express or implied permission of the Directors[10]. It thus provides for mechanisms to recover tax from Directors, and also contemplates penalties personally on Directors for the offenses committed by the Company. In the same vein, it expressly provides for proceeding personally against Directors in the event of liquidation/winding up/bankruptcy of the Company.

Personal Liability of Director for public and private Companies: recovery of tax dues

It is important to note that while the CGST Act envisages transfer of liability personally to Directors in specific situations for private Companies, it does not contemplate the same for public Companies. Sections 88(3) and 89

10. Section 88; Section 89; Section 137, the CGST Act 2017

of the CGST Act imposes joint and several liability on the Directors of a private Company. Recovery from a Director is possible only in situations attributable to gross neglect, misfeasance or breach of duty of the Director in relation to the affairs of the Company. Further, a Director can only be made liable when it is conclusively determined that the Company is unable to settle the tax/interest/penalty due[11]. The protection provided to company under insolvency under IBC laws may not be extended to directors.

Director cannot be made liable in absence of negligence or breach of duty

For instance, if a Director being proceeded against was not a Director at all during the concerned period, there cannot be personal liability fastened on him. An attachment order against such a Director is to be set aside ***[Prasanna Karunakar Shetty vs. State of Maharashtra - 2024 (4) TMI 779].***

Civil penalties on Director

Section 122(1A) of the CGST Act further proposes penalty upon any person who retains the benefit of, or upon any person at whose instance the following transactions are conducted:

a. Supplying goods and/or services without issue of any invoice or by issuing false/incorrect invoice;

b. issues any invoice or bill without supply of goods or services or both;

c. takes or utilises input tax credit ("**ITC**") without actual receipt of goods or services or both either fully or partially;

d. takes or distributes ITC in contravention of section 20 of the CGST Act, or the rules made thereunder.

Further, Section 122(3) of the CGST Act proposes imposition of penalty upon any person who aids or abets any of the offenses specified in Section 122(1) of the CGST Act; or acquires possession of or in any way concerns himself in transporting, removing etc., or in any manner deals with any goods which he knows or has reasons to believe are liable to be confiscated under the CGST Act or rules made thereunder; or receives/supplies in contravention of the CGST Act or rules made thereunder; or fails to appear before the central tax officers in response to the summons issued under section 70 of the CGST Act; or fails to issue invoice in accordance with the provisions of the CGST Act or rules made thereunder or fails to account for an invoice in his books of accounts.

It is to be noted that though Section 122 does not specifically mention 'Director', considering the responsibility and indulgence in day-to-day activities of the Company and the attribution doctrine described above, the executive Directors of a Company can also attract penalties under the above provisions.

Criminal liability of Directors under CGST Act

The criminal offences provided under section 132 of the CGST ACT is line with the civil offences under Section 122(1A) of the CGST Act. Section 132 of the CGST Act provides for offenses punishable with fine as well as imprisonment such as supply of goods without issue of invoice, issues invoice without supply, fraudulent ITC etc. The section list down nine

11. *Smt. K. Malathi vs. State Tax Officer, A.R. Ramasubramania Raja 2023 (11) TMI 513*

offenses, cognisable and non-bailable and non-cognisable and bailable. The punishment upon violation of the offenses ranges from six (6) months to five (5) years of imprisonment.

A Director cannot be punished under Section 132 of the CGST Act without determining his active role in the offence committed and demonstrating *mens rea* in terms of Section 137, the CGST Act 2017. They can be prosecuted only if there is sufficient material to prove their active role coupled with criminal intent ***[Sunil Bharti Mittal vs. Central Bureau of Investigation (2015) 4 SCC 609].***

Following the principle laid down in the *Sunil Bharti Mittal* case, criminal proceedings against the managing Director of the Company initiated solely on the premise that he is the only non-independent, executive Director of the Company were quashed. A Director can only be accused if there is sufficient evidence or material to prove their active role in the offense ***[Shiv Kumar Jatia vs. NCT - AIR 2019 SC 4463].***

GST Implications Re Director Remuneration:

Director's remuneration: reverse charge

Directors are paid remuneration towards the services provided to the Company. The services provided by the Directors to their Companies are taxable in the hands of the Company under reverse charge basis[12]. However, the services provided by an employee to its employer is neither treated as supply of goods nor as supply of services as per Para 1 of Schedule III of the CGST Act. No GST is applicable on employment services. The Executive Directors are the employees of the Company. The remuneration paid to such Directors are declared as 'salaries' in the books of a Company and subjected to TDS under Section 192 of the Income Tax Act, 1961. Therefore, question arises as to whether the salaries/remuneration paid to these Directors will attract GST under reverse charge basis.

In this regard, the CBIC vide Circular[13] clarified that remuneration paid to the executive Directors, being consideration for services by an employee to and employer in the course or in relation to his employment, is not liable to GST. However, sitting fee paid to non-executive or independent Directors that are not employees of the Company is not in the nature of 'salaries' and is therefore out of the purview of Schedule III of the CGST Act. It is thus, "supply" liable to tax in the hands of the Company under reverse charge basis.

Personal guarantee by a Director

Often the Directors of a Company provide personal guarantee to banks/financial institutions for sanctioning of credit facilities without any consideration. The Directors being related party, certain doubts have arisen on the nature of transaction and liability in terms of deeming supply provisions. GST council vide Circular[14] has clarified the taxability of personal guarantee. The Circular has provided concession on valuation based on RBI regulations, deeming the value of the supply of personal guarantee by the Director to be 'nil'. It is important to examine the nature of each service rendered by a Director to the Company, so as to determine liability under RCM or FCM basis. The Circular is not

12. Sl. No. 6, Notification No. 13/2017 – Central Tax (Rate) dated 28.06.2017
13. Circular No. 140/10/2020-GST dated 10.06.2020
14. Circular No. 204/16/2017 dated 27.10.2023

applicable for other independent services or professional services rendered by Directors.

Conclusion

The law has evolved to specifically attribute liability to directors for the offences committed by the company. Directors are responsible for the conduct and actions of the Company. Personal penalties serve to ensure compliance, accountability, and responsibility at the individual level, especially when violations of Customs and GST laws involve wilful misconduct, negligence, or collusion.

Thus, Directors and Companies must ensure that frequent compliance checks and independent reviews of the actions/business models of the Company are carried out in light of changing laws and amendments. This will help mitigate the risk of the strict liability contemplated in Customs and GST laws and will help prove the *bona-fides* of the Company and the Director. The legal position needs to be evaluated during investigation for further steps to be taken in relation to anticipatory bail, compounding etc.. As held by Apex Court, tax planning may be legitimate provided it is within the framework of law and devoid of subterfuges and colourable devices. The burden of proof will be on the directors and company to prove the *bona-fides*.

Abstract

Personal Liability of Directors under Customs and GST Laws.

Customs Act, 1962

- For civil liability, the provisions refer to a "person" who would be liable. It is settled that this extends not only to the corporate person, but also to natural persons in charge of such corporate person
- For criminal liability, Section 140 explains clearly that Directors shall also be liable for offences committed by a Company.

Central Goods and Services Act, 2017

- Section 88 and Section 89 categorically provides for recovery of liability from a director in cases where the company fails to discharge its liability during normal course of business or during bankruptcy/liquidation.
- Further, as regards punishment/ prosecution, Section 137 is *pari materia* to Section 140 of the Customs Act and creates a deeming fiction whereby *inter alia*, the directors of the company can also be considered liable for an offense committed by the company and can be punished accordingly.
- Nature of the services rendered by a director needs to be examined to determine the GST liability.

Fastening personal liability on directors, the interpretation of the law by judiciary contemplates *mens rea* and active role of the directors in the offences committed by the company. The independent review of legal compliance, business models will help to prove the *bona-fides* of the Company and the Director. As held by Apex Court, tax planning may be legitimate provided it is within the framework of law and devoid of subterfuges and colourable devices. The burden of proof will be on the directors and company to prove the *bona-fides*.

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Location of Board of Directors Meetings and their relevance for determining tax residency and Place of Effective Management

CA Pranay Bhatia

Overview

The article delves into the risk of potential Place of Effective Management (POEM) for foreign companies due to the pivotal roles, extensive responsibilities, and functions undertaken by directors under income tax law. It highlights how directors' decisions significantly influence a company's tax residency in India, particularly when operations span across multiple jurisdictions.

It examines Indian tax law, particularly Section 6(3) of the Income Tax Act, 1961, emphasizing the "substance-over-form" principle. Key clarifications by the CBDT and thresholds for applicability are also highlighted.

Further it includes impacts of directors' credentials, authority, and decision-making on POEM. International principles, including OECD and UN Model Tax Conventions, are discussed, showcasing their approaches to dual residency and treaty compliance. Jurisprudence from Indian and global courts, such as De Beers Consolidated Mines Ltd and Bywater Investments Ltd, provides practical insights into POEM's application.

Additionally, the article addresses the challenges posed by technological advancements and regional headquarters in POEM determination. It offers a nuanced perspective on balancing legal principles with business realities, providing a comprehensive guide for directors and tax professionals to navigate POEM complexities effectively.

Introduction to Tax Residency and POEM

The concept of tax residency is pivotal in determining foreign company liability under Indian income tax law. For companies, the Place of Effective Management ('POEM') is a critical factor in establishing tax residency.

Indian Tax Law

Under Indian tax law, a company is deemed resident in India if it is incorporated in India; or Its POEM is located in India during the relevant financial year.

POEM is defined as the place where key management and commercial decisions, essential for the conduct of a company's overall business are substantively made.

International OECD Principles

The OECD Model Tax Convention recognizes POEM to resolve dual residency issues, focusing on management decisions and treaty compliance. It aims to prevent tax avoidance by scrutinizing cross-border operations, with procedural safeguards for fair outcomes.

International UN Model

The UN Model aligns with OECD principles but offers flexibility for countries to adapt. It suggests a case-by-case approach to dual residency issues, incorporating multiple factors such as board activities and governance laws to minimize abuse while accommodating diverse treaty practices.

Key Ingredients to POEM

Indian Tax Law

The concept of POEM was introduced into Indian tax law through Section 6(3) of the Income Tax Act, 1961 ('the Act') to determine the residential status of a company. A company is considered a resident in India if:

- It is incorporated as an Indian company; or
- Its POEM is located in India during the relevant financial year.

The term "POEM" is defined as the location where key management and commercial decisions necessary for the conduct of the company's overall business are, in substance, made. This provision aligns India's approach with global norms, emphasizing the substance-over-form principle to address tax residency in cross-border operations.

CBDT Clarifications

To address ambiguities and provide clarity, the Central Board of Direct Taxes (CBDT) issued Circular No. 6/2017 dated January 24, 2017, offering guidelines on interpreting POEM. These guidelines distinguish between active business outside India (ABOI) and other cases, providing a framework to assess POEM of a company.

Companies engaged in Active Business Outside India (ABOI)

A company is considered engaged in "active business outside India" if:

- Passive income is not more than 50% of its total income;
- Less than 50% of its total assets are located in India;
- Less than 50% of its employees are situated or resident in India; and
- Payroll expenses for such employees are less than 50% of total payroll expenditure.

It is important to note that these conditions need to be cumulatively satisfied to substantiate that a company's active business is outside India.

Further, it is stated that in case the Board of Directors (BoD) is not exercising its management powers and these are instead being exercised by the holding company or another person(s) resident in India, the POEM will be considered to be in India.

However, the BoD's adherence to global policies set by the parent company in areas such as payroll, accounting, HR, IT infrastructure, supply chain, and routine banking operations — if not specific to any entity — should not constitute the BoD standing aside.

Companies Not Engaged in Active Business Outside India

For other than ABOI companies, POEM determination follows a two-stage process:

- Identify the persons making key management and commercial decisions for the business as a whole.
- Determine where these decisions are made.

It is pertinent to note that the location where management decisions are made is more important than where they are implemented.

Key principles include:

- ***Board Meetings:*** Location of board meetings is relevant if the board retains and exercises authority to govern and make key decisions. Merely formal meetings at a location are insufficient.
- ***Delegated Authority:*** If authority is delegated to senior management or committees, POEM is the location where key decisions are developed and formulated.
- ***Head Office:*** A critical factor if senior management and their support staff operate predominantly from a single location. In decentralized structures, head office determination depends on where senior managers predominantly work or meet to decide key strategies.
- ***Shareholder Decisions:*** Decisions made by shareholders on matters reserved under company laws, such as asset sales or liquidation, are not relevant for determining a company's POEM as they impact the company's existence rather than its business conduct. However, if shareholders limit the authority of the board or management, their involvement may cross into effective management. This determination depends on the specific facts of each case.
- ***Routine Decisions:*** Day-to-day operational decisions by junior or middle management are not relevant for POEM.
- ***Secondary Factors***: If primary factors do not conclusively determine POEM, secondary considerations include:
  - — Place of main and substantial business activity.
  - — Location where accounting records are maintained.

POEM determination must consider all relevant facts about a company's management and control, not isolated factors. The principles outlined above can be traced from principles derived from various judicial precedents wherein Indian courts have tested POEM of a company :

- Hon'ble Bombay High court in case of ***Narottam & Pereira Ltd [(1953) 23 ITR 454 (BOM)***] emphasized that "control and management" referred to the central, directive authority—the "head and brain"—which was exercised by the BoD in Bombay. Despite granting wide powers to managers in Ceylon, the directors retained overarching control, issuing directives and overseeing operations from Bombay.
- In ***Saraswati Holding Corporation Inc. [(2007) 16 SOT 535 (Del)]***, the Hon'ble Delhi ITAT held that the assessee, a Mauritius company, was not a resident of India under Section 6(3)(ii) as its key decisions were made abroad. The POA only authorized day-to-day operations in India, and evidence like board resolutions and call records confirmed control remained outside India. The erroneous analysis of POEM by authorities was set aside, restricting taxation to income accruing in India.
- Similarly in case of ***Nandlal Gandalal 40 ITR 1, 15 (SC)***, apex court have outlined as how the term 'control and management' should operate; in case of ***Radha Rani Holdings Pvt Ltd [(2007) 16 SOT 495 (Del)***] court has analyzed the similar aspect.

Further, the circular outlines detailed definitions of various key terms relevant for analyzing any facts of the case.

Furthermore, the Circular states that the above principles for determining POEM are for guidance only, and no single factor is decisive. The Assessing Officer (AO) must seek prior approval from the Principal Commissioner or Commissioner before initiating proceedings to treat a foreign company as a resident based on POEM in the manner prescribed.

Subsequent Clarifications:

- Threshold Criteria: Circular No. 08 of 2017 dated 23rd February 2017 clarified that the POEM provisions would not apply to companies with turnover or gross receipts of Rs 50 crore or less in a financial year.
- Clarification to concerns raised by Stakeholder:

Several stakeholders raised concerns regarding the potential for POEM for certain multinational companies with regional headquarters in India. The concern primarily lies in situations where employees with multi-country responsibilities or oversight over operations in other countries within the region are based in India. Such arrangements could lead to their income from operations outside India being taxed in India, which raises questions about the scope of POEM's application in these contexts.

Vide Circular No. 25 of 2017 dated 23rd Oct 2017, in light of the above concerns raised, it has been clarified that the mere operation of a Regional Headquarters in India for subsidiaries or group companies, as long as it follows the general policies of the parent company in areas such as payroll, accounting, HR, and supply chain functions, will not, by itself, trigger POEM for those subsidiaries. This is particularly relevant when the activities in India are not specific to any one entity but are part of the parent company's broader group policy.

Therefore, the activities of a regional headquarters located in India will not be a sufficient basis to establish the POEM for subsidiaries or group companies unless there is evidence of the BoD standing aside from management decisions.

The above outlines the key highlights of various circulars issued by the department. For a more detailed analysis of specific facts, it is recommended to refer to the respective circulars for a comprehensive understanding.

Credentials of the Directors

The following factors provide insight into whether the BoD genuinely exercises control over the company's key management and commercial decisions or merely acts as a rubber stamp for decisions made elsewhere.

- ***Qualifications and Expertise***

  A board comprising directors with extensive industry experience, technical knowledge, and leadership skills is more likely to be involved in substantive decision-making processes.

- ***Role and Authority***

  The scope of authority vested in directors must be assessed to determine whether they are actively involved in shaping the company’s policies and strategies as an independent authority.

- ***Substantive Participation in Decision-Making***

  The frequency, content, and outcomes of board meetings indicate substantive management. Regular meetings addressing strategic matters suggest the POEM aligns with the meeting location, while mere approval of pre-determined decisions points to management outside the board's jurisdiction.

- ***Influence of External Parties***

  If the BoD acts under the influence of external parties, such as controlling shareholders, parent companies, or other individuals, the POEM is likely to shift to the location of these external decision-makers. It should be noted that if the Board takes advise of external consultants and then decides to follow the advice, that should not adversely impact the POEM analysis.

In this regard, reference could be placed on the Supreme Court ruling in case of ***Mansarovar Commercial (P) Ltd. [(2023) 293 Taxman 312 (SC)]***, wherein Apex Court held that the control and management of a company's affairs must be demonstrated through de facto, not merely de jure, control—i.e., actual exercise of authority in the conduct and management of its affairs. The domicile or registration of the company is irrelevant; the decisive test lies in identifying where the sole right to manage and control the company resides.

A detailed evaluation of the directors' credentials ensures that the determination of POEM aligns with the substance-over-form principle, focusing on the actual location of effective management rather than superficial formalities.

International Legal Principles

- ***OECD Model Tax Convention***

  The concept of POEM finds recognition in the OECD Model Tax Convention on Income and on Capital (2017) as a critical factor in determining the tax residency of entities other than individuals. Article 4(3) of the Convention addresses cases where an entity is deemed a resident of both contracting states. It provides that such cases should be resolved by mutual agreement between the competent authorities of the respective states. The resolution considers factors such as the POEM, the jurisdiction of incorporation, and other relevant criteria. In the absence of mutual agreement, the entity may be denied relief or exemption from tax under the Convention, except as agreed upon by the competent authorities.

The Convention highlights that careful scrutiny of the facts may reveal the true POEM of a subsidiary lies in the jurisdiction of its parent company, ensuring that the entity is taxed appropriately under domestic laws and treaties.

Furthermore, the presence of substantial management activities in the parent's jurisdiction could establish a permanent establishment (PE) in that state, thereby attributing profits accordingly.

Importantly, the revised approach also introduces procedural safeguards, such as timely requests for resolution under Article 25, specifying the timeframe for such decisions and clarifying the applicability of outcomes to different periods.

Despite these refinements, certain countries, such as Japan and Korea, have reservations about using POEM as the determining criterion, preferring alternatives like "head or main office." These divergences underline the ongoing debate on the most effective mechanism to address tax residency in bilateral treaties while minimizing opportunities for abuse.

In essence, the OECD's framework underscores the importance of POEM as a dynamic and nuanced tool to resolve tax residency issues, balancing the need for clarity, prevention of abuse, and adaptation to complex cross-border structures.

- ***UN Model Tax Convention***

  Article 4, Paragraph 3 of the UN Model Tax Convention mirrors its counterpart in the OECD Model Tax Convention. The 2017 update to the UN Model aligns closely with the OECD Commentary, emphasizing a case-by-case resolution rather than sole reliance on the POEM criterion.

  The UN Model adopts the OECD's 2017 recommendation (arising from the BEPS Action 6 report) that acknowledges dual-residence cases are rare but often exploited for tax avoidance. As such, it discourages an automatic reliance on POEM and instead suggests that competent authorities consider multiple factors.

  While the OECD Commentary recognizes the limitations of the POEM criterion in addressing tax avoidance, the UN Model explicitly retains flexibility for states that prefer using POEM as a decisive factor. The UN Model provides an alternative formulation, allowing states to adopt pre-2017 language emphasizing POEM, which ensures its applicability in a manner that prevents abuse. This approach reflects the UN's practical considerations in accommodating varying domestic tax policies and treaty practices.

  In conclusion, the UN Model underscores a comprehensive and adaptable framework for resolving dual-residence cases, harmonizing principles from the OECD Model while acknowledging the distinct needs of developing and developed states.

- ***Some of the International Jurisprudence:***

  The concept of POEM is extensively examined by courts globally.

- Reference could be placed on judgement pronounced in case of ***De Beers Consolidated Mines Ltd vs. Howe [[1906] A.C. 455 (H.L.) (Eng.)***] wherein South African company was held to be resident of UK as London office controlled key management decisions. In the said case the House of Lords observed that real control of the company was exercised in London, where key decisions on contracts, policy, asset disposal, mine operations, profit application, and director appointments were made, while only routine expenditures at the mines were managed locally.

- Another ruling is in the case of ***Bywater Investments Ltd. & Ors. [[2016] HCA 45***] wherein, Australian Federal Court holds POEM as the place where the BoD makes its decisions. The Court examined the residential status of appellant companies for 2001-2007, noting that, despite their incorporation in different jurisdictions and formal directors/shareholders being Mr. Borgas and family, substantive decisions were controlled by Mr. Gould from Sydney. Referring to the POEM definition in DTAAs, the Court concluded that the companies' POEM was in Australia, where key decisions were made.

- In case of ***Unit Construction Co. Ltd. [42 ITR 340, HL]***, House of Lords held that the term "control and management" signifies the central authority or the "head and brain" responsible for key aspects such as policy-making, financial decisions, profit allocation, and other critical management activities of a company. Control is not confined to the country of incorporation; a company can have multiple residences under tax laws. A company's residency in a foreign jurisdiction does not automatically negate its residence in India for tax purposes.

Impact of Technological Advancements

- ***Virtual Meetings and the Impact on POEM***

  The rapid advancements in technology have significantly altered the way businesses operate, especially in terms of decision-making processes. One of the most notable impacts has been the widespread adoption of virtual meetings, which has reshaped the traditional concept of POEM.

  According to Circular No. 06 of 2017 issued by CBDT, the use of modern technology has had a profound effect on determining the POEM of a company. The circular acknowledges that virtual meetings may cause the physical location of board or executive committee meetings to be less relevant in determining where key decisions are made. Instead, substance over form has become the guiding principle.

  Even though meetings may be held virtually, the actual place where the directors or persons making decisions (or the majority of them) usually reside can play a crucial role in determining POEM.

- ***Adaptation by Tax Authorities***

  The adaptation by tax authorities to this evolving landscape is critical. As virtual meetings become more commonplace, tax authorities must evaluate POEM based on where the substantive decision-making occurs, rather than the physical location of meetings.

  Moreover, the determination of POEM is not just confined to the location of meetings but also extends to the overall management structure. This nuanced approach reflects a broader understanding of the global nature of business operations in the digital age.

  In conclusion, as technology continues to advance, the definition of POEM must evolve to account for virtual environments. This shift will be crucial in providing clarity and fairness in assessing the residency status of companies in an era of virtual management.

  Circular Resolutions and their Impact on Tax Residency

- ***Legal Status of Circular Resolutions***

  Circular resolutions, though not held in a formal meeting, carry the same legal weight as resolutions passed during physical board meetings. However, the use of circular resolutions must be in line with the company's internal procedures, which should specify when such a resolution can be validly passed. Additionally, the effectiveness of circular resolutions depends on whether the requisite quorum is met, as prescribed in the company's constitution or relevant laws.

- ***Impact on POEM and Tax Residency***

  POEM, a key determinant of a company’s residency status, is primarily based on where key management decisions are made. In this context, according to above said circular, when circular resolutions or round robin voting are employed, several factors need to be considered to assess the POEM. These factors include, frequency of use, type of decisions (whether routine or strategic), location of the parties involved.

Linking with Business Activity

Outlined below are the few critical functions, sector-wise, BoD should execute in the jurisdiction where POEM is intended to be located:

- Manufacturing Sector:
  - — ***Production Planning***: Includes decisions on production capacity, process optimization, and technological upgrades.
  - — ***Supply Chain Management***: Strategic oversight of vendor relationships, logistics, and procurement processes.
  - — ***Regulatory Compliance***: Ensuring adherence to local regulations, environmental standards, and safety protocols.
  - — ***Quality Control***: Decisions related to processes, product standards, and certifications should originate from the jurisdiction where POEM is determined.
- Trading Business:
  - — ***Market Expansion Strategies:*** Decisions regarding the selection of new markets, negotiation of trade terms, and finalization of distribution agreements.
  - — ***Currency Hedging and Risk Management***: Financial risk management, including decisions on currency hedging, insurance, and trade credit management.
  - — ***Supplier and Buyer Relations:*** Strategic decisions about supplier negotiations, long-term contracts, and strategic alliances etc.
- IP Development:
  - — ***R&D Strategy***: The overall research and development strategy, including new IP generation and innovation pathways, should be formulated and executed from the jurisdiction where POEM resides.
  - — ***IP Portfolio Management***: Acquisition, protection, and licensing of intellectual property rights ensuring control remains centralized.
  - — ***Cross-border Licensing and Royalties***: Origination of high-level decisions about international licensing agreements and royalty structures.
  - — ***Strategic Partnerships***: Decisions regarding joint ventures, collaborations, and partnerships for IP development or commercialization.
- Investment Decisions:
  - — ***Capital Raising***: Decisions regarding capital raising through equity or debt, including the structuring of offerings and investor relations.
  - — ***Mergers and Acquisitions***: Approval of mergers, acquisitions, or disinvestment, along with the due diligence process.
  - — ***Portfolio Management***: Oversight of investment portfolios, asset allocations, and performance

reviews ensuring centralized management.

— ***Strategic Investment Planning***: Long-term investment strategies, including identification and prioritization of high-growth sectors and risk management.

By ensuring these critical functions are executed by the BoD from the jurisdiction where POEM is intended to be, organizations can maintain alignment with POEM requirements, safeguarding against unintended tax residency implications.

Conclusion

The POEM is a nuanced concept that requires careful evaluation of a company's management and governance structure. Directors play a pivotal role in determining POEM through their decision-making, governance practices, and adherence to regulatory frameworks. It is critical to ensure that POEM is assessed holistically, considering substance over form, to minimize disputes and tax exposures.

- ***Critical Dos and Don'ts***

  Dos: Document key decisions with clarity, ensure structured and substantive board meetings, maintain detailed records, and evaluate the impact of virtual meetings on decision-making.

  Don'ts: Avoid undocumented decisions, delegating key decisions without oversight, relying solely on parent company policies, or creating a perception of a passive board.

- ***Why BoD Play an Important Role***

  The BoD plays a pivotal role in determining POEM, as emphasized under Section 6(3) of the Act, CBDT Circular No. 6/2017 and in various judicial precedents. The board's active involvement in strategic decision-making, independence, and credentials are critical factors in identifying the jurisdiction where effective management resides.

  Tax authorities assess board minutes, resolutions, and the substantive nature of deliberations to evaluate POEM. Alignment with OECD and UN MTC principles further underscores the board's role in ensuring decisions reflect genuine management control within the jurisdiction, avoiding risks of treaty abuse or adverse tax consequences.

- ***How to Ring-Fence and Protect from Unintended Consequences***

  To mitigate POEM-related risks, companies should adopt robust governance practices, conduct regular compliance checks, document key decisions transparently, consult tax experts for complex issues, and use secure technology for virtual meetings while ensuring substantive decision-making is well-recorded. These measures help safeguard tax residency, mitigate disputes, and ensure compliance with evolving laws.

Contemporary Challenges Faced by Directors

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Overview

In India and other common law jurisdictions, directors are the principal officers of a company, responsible for acting in, and representing, the company's best interests, and maintaining oversight for regulatory and compliance functions. The role has always been complex and multi-faceted, as directors are required to balance commercial realities and the demands of shareholders with their responsibilities towards the company itself, through a set of fiduciary duties, prescribed under both statute and common law, that can often be challenging to navigate in practice. This is especially the case in the modern era, where directors are faced with an increasingly complex regulatory and commercial landscape. In this article, I analyse some of the specific challenges directors must contend with in contemporary corporate governance. In particular, I have outlined practical considerations for directors under the Companies Act and the LODR, focus areas under India's emerging ESG framework, the role directors play in a company's data privacy and intellectual property matters, and the governance of startups.

Introduction

In India and other common law jurisdictions, directors are the principal officers of a company, responsible for acting in, and representing, the company's best interests, and maintaining oversight for regulatory and compliance functions. The role has always been complex and multi-faceted, as directors are required to balance commercial realities and the demands of shareholders with their responsibilities towards the company itself. This is especially the case in the modern era, where directors are faced with an increasingly complex regulatory and commercial landscape. In this article, I analyse some of the specific challenges directors must contend with in contemporary corporate governance.

An Increased Burden of Compliance

A Director's Principal Obligations

As the primary governing and administrative body of a company, the board has a direct statutory responsibility to ensure adherence to governance, compliance, and reporting requirements. Under the Indian Companies Act 2013 (**"Companies Act"**), directors are required to act in good faith to promote the objects of a company and in the company's best interests; exercise due and reasonable care and independent judgement; and avoid any conflicts of interest[1]. For listed entities, the Listing Obligations and Disclosure Requirements Regulations 2015 (**"LODR"**) issued by the Securities and Exchange Board of India (**"SEBI"**) explicitly require the board to review risk policies, annual budgets, and business plans; monitor the effectiveness of the company's governance practices; select and monitor key managerial personnel (**"KMP"**); monitor potential conflicts of interest; ensure the integrity of the company's reporting systems; and establish a corporate culture by which the company's affairs are to be run[2].

These statutory obligations are long-standing and will be familiar to any person seeking to serve on a board. In practice, however, the specifics of these obligations are ever-changing, and have grown more involved and stringent with time. For instance:

(i) The LODR previously provided for a 24-hour window within which pertinent information needed to be disclosed to the stock exchanges[3]. With effect from 15 July 2023, this has been changed to a sliding-scale reporting period. Where the board has taken a decision, the related information needs to be disclosed within 30 minutes of the closure of the meeting[4]. Similarly, where any relevant information is emanating from the listed company itself, disclosure needs to be made within 12 hours[5].

(ii) Also with effect from 15 July 2023, the LODR now requires the top 100 listed entities to react to any material price movement (as specified by stock exchanges) by specifically confirming, denying, or clarifying any related non-general information reported in the mainstream media, within 24 hours of the trigger of the price movement[6].

Changes of this nature are specific, contextual, and require close attention from directors. Taken individually, these requirements appear to deal with the minutiae of specific reporting scenarios; viewed as a collective, however, obligations of this nature serve to ensure that companies are governed responsibly, with a view to protecting public markets and keeping regulators and the general public informed of any material developments. This is a key corporate governance goal that directors should look to pursue as well. As a result, care must be taken to ensure that the company's oversight and compliance functions can sufficiently assess the nature of any given event and related information, determine whether a disclosure needs to be made, and then actually complete that disclosure within prescribed timelines to the level of detail required. Increasingly, directors are required to play an active role in this process – passivity can compromise a company's governance framework.

Increased Regulatory Scrutiny

In addition to increased regulatory complexity, directors also need to contend with a heightened degree of scrutiny from regulators for contraventions of law. A useful example

1. Section 166, Companies Act.
2. Regulation 4(2)(f), LODR.
3. Erstwhile Regulation 30(6), LODR.
4. Regulation 30(6)(i), LODR.
5. Regulation 30(6)(ii), LODR.
6. Proviso to Regulation 30(11), LODR.

is the treatment of non-compliance with Corporate Social Responsibility (**"CSR"**) requirements under the Companies Act in the recent past. The erstwhile statutory position was that, if a company did not make the necessary CSR expenditure during a given financial year, it would be sufficient for the board to record the reasons for this in their annual report[7]; as of 2021, additional requirements have been introduced, including the obligation to transfer unspent amounts to a designated fund within six months of the close of the financial year[8].

These amendments constitute an increase in the compliance burden for CSR, and have also been vigorously enforced by regulators. For instance, in a recent adjudication order issued in response to a suo moto application made by Xiaomi India, the company was held to be in violation of this requirement because it did not transfer its CSR shortfall within six months of the close of FY 2022-23[9]. The actual shortfall amount was relatively small (INR 86,511) and arose on account of exchange rate fluctuations, and was ultimately deposited within 12 months of the close of the financial year[11]; regardless of this, however, the company and its directors were penalised with a fine for this contravention[11]. This is an indication that the regulators will look to give teeth to new compliance obligations through appropriate enforcement action, and directors should accordingly take all necessary steps to ensure compliance to the fullest extent possible.

Considerations for Independent Directors

A clear indicator of the changing nature of directors' roles is the treatment of protections for independent directors in the recent past. Under both the Companies Act[12] and the LODR[13], an independent director is only liable for acts that occurred with *'knowledge, attributable through Board processes, and with his consent or connivance or where he had not acted diligently'*. This appears to set a fairly high bar, as an independent director who acts reasonably cannot be held personally liable. In practice, this position is being re-examined, and independent directors are being held to an increasingly high standard of conduct.

In its final order in the matter of LEEL Electricals Limited[14], SEBI noted the contention of two independent directors serving on the company's audit committee that they had been informed they did not need to have any financial or corporate expertise and were not expected to engage in any detailed financial review, and thus should not be held liable for any financial improprieties engaged in by the management. SEBI rejected this

7. Proviso to Section 135(5), Companies Act.
8. Id, as of 22 January 2021.
9. Order of Adjudication for Violation of Provisions of Section 135 of the Companies Act 2013 by Xiaomi Technology India Private Limited, Registrar of Companies, Karnataka, Ministry of Corporate Affairs, 13 September 2024.
10. Id, at para 6.
11. Id, at para 8.
12. Section 149(12), Companies Act.
13. Regulation 25(5), LODR.
14. WTM/AB/CFID/CFID/30277/2024-25, dated 18 April 2024.

contention, noting *'the solemn responsibility entrusted to AC members involves active and diligent oversight, irrespective of any misleading directives from higher management. This acknowledgment of their purportedly limited role should not absolve them from facing the consequences of their inability to act decisively in the face of financial malfeasance.*[15]*'* Both independent directors were penalised with fines and prohibited from being associated with listed entities for a period of three years.

As evidenced by this recent order, SEBI is actively examining whether independent directors are indeed acting diligently in the discharge of their duties – the mere lack of knowledge or connivance is not sufficient, as directors also need to ensure that they are taking active steps to maintain appropriate governance measures as custodians of the company. Directors need to keep this in mind while navigating their roles – as noted in the preceding section, it is essential to play an active role in matters of corporate governance, wherever possible.

Evolving Role of Directors in the Digital Age

As Indian business increasingly adopt digital and online tools and strategies, directors' responsibilities in these areas have grown as well. Directors have an overarching responsibility under the Companies Act to implement proper and functioning systems to comply with all applicable laws, and to confirm that they have taken relevant steps in this regard as part of the Directors' Responsibility Statement contained in the annual board report[16]. The Code for Independent Directors indirectly sets a similar standard for independent directors, by requiring them to keep themselves informed of the company's affairs and its external environment[17], participate actively in risk management discussions[18], and ensure that their concerns about the running of the company are suitably addressed by the board[19].

As a result, directors are responsible for ensuring compliance with such requirements as:

(i) The proper collection, storage, handling, and transmission of sensitive personal data or information, along with the implementation of reasonable security practices and procedures, under the Information Technology (Reasonable Security Practices and Procedures and Sensitive Personal Data or Information) Rules, 2011;

(ii) Adopting appropriate cybersecurity measures, taking action to remove harmful or illegal content, and reporting cybersecurity incidents to the Indian Computer Emergency Response Team, under the Information Technology (Intermediary Guidelines and Digital Media Ethics Code) Rules, 2021;

(iii) The prevention of reproduction or distribution of copyrighted materials under the Copyright Act 1957;

15. Id, at para 149.
16. Section 134(5)(f), Companies Act.
17. Para III(7), Schedule IV, Companies Act.
18. Para II(1), Schedule IV, Companies Act.
19. Para III(6), Schedule IV, Companies Act.

(iv) The prevention of trademark infringement and potential passing-off through the use of marks that are similar to pre-existing third-party intellectual property, under the Trademarks Act 1999; and

(v) A range of new statutory obligations under the Digital Personal Data Protection Act, 2023[20], including obtaining appropriate consents for data collection and processing, implementing data protection measures and preventing breaches of personal data, and deleting personal data when no longer required or upon the withdrawal of consent.

These are complex obligations, often technical in nature, and it is not straightforward for independent directors, in particular, to monitor and ensure compliance, given that they are not directly involved in day-to-day management. In practice, the solution lies in the Code for Independent Directors that prescribes the duties of independent directors in the first place – the Code explicitly provides that independent directors should *'seek appropriate clarification or amplification of information and, where necessary, take and follow appropriate professional advice and opinion of outside experts at the expense of the company'*[21]. Accordingly, independent directors should request all relevant technical information from management, and seek out independent advice to review such information and assess compliance. For instance, detailed documentation pertaining to the handling of personal information, or ongoing IP litigation involving the company, can be requisitioned and then reviewed by outside counsel and other professional advisors, to inform an independent director's assessment of whether the company is taking all appropriate measures, or whether any issues need to be escalated for consideration by the board at large.

The Role of Directors in ESG Compliance

The ESG Framework

As the Indian economy matures, the framework for ESG compliance is steadily transitioning from a voluntary, opt-in system to a set of mandatory requirements. The introduction of the Business Responsibility and Sustainability Reporting ("**BRSR**") framework in 2021 under the LODR[22] marked a concrete step in this direction, requiring the top 1000 listed companies by market capitalisation to include ESG disclosures in their annual reports[23]. The BRSR framework requires disclosures for 'essential' and 'leadership' indicators against the nine principles of 'National Guidelines on Responsible Business Conduct', with essential indicators being mandatory disclosures, and leadership indicators being voluntary[24]. The

20. This statute is still in the process of being implemented, so these obligations would not currently apply. Once fully adopted, however, this Act would introduce a large number of new compliance obligations for Indian companies.
21. Para III(2), Schedule IV, Companies Act.
22. 'Business responsibility and sustainability reporting by listed entities', SEBI Circular SEBI/HO/CFD/CMD-2/P/CIR/2021/562, 10 May 2021.
23. Regulation 34(2)(f), LODR.
24. Ibid note 23, at para 4.

principles and related reporting requirements are quite comprehensive – for instance:

(i) The first principle is that businesses should conduct and govern themselves with integrity, and in a manner that is ethical, transparent, and accountable[25]. Essential indicators include details of training and awareness programmes conducted for directors, KMP, etc, and details of any fines or penalties levied by regulators[26]; leadership indicators include details of awareness programmes conducted for value chain partners, and conflict-of-interest processes implemented[27].

(ii) The third principle is that businesses should respect and promote the well-being of all employees, including those in their value chains[28]. Essential indicators include details of measures taken for employees (including insurance coverage, maternity benefits, etc), and accessibility measures taken for persons with disabilities[29]; leadership indicators include details of measures taken to ensure that value chain partners have paid statutory dues, and transition assistance programs for employees who have retired or been terminated[30].

(iii) The sixth principle is that businesses should respect and make efforts to protect and restore the environment[31]. Essential indicators include details of total energy consumption (including for electricity and fuel), water consumption, and emissions[32]; leadership indicators include details of operations in ecologically sensitive areas, as well as initiatives taken to improve resource efficiency and reduce the impact of emissions[33].

This framework was further supplemented by the introduction of the BRSR Core in 2023[34], which outlines nine key ESG attributes (including greenhouse gas and water footprint, waste management, enhancing employee wellbeing, and enabling gender diversity) and identifies specific parameters, measurement metrics, and approaches for data collection and assurance[35]. For greenhouse gas footprint, for instance, the parameters include a detailed breakup of emissions and intensity, with measurement metrics requiring the tracking of direct and indirect emissions, and the specified data approaches including tracking

25. 'National Guidelines on Responsible Business Conduct', Ministry of Corporate Affairs, page 14.
26. 'Business Responsibility & Sustainability Reporting Format', SEBI, page 8.
27. Id, at page 10.
28. Ibid note 26, at page 18.
29. Ibid note 27, at pages 13 and 14.
30. Ibid note 27, at page 17.
31. Ibid note 26, at page 24.
32. Ibid note 27, at pages 22 and 23.
33. Ibid note 27, at page 29.
34. 'BRSR Core – Framework for assurance and ESG disclosures for value chain', SEBI Circular, SEBI/HO/CFD/CFD-SEC-2/P/CIR/2023/122, 12 July 2023.
35. 'Annexure I – Format of BRSR Core', as part of the SEBI Circular for the BRSR Core.

absolute fossil fuel consumption, emission factor, and quantity of carbon capture[36]. This framework establishes a glide path for companies to mandatorily provide reasonable assurance of the BRSR Core, with the top 400 listed entities required to comply as of FY 2024-25[37].

The Responsibility of Directors

As board members, directors have a direct statutory responsibility to ensure that their companies comply with these requirements. The BRSR framework also makes specific references to this responsibility – for instance, the BRSR Core requires the board to ensure that the assurance provider for the BRSR Core has the expertise required to undertake this work[38]. This represents a substantial increase in a director's compliance workload as compared to just a few years ago, when ESG requirements had not yet been crystalised in law. As noted above, these reporting requirements are specific and detailed, and require a substantial investment of time and resources by directors to ensure compliance and accuracy; directors need to pay careful attention to the information and advice that they are provided with in this regard, and ensure that they have access to all the information they need in order to properly assess compliance.

I would argue, however, that the role played by directors in ESG matters extends beyond these statutory prescriptions. These requirements currently apply to a relatively small set of large, listed entities, but the principles under ESG readily apply to a wide range of companies at various stages of growth[39]. ESG-focused investment is expected to increase significantly worldwide, as investors are placing a premium on businesses that prioritise equity, sustainability, and responsible growth. An ESG focus is no longer purely optional for any business, but actively encouraged in order to enhance a company's profile and viability. Crucially, and as outlined in the BRSR framework, ESG analysis should apply not only to the company itself but also to its value chain partners, as businesses are expected to critically examine their commercial relationships through the lens of sustainability and responsible business practices. As a result, it may be advisable for directors in smaller-scale, growing companies to actively pursue ESG goals and to look to establish a corporate culture that values and prioritises these goals, to ensure that their companies remain competitive for potential investors and build sustainable and equitable business models.

Challenges Faced by Directors at Startups

Growth and Accountability – A Paradox?

In the sections above, we've addressed some of the challenges faced by directors at large listed entities. There is also a unique set of challenges to contend with at the opposite end of the growth spectrum, namely, startups. Startups are an increasingly prominent part of the Indian economy, as a rapidly-

36. Id, at page 1.
37. Ibid note 35, at para 3.4.
38. Ibid note 35, at para 5.1
39. See 'Exponential expectations for ESG', PwC report on 'Asset and wealth management revolution 2022', 10 October 2022,

expanding middle class and increased internet penetration combine to create a massive potential customer base for technology-driven new-age businesses. Consequently, investment in startups (including foreign investment) has skyrocketed in recent years. This has led to increased financial stakes at many startups, as well as complex dynamics at the governance level, as the interests and perspectives of founders and investors are not always aligned.

These dynamics can make a director's job on a startup's board quite complicated. Fundamentally, a director's responsibility is to the company, a concept generally referred to as the director's 'fiduciary duty'. A director is required, first and foremost, to consider whether an action or decision would be in the best interests of the company, regardless of how other stakeholders (including shareholders) might view these interests. These shareholders – founders and investors included – often have their own opinions regarding how the board should operate, and in fact are often the parties that have nominated members of the board in the first place, leading to further complexity for directors.

Some prominent recent instances of corporate governance failures at startups can be instructive for directors. The vehicle service startup GoMechanic underwent turmoil in early 2023 after key management figures admitted to financial improprieties and misstatements in the company's financial statements[40]. Similarly, edtech startup BYJU'S has seen operational upheaval and a collapse in its valuation in the light of allegations of financial mismanagement. From an outsider's perspective, a common thread in these cases appears to be that an aggressive growth mindset – common to many startups – took precedence over the creation of a stable corporate governance framework, potentially limiting access to information for stakeholders and inhibiting deliberative decision-making. GoMechanic now appears to be on the road to recovery by pursuing a more sustainable growth trajectory, with the support of investors[41]. A key lesson here is that, while growth and expansion are a natural imperative for founders and investors alike, it is the role of directors to ensure that systems are put in place to responsibly manage such growth, minimise information asymmetry, and build trust amongst stakeholders; directors must endeavour to make independent decisions, in the interest of a company's long-term growth, while pursuing these goals.

An Indicative Framework for Startup Governance

In light of these recent instances of governance failures at startups, the Confederation of Indian Industry has released a Corporate Governance Charter for Start-ups, advocating that any governance setup must be underpinned by the basic principles of accountability, transparency, fairness, and responsibility[42]. The Charter provides

40. See 'Corporate governance mishap in a startup: a case of GoMechanic', by S Dhamija and R Nayyar.
41. See 'Investors demanded sustainability over rapid growth: GoMechanic's Kakkar', Business Standard, 11 September 2024.
42. 'Corporate Governance Charter for Start-ups', Confederation of Indian Industry, April 2024, page 8.

indicative governance guidelines for startups across growth stages, and outlines several specific proposals that, in my view, would be beneficial for startup management. In particular, the Charter recommends:

(i) Requiring complete and timely disclosures for conflicts of interest, insider trading, etc.[43];

(ii) Maintaining open lines of communication between board members and management, and providing updated financial information (including periodic reporting of key business metrics)[44];

(iii) Creating a well-defined framework for related party transactions and conflict resolution, with clear board oversight[45];

(iv) Setting up periodic 'executive sessions' between the board and key leadership figures[46];

(v) Ensuring that the company's statutory auditors interact periodically with the board[47]; and

(vi) Ensuring that any delegation of authority occurs with the board's approval[48].

Wherever practicable, directors can look to actively implement these proposals at their respective companies, to ensure that they and other key management figures act responsibly, and to help facilitate their own governance duties. The Charter also provides a 'Governance Scorecard'[49], which is another useful tool that directors can look to introduce into any existing governance framework to track managerial oversight and organisational progress in concrete terms.

Conclusion

As legal requirements become increasingly complex and wide-ranging, and as commercial pressures on companies grow, so do the challenges that a director faces on a daily basis. It is important that directors are proactive in establishing comprehensive corporate governance practices, and monitoring compliance on an ongoing basis, in order to both protect themselves from liability, and protect the interests of the company and its stakeholders. Directors need to leverage all of the resources available to them, including internal records and third-party advice, as well as their relationships with founders, investors, and other stakeholders, in order to build a stable governance framework that will help their companies grow in a sustainable and legally compliant manner in the long term.

43. Id, at page 14.
44. Id, at page 14.
45. Id, at page 18.
46. Id, at page 19.
47. Id, at page 19.
48. Id, at page 19.
49. Id, at page 23.

DIRECT TAXES
Supreme Court

Keshav B. Bhujle
Advocate

1 ***UOI vs. Rajeev Bansal (and other appeals); [2024] 469 ITR 46 (SC): Dated 03/10/2024:***

A. Reassessment — Notice — Sanction of spe cified authority — Important safeguard — Strict adherence necessary:

B. Reassessment — Change of law — New procedure — Time limits for notice — Issuance of notice under new regime not permissible if time-barred under old regime — Time limit of four years reduced to three years for all situations — All notices issued invoking time limit u/s. 149(1)(b) of the old regime to be dropped if income escaping assessment is less than rupees fifty lakhs:

C. Taxation and other Laws (Relaxation of Certain Provisions) Act, 2020 and CBDT Instruction No. 1 of 2022 Dated 11-5-2022: Reassessment — Notice — Time limits — Extension of time for all compliances owing to Covid pandemic — Effect — If time prescribed for passing of any order or issuance of any notice, sanction, or approval fell for completion or compliance from 20-3-2020 to 31-3-2021 — If completion or compliance of such action could not be made during stipulated period, time extended to 30-6-2021 — Time limits of four years and six years from end of relevant assessment years specified under IT Act not affected:

D. Reassessment — Change of law — New procedure — Effect of decision of Supreme Court in Ashish Agarwal[2] — After 1-4-2021, Act to be read with substituted provisions — Provisions of Taxation and other Laws (Relaxation of Certain Provisions) Act, 2020 to apply to after 1-4-2021 if action or proceeding specified under substituted provisions of Act falls for completion between 20-3-2020 and 31-3-2021 — 2020 Act overrides section 149 of Act only to relax time limit for issuance of reassessment notice u/s. 148 — The 2020 Act will extend the time limit for grant of sanction by specified authority — Test to determine whether 2020 Act will apply — If three years from the end of assessment year falls between 20-3-2020 and 31-3-2021, the specified authority has time till 30-6-2021 to grant approval — If four years from the end of assessment year falls between

20-3-2020 and 31-3-2021, the specified authority has extended time till 31-3-2021 to grant approval — Directions in Ashish Agarwal extends to all reassessment notices issued under old regime between 1-4-2021 and 30-6-2021 — Show-cause notices deemed to be stayed from date of issuance of deemed notice between 1-4-2021 and 30-6-2021 till the supply of relevant information and material by AO to assessees in terms of directions in Ashish Agarwal and two weeks allowed to assessees to respond to show-cause notices — AO required to issue reassessment notice u/s. 148 of the new regime within the time limit surviving under Act read with 2020 Act — All notices issued beyond surviving period are time barred and liable to be set aside: Ss. 147, 148, 148A, 149, 151 of ITA 1961: A. Ys. 2013-14 to 2017-18:

The present batch of appeals involves the interplay of three Parliamentary statutes: the Income-tax Act, 1961, the Taxation and Other Laws (Relaxation and Amendment of Certain Provisions) Act, 2020 ([2020] 428 ITR (St.) 29), and the Finance Act, 2021 ([2021] 432 ITR (St.) 52).

Notifications dated March 31, 2021 ([2021] 432 ITR (St.) 141) and April 27, 2021 ([2021] 434 ITR (St.) 11) issued by the Central Government u/s. 3(1) of the 2020 Act contained an Explanation declaring that the provisions under the old regime shall apply to the reassessment proceedings initiated under them. The Assessing Officers accordingly issued reassessment notices between April 1, 2021 and June 30, 2021, relying on the provisions u/s. 148 of the old regime. These reassessment notices were challenged by the assessees before the High Courts. The High Courts allowed the assessees' writ petitions and quashed reassessment notices issued between April 1, 2021, and June 30, 2021, under the old regime on the grounds that : (i) sections 147 to 151 stood substituted by the Finance Act 2021 ([2021] 432 ITR (St.) 52) from April 1, 2021 ; (ii) in the absence of any savings clause, the Department could initiate reassessment proceedings after April 1, 2021 only in accordance with the provisions of the new regime since they were remedial, beneficial, and meant to protect the rights and interests of the assessees; and (iii) the Central Government could not exercise its delegated authority to "re-activate the pre-existing law". In ***UOI vs. Ashish Agarwal*** [2], the Supreme Court held that it was "in complete agreement with the view taken by various High Courts in holding that "the benefit of the new provisions shall be made available even in respect of the proceedings relating to past assessment years, provided section 148 notice has been issued on or after April 1, 2021". However, the court exercised its discretionary jurisdiction under Article 142 of the Constitution in order to balance the interests of the Department and the assessees and directed that the reassessment notices issued under the old regime shall be deemed to have been issued u/s. 148A(b) of the new regime, that Assessing Officers shall, within thirty days, provide to the respective assessees the information and material relied upon by the Department so that the assessees could reply to the show-cause notices within two weeks thereafter. The requirement of conducting any enquiry, if required, with the prior approval of specified authority u/s. 148A(a) was dispensed with as a one-time measure vis-à-vis notices issued u/s. 148 of the unamended Act from April 1, 2021, till date, including those quashed by the High Courts. The Court directed that the Assessing Officers shall thereafter pass orders in terms of section 148A(d) in respect of each of the assessees concerned; thereafter after following the procedure as required u/s. 148A, they may issue notice u/s. 148 (as substituted).

On May 11, 2022 ([2022] 444 ITR (St.) 43), the CBDT issued an Instruction "clarifying" that Ashish Agarwal [2] would apply "to all cases where extended reassessment notices had been issued irrespective of whether such notices have been challenged, that the reassessment notices would travel back in time to their original date when such notices were to be issued and then new section 149 of the Act is to be applied at that point". The Board clarified that for A. Ys. 2013-14, 2014-15 and 2015-16, fresh notice u/s. 148 of the Act could be issued with the approval of the specified authority only if the case fell under clause (b) of sub-section (1) of section 149 as amended by the Finance Act, 2021 ([2021] 432 ITR (St.) 52). The specified authority u/s. 151 of the new law, in this case, shall be the authority prescribed under clause (ii) of that section. For A. Ys. 2016-17 and 2017-18, fresh notice u/s. 148 could be issued with the approval of the specified authority under clause (a) of sub-section (1) of new section 149 of the Act since they were within the period of three years from the end of the relevant assessment year. The specified authority u/s. 151 of the new law, in this case, shall be the authority prescribed under clause (i) of that section. The Assessing Officers accordingly considered the replies furnished by the assessees and passed orders u/s. 148A(d). Subsequently, notices u/s. 148 of the new regime were issued to the assessees by the Assessing Officers between July and September 2022 for the A. Ys. 2013-14, 2014-15, 2015-16, 2016-17, and 2017-18. The High Courts declared these notices invalid on the grounds that they were (i) time-barred and (ii) issued without the appropriate sanction of the specified authority.

On appeals, the Supreme Court held as under:

"i) An assessment acquires finality on the making of an assessment order by the Assessing Officer. It creates a vested right in favour of the assessee. Reassessment is nothing but a fresh assessment. The effect of reopening the assessment is to vacate or set aside the order of assessment and to substitute in its place the order of reassessment. The procedure of reassessment of tax is quasi-judicial because it prejudicially affects the vested rights of the assessee.

ii) If a statute expressly confers a power or imposes a duty on a particular authority, then such power or duty must be exercised or performed by that authority itself. Further, when a statute vests certain power in an authority to be exercised in a particular manner, then that authority has to exercise its power following the prescribed manner. Any exercise of power by statutory authorities inconsistent with the statutory prescription is invalid.

iii) The Income-tax Act 1961 mandates Assessing Officers to fulfil certain preconditions before issuing a notice of reassessment. Section 149 requires Assessing Officers to issue a notice of reassessment u/s. 148 within the prescribed time limits. Further, section 151 requires Assessing Officers to obtain the sanction of the specified authority before issuing notice u/s. 148. Section 151 must be strictly adhered to because it contains "important safeguards". A statutory authority may lack jurisdiction if it does not fulfil the preliminary conditions laid down under the statute, which are necessary to the exercise of its jurisdiction. There cannot be any waiver of a statutory requirement or provision that goes to the root of the jurisdiction of assessment. An order passed without jurisdiction is a nullity. Any consequential order passed or action taken will also be invalid and without jurisdiction. Thus, the power of Assessing Officers to reassess is limited and based on the fulfilment of certain preconditions.

iv) The Finance Act, 2021 ([2021] 432 ITR (St.) 52) substituted the entire scheme of reassessment u/s. 147 to 151 of the Income-tax Act, 1961, with effect from April 1, 2021. Broadly speaking, the changes were : (i) section 148 mandates the Assessing Officer to initiate proceedings only based on prior information and with the prior approval of the specified authority ; (ii) section 148A requires the Assessing Officer to provide an opportunity of being heard to the assessee before deciding to issue a reassessment notice u/s. 148. Section 148A requires the Assessing Officer to (a) conduct any enquiry, if required, with the prior approval of the specified authority ; (b) provide an opportunity for hearing to the assessee by serving a show-cause notice with the prior approval of the specified authority ; (c) consider the reply furnished by the assessee in response to the show-cause notice; and (d) decide on the basis of available material, including the reply of the assessee, whether or not it is a fit case to issue a notice u/s. 148 by passing an order ; (iii) The time limit u/s. 149 has been reduced from four years to three years from the end of the relevant assessment year for all situations. Assessments can be reopened beyond three years but within ten years from the end of the relevant assessment year if the income chargeable to tax which has escaped assessment amounts to or is likely to amount to rupees fifty lakhs or more. However, the first proviso to section 149 prohibits the issuance of a reassessment notice under the new regime if such notices have become time-barred under the old regime; and (iv) the sanctioning authorities specified u/s. 151 of the new regime are different from those specified under the old regime.

v) Section 151 of the new regime specifies the following authorities for sections 148 and 148A: (i) Principal Commissioner or Principal Director or Commissioner or Director if three years or less have elapsed from the end of the relevant assessment year; and (ii) Principal Chief Commissioner or Principal Director General or Chief Commissioner or Director General if more than three years have elapsed from the end of the relevant assessment year.

vi) Notices have to be judged according to the law existing on the date the notice is issued. Section 149 of the old regime primarily provided two-time limits : (i) four years for all situations and (ii) beyond four years and within six years if the income chargeable to tax which escaped assessment amounted to rupees one lakh or more. After April 1, 2021, the time limits prescribed under the new regime came into force. The ordinary time limit of four years was reduced to three years. Therefore, in all situations, reassessment notices could be issued under the new regime if not more than three years have elapsed from the end of the relevant assessment year.

vii) The first proviso to section 149(1)(b) requires the determination of whether the time limit prescribed u/s. 149(1)(b) of the old regime continues to exist for the A. Y. 2021-22 and before. Resultantly, a notice u/s. 148 of the new regime cannot be issued if the period of six years from the end of the relevant assessment year has expired at the time of issuance of the notice. This also ensures that the new time limit of ten years prescribed u/s. 149(1)(b) of the new regime applies prospectively. For example, for the A. Y. 2012-13, the ten-year period would have expired on March 31, 2023, while the six-year period expired on March 31, 2019. Without the proviso to section 149(1)(b) of the new regime, the Department could have had the power to reopen assessments for the year 2012-13 if the escaped assessment amounted to rupees fifty lakhs or more. The proviso limits the retrospective operation of section 149(1)(b) to protect the interests of assessees. Another important change u/s. 149(1)(b) of the new regime is the increase in the monetary threshold from rupees one lakh to rupees fifty lakhs. The old regime prescribed a time limit of six years from the end of the relevant assessment year if the income chargeable to tax, which escaped assessment, was more than rupees one lakh. In comparison, the new regime increases the time limit to ten years if the escaped assessment amounts to more than rupees fifty lakhs. The proviso to section 149(1)(b) limits the retrospectivity of that provision with respect to the time limits specified u/s. 149(1)(b) of the old regime.

viii) The position of law is : (i) section 149(1) of the new regime is not prospective. It also applies to past assessment years ; (ii) the time limit of four years is now reduced to three years for all situations. The Department can issue notices u/s. 148 of the new regime only if three years or less have elapsed from the end of the relevant assessment year ; (iii) the proviso to section 149(1)(b) of the new regime stipulates that the Department can issue reassessment notices for past assessment years only if the time limit survives according to section 149(1)(b) of the old regime, that is, six years from the end of the relevant assessment year; and (iv) all notices issued invoking the time limit u/s. 149(1)(b) of the old regime will have to be dropped if the income chargeable to tax, which has escaped assessment is less than rupees fifty lakhs.

ix) The Taxation and Other Laws (Relaxation of Certain Provisions) Act, 2020, came into force with retrospective effect from March 31, 2020. Section 3(1) of this Act extended the time limit for completion of actions or compliances under the “specified Act”, which fell for completion or compliance during the period from March 20, 2020 and December 31, 2020, to March 31, 2021. Section 3(1) empowered the Central Government to extend the time limit beyond March 31, 2021, by a notification. In pursuance of its powers, the Central Government issued notifications to extend the period of relaxation till June 30, 2021. The effect of the 2020 Act and the notifications issued under the legislation was that : (i) if the time prescribed for the passing of any order or issuance of any notice, sanction, or approval fell for completion or compliance from March 20, 2020, to March 31, 2021; and (ii) if the completion or compliance of such action could not be made during the stipulated period, the time limit for completion or compliance of such action was extended to June 30, 2021. Section 3(1) of the 2020 Act is only concerned with the performance of actions contemplated under the provisions of the specified Acts. Consequently, the amendment or substitution of a provision under the specified Acts will not affect the application of the 2020 Act, so long as the action contemplated under the provision falls for completion during the period specified by the 2020 Act, that is, March 20, 2020, to March 31, 2021.

x) The proviso to section 149(1)(b) of the new regime specifically refers to the time limits specified u/s. 149(1)(b) of the old regime. Without the application of the 2020 Act, the six-year period time limit for issuance of reassessment notices after April 1, 2021, expires for A. Y. 2013-14 and 2014-15, expires on March 31, 2020, and March 31, 2021, respectively; and (ii) for the A. Y. 2016-17 and 2017-18, the three-year period, expires on March 31, 2020 and March 31, 2021, respectively.

xi) The 2020 Act did not amend the time limits of four years and six years from the end of the relevant assessment years as specified under the Act. It merely provided a relaxation of the time period for issuance of a reassessment notice u/s. 148. The 2020 Act has no application in situations where the time limit specified u/s. 149 expired before March 20, 2020. The effect of the 2020 Act is that at the time of issuance of a reassessment notice u/s. 148, the Department has to determine two things: (i) the time limit specified u/s. 149; and (ii) the extent of relaxation provided by the 2020 Act and its notifications for issuance of notices. Thus, although the 2020 Act did not amend section 149 of the Act, it has to be read with section 149 to determine the time limit for issuance of a notice. This was the legislative intent behind the enactment of the 2020 Act.

xii) The substitution of sections 147 to 151 will not affect the purpose of the 2020 Act, which is to provide relaxation of the time limit for completion or compliance of any actions falling for completion between March 20, 2020, and March 31, 2021. The 2020 Act will continue to apply to the Act after April 1, 2021, if any action or proceeding specified under the substituted provisions of the Act falls for completion between March 20, 2020 and March 31, 2021.

xiii) After April 1, 2021, the Act has to be read along with the substituted provisions. The substituted provisions apply retrospectively for past assessment years as well. On April 1, 2021, the 2020 Act was still in existence, and the Department could not have ignored the application of the 2020 Act and its notifications. Therefore, for issuing a reassessment notice u/s. 148 after April 1, 2021, the Department would still have to look at (i) the time limit specified u/s. 149 of the new regime; and (ii) the time limit for issuance of notice as extended by the 2020 Act and its notifications. The Department cannot extend the operation of the old law under the 2020 Act, but it can certainly benefit from the extended time limit for completion of actions falling for completion between March 20, 2020 and March 31, 2021.

xiv) The non-obstante clause in section 3(1) has to be read as controlling the provisions of the specified Acts, including the provisions of the Act. Section 3(1) overrides section 149 only to the extent of relaxing the time limit for issuance of reassessment notice u/s. 148. The time limit for issuance of reassessment notices, which fall for completion between March 20, 2020 and March 31, 2021, has been extended till June 30, 2021. However, the non-obstante clause u/s. 3(1) of the 2020 Act will operate neither to extend the time limit of three years from the end of the relevant assessment year u/s. 149(1)(a) of the new regime nor to extend the time limit of six years from the end of the relevant assessment years u/s. 149(1)(b) of the old regime. The non-obstante clause ensures that the Department has additional time beyond the statutory stipulated time limit to complete or comply with the formalities, given the administrative difficulties that arose due to the COVID-19 pandemic.

xv) Grant of sanction by the appropriate authority is a precondition for the Assessing Officer to assume jurisdiction u/s. 148 to issue a reassessment notice. Section 151 of the new regime does not prescribe a time limit within which a specified authority has to grant sanction. Rather, it links up the time limits with the jurisdiction of the authority to grant sanction. Section 151(ii) of the new regime prescribes a higher level of authority if more than three years have elapsed from the end of the relevant assessment year. Thus, non-compliance by the Assessing Officer with the strict time limits prescribed u/s. 151 affects his jurisdiction to issue a notice u/s. 148.

xvi) Under the Finance Act, 2021 ([2021] 432 ITR (St.) 52), the Assessing Officer was required to obtain prior approval or sanction of the specified authorities at four stages: at the stage of section 148A(a) – to conduct any enquiry, if required, with respect to the information which suggests that the income chargeable to tax has escaped assessment; at the stage of section 148A (b) – to provide an opportunity of hearing to the assessee by serving upon them a show-cause notice as to why a notice u/s. 148 should not be issued based on the information that suggests that income chargeable to tax has escaped assessment (this requirement was deleted by the Finance Act, 2022 ([2022] 442 ITR (St.) 91)); at the stage of section 148A(d) – to pass an order deciding whether or not it is a fit case for issuing a notice u/s. 148; and section 148 – to issue a reassessment notice.

xvii) The third proviso to section 149 excludes the following periods to calculate the period of limitation : (i) the time allowed to the assessee u/s. 148A(b); and (ii) the period during which the proceedings u/s. 148A are "stayed by an order or injunction of any court".

xix) When the Court deemed the section 148 notices under the old regime as section 148A(b) notices under the new regime, it impliedly waived the requirement of obtaining prior approval from the specified authorities u/s. 151 for section

148A(b) notices. The Court in Ashish Agarwal had directed the Assessing Officers to "pass orders in terms of section 148A(d) in respect of each of the assessees concerned". Further, it directed the Assessing Officers to issue a notice u/s. 148 of the new regime "after following the procedure as required u/s. 148A". Although the Court waived the requirement of obtaining prior approval u/s. 148A(a) and section 148A(b), it did not waive the requirement for section 148A(d) and section 148. Therefore, the Assessing Officer was required to obtain prior approval of the specified authority according to section 151 of the new regime before passing an order u/s. 148A(d) or issuing a notice u/s. 148. These notices ought to have been issued following the time limits specified u/s. 151 of the new regime read with the 2020 Act, where applicable.

xx) Ashish Agarwal [2] was primarily concerned with the validity of the reassessment notices issued between April 1, 2021, and June 30, 2021, under the old regime. The scope of the directions in Ashish Agarwal applied Pan-India, including all the ninety thousand reassessment notices issued under the old regime during the period April 1, 2021 and June 30, 2021. The operation of the directions could not be limited to the three categories mentioned by the Court. The Court directed the Department to provide all the relevant material or information to the assessees and thereafter allowed the assessees to respond to the show-cause notices by availing of all the defences, including that available u/s. 149. Thus, the Court balanced the equities between the Department and the assessees by giving effect to the legislative scheme of reassessment as contained under the new regime. It supplemented the existing legal framework of the procedure of reassessment under the Act with a remedy grounded in equitable standards.

xxi) In Ashish Agarwal 1, the Court did not quash the reassessment notices issued u/s. 148 of the old regime. The reassessment proceedings erroneously initiated by the Department under the old regime were not wiped out from existence. Consequently, the Department was not required to start the procedure of reassessment afresh after the decision of this Court in Ashish Agarwal 1.

xxii) U/s. 148A(b), the Assessing Officer has to comply with two requirements : (i) issuance of a show-cause notice; and (ii) supply of all the relevant information which formed the basis of the show-cause notice. The supply of the relevant material and information allows the assessee to respond to the show-cause notice. The deemed notices were effectively incomplete because the requirement of supplying the relevant material or information to the assessees was not fulfilled. The requirement could only have been fulfilled by the Department by actual supply of the relevant material or information that formed the basis of the deemed notice. Thus, during the period between the issuance of the deemed notices and the date of judgment in Ashish Agarwal [2], the Assessing Officers were deemed to have been prohibited from proceeding with the reassessment proceedings. Resultantly, the show-cause notices were deemed to have been stayed by order of the Court from the date of their issuance (somewhere from April 1, 2021, till June 30, 2021) till the date of decision in Ashish Agarwa, that is, May 4, 2022. After the supply of the relevant material and information to the assessee, time began to run for the assessees to respond to the show-cause notices.

xxiii) That the third proviso to section 149 excludes "the time or extended time allowed to the assessee". Resultantly, the entire time allowed to the assessee to respond to the show-cause notice had to be excluded for computing the period of limitation. In Ashish Agarwal, the Court provided two weeks to the assessees to reply to the show-cause notices. This period of two weeks was also liable to be excluded from the computation of limitation given the third proviso to section 149. Hence, the total time that was excluded for computation of limitation for the deemed notices was : (i) the time during which the show-cause notices were effectively stayed, that is, from the date of issuance of the deemed notice between April 1, 2021 and June 30, 2021 till the supply of relevant information or material by the Assessing Officers to the assessees in terms of the directions in Ashish Agarwal; and (ii) two weeks allowed to the assessees to respond to the show-cause notices.

xxiv) All the reassessment notices under challenge in the appeals were issued from April 1, 2021 to June 30, 2021 under the old regime. Ashish Agarwal deemed these reassessment notices under the old regime as show-cause notices under the new regime with effect from the date of issuance of the reassessment notices. The effect of creating the legal fiction was that the Court has to imagine as real, all the consequences and incidents that would inevitably flow from the fiction. Therefore, the logical effect of the creation of the legal fiction by Ashish Agarwal was that the time surviving under the Act read with the 2020 Act would be available to the Department to complete the remaining proceedings in furtherance of the deemed notices, including issuance of reassessment notices u/s. 148 of the new regime. The surviving or balance time limit could be calculated by computing the number of days between the date of issuance of the deemed notice and June 30, 2021.

xxv) In Ashish Agarwal, the Court allowed the assessees to avail of all the defences, including the defence of expiry of the time limit specified u/s. 149(1). The reassessment notices pertained to the A. Ys. 2013-14, 2014-15, 2015-16, 2016-17, and 2017-18. To assume jurisdiction to issue notices u/s. 148 with respect to the relevant assessment years, an Assessing Officer has to: (i) issue the notices within the period prescribed u/s. 149(1) of the new regime read with the 2020 Act, and (ii) obtain the previous approval of the authority specified u/s. 151. Therefore, the reassessment notices issued u/s. 148 of the new regime, which were in pursuance of the deemed notices, ought to be issued within the time limit surviving under the Income-tax Act read with the 2020 Act. A reassessment notice issued beyond the surviving time limit will be time-barred."

DIRECT TAXES
High Court

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Advocate

1 *PCIT vs. Culver Max Entertainment (P.) Ltd. [2024] 169 taxmann.com 586 (Bombay)*

Passing of assessment order – Section 143(3) of the Income Tax Act 1961 – Assessment order passed in the name of non-existing company, despite having information of amalgamation – *void ab initio.*

Facts

During the course of assessment proceedings, the Assessee had intimated the AO that it had merged with another company and accordingly, the assessment order ought to be passed in the name of the surviving entity. Further, such a disclosure was also made by the assessee before the Transfer Pricing Officer. However, despite such clear intimation by the Assessee, the AO proceeded to pass the assessment order in the name of a non-existent entity. On appeal, the first appellate authority quashed the assessment order on the ground that the assessment order passed in the name of non existent entity is non est. On further appeal by the department, the Appellate Tribunal upheld the order of the Ld. CITA. The department being further aggrieved filed an appeal before the Hon'ble Bombay High Court under the provisions of section 260A of the Act.

Ruling of the High Court

Hon'ble Bombay High Court was pleased to dismiss the appeal of the department by observing that the Assessee had duly intimated the AO about the merger and that such a finding of fact recorded by the Tribunal was not assailed by the income-tax department. Hence, there was no reason for the AO to pass the assessment order in the name of a non-existing entity.

2 *Subhash Chander Dabas vs. Assistant Commissioner of Income-tax [2024] 169 taxmann.com 547 (Delhi)*

Notice for reopening - section 148 of the Income Tax Act 1961 – allegation of receipt of certain sums constituted formation of opinion that income has escaped assessment – department having accepted that the said allegation could not be sustained - notice under section 148 will not sustain.

Facts

The assessee before the Hon'ble Delhi High Court was an individual engaged in construction and property development. The assessee filed his income tax return for the assessment year 2012-13, declaring a total income of ₹ 10.75 lakhs. The assessment was completed on March 26, 2015, under section 143(3) of the Act accepting the declared income.

A notice under section 148 was issued, alleging that ₹ 24.8 crore received from the Delhi States Newspaper Employee Cooperative

Group Housing Society (DSNE CGHS) by the assessee had escaped assessment. The alleged benami transactions involved flats booked in the names of relatives and sold for large sums, with the proceeds routed to the assessee's entities. The assessee challenged the notice issued under section 148 and proceedings before the Delhi High Court. Hon'ble High Court was pleased to pass an interim order allowing proceedings to continue but restraining enforcement of any assessment order. In the reassessment proceedings, the department conceded that the original reason for reassessment (direct receipt of ₹ 24.8 crore) was incorrect. However, the department continued the reassessment proceedings by deviating from the original reasons to deemed dividend under section 2(22)(e) without revising the original notice. The AO finally passed the assessment order by making an addition under section 2(22)(e) of the Act.

Ruling of High Court

Hon'ble High Court was pleased to allow the writ petition filed by the assessee and quashed the notice issued by the AO under section 148 of the Act by observing that the solitary allegation which constituted the basis for the formation of opinion that income had escaped assessment was an alleged receipt of ₹ 24.80 crores by the assessee from DSNE CGHS. The department subsequently accepted that this allegation would not sustain. Thus, there is an evident disconnect between the reasons originally recorded for the initiation of reassessment action and the disclosures made in the final assessment order. The original reasons alone were pertinent for evaluating the validity of the formation of opinion.

3 ***Nokia Solutions and Networks India (P.) Ltd. vs. Joint Commissioner of Income-tax [2024] 169 taxmann.com 544 (Delhi)***

Stay and recovery of demand - Section 220 read with Section 245 – adjustment of refunds determined for the assessment years 2008-09 and 2017-18 against the outstanding demand for the assessment year 2015-16, despite the demand being stayed is against the well settled provisions of law.

Facts

The assessee before the Hon'ble Delhi High Court is a private limited company, engaged in manufacturing and trading telecommunication network equipment. The assessee had filed its income tax return for the assessment year 2015-16, declaring an income of ₹ 994.64 crores. The AO finalised the assessment determining total income at ₹ 1166.69 Crores and raising a tax demand of ₹ 43.38 crores. The assesseee being aggrieved by the assessment order filed an appeal before the Commissioner of Income Tax (Appeals) [CIT(A)], which is pending for adjudication. Meanwhile, the assessee applied under section 220(6) of the Income-tax Act, 1961, for a stay on the recovery of the outstanding demand. On February 5, 2019, the AO disposed the stay application and directed the assessee to deposit 20% of the outstanding tax demand as a condition for granting a stay of recovery of the balance amount. The AO subsequently modified the conditions for granting stay by directing the assessee to deposit of ₹ 7 crores by February 28, 2019. The assessee duly complied with the said directions by depositing ₹ 7.5 crores. The assessee also filed a rectification application under section 154, pursuant to which the outstanding demand was reduced to ₹ 38.71 crores. In the meantime, certain refunds for the assessment years 2008-09 and 2017-18 were determined by the department to be payable to the assessee. The department, however, adjusted these refunds against the balance outstanding demand for the assessment year 2015-16, which was stayed in terms of the orders dated February 5, 2019, and February 21, 2019. The assessee being aggrieved by this adjustment, challenged the action of the department before the Hon'ble Delhi High Court.

Ruling of the Hon'ble High Court

Hon'ble Delhi High Court was pleased to allow the petition of the assessee by observing that in terms of the instructions issued by the Central Board of Direct Taxes (CBDT), stay is required to be granted to the assessee in respect of disputed demands on the condition that the assessee deposits an amount equal to 20% of the outstanding tax demand. Adjusting refunds against the stayed demand would place the assessee, who is entitled to a refund, in a disadvantageous position compared to those assessees to whom no refund is due. There is no allegation that the assessee is alienating its assets to frustrate the recovery of any demand or that it would be unable to pay the disputed demand if confirmed in the appellate proceedings. Thus, the revenue's decision to adjust the refund due to the assessee for the assessment years 2008-09 and 2017-18 is arbitrary.

4 ***Frontier Information Tech Ltd vs. DCIT [2024] 169 taxmann.com 729 (Telangana)***

Business Disallowance – section 43B of the Income Tax Act 1961 – cessation of liability on conversion of interest due into equity shares – amounts to actual payment entitled for deduction under section 43B of the Act.

Facts

The assessee filed its return of income for the AY 1999-2000 declaring a loss. During the year under consideration, the assessee had converted the interest due of ₹ 75.75 lakhs to Andhra Pradesh Industrial Development Corporation Limited (APIDC) into equity shares by issuing 5.05 lakhs shares of ₹ 10 each totaling to a sum of ₹ 50.50 lakhs. Interest of ₹ 39.94 lakhs had accrued to the assessee and was due to Andhra Pradesh State Financial Corporation (APSFC). During the assessment proceedings, the AO show caused the assessee as to why the unpaid interest of ₹ 75.75 lakhs and ₹ 39.94 lakhs shall not be disallowed under Section 43B of the Act. The assessee in reply to the said query explained that it had paid outstanding interest and had received back the same amount as additional loan from financial institutions. The assessee also stated that since constructive payment of interest outstanding was made on or before the due date, no disallowance under Section 43B of the Act is called for.

However, the AO concluded that the actual payment of the amount is sine qua non for allowing deduction under Section 43B of the Act. It was further held that conversion of outstanding interest liability into loan i.e., funding interest or into equity does not amount to actual payment. Accordingly, a sum of ₹ 75,75,000/- and ₹ 39,94,429/- was disallowed under Section 43B of the Act on the ground that the same was not actually paid.

On appeal, the Commissioner (Appeals) upheld the view of the AO. Being aggrieved by the order of the Ld. CIT(A) the assessee challenged the same before the Appellate Tribunal. The Appellate Tribunal vide impugned order partially allowed the assessee's appeal. The assessee being further aggrieved challenged the order of the Tribunal before the Hon'ble High Court under section 260A of the Act.

Ruling of the Hon'ble High Court

Hon'ble High Court was pleased to allow the appeal of the assessee by observing that it is not the case of the Revenue that liability of the assessee to pay interest has not ceased to exist on issuance of equity shares. The claim of the assessee for deduction under Section 43B of the Act has been denied on the ground that the actual payment has not been made. However, as the liability of the assessee to pay interest ceased to exist on issue of shares in favour of APIDC, the same would be tantamount to actual payment within the meaning of Section 43B of the Act. The assessee, therefore, is entitled to benefit of Section 43B of the Act.

DIRECT TAXES
Tribunal

CA Nikhil Mutha CA Viraj Mehta CA Kinjal Bhuta
Advocate

1 ***DCIT vs. Qyuki Digital Media Pvt Ltd (ITA No. 3758/Mum/2023) (AY 12-13)***

Section 37 – Revenue Expenses claimed – No operative income – Business has already been set up – Expenses allowed to be claimed – Expenses not to be treated as pre-operative expenses

Facts

During the assessment, the AO observed that the assessee has claimed expenses of ₹ 4.36 crores in the Profit & Loss Account, but did not show any operative income. AO held that the assessee has not started its business activities till date. Accordingly, the AO took the view that the expenses of ₹ 4.36 crores claimed by the assessee cannot be treated as revenue expenses and it was considered as pre-operative expenses and disallowance was made u/s 37. On appeal, CIT(A) allowed the assessee's appeal on account that the business has been set up and the assessee is carrying on work in accordance with its objectives. Accordingly, the CIT(A) held that the non-generation of income after setting up of business cannot be a ground to disallow expenses. Being aggrieved, appeal is filed by the department.

Held

Hon. ITAT held that for AY 13-14, Co-ordinate Bench of the Tribunal in assessee's own case has allowed assessee claim on account that assessee has set up its business and hence, the entire expenses are allowable as a deduction. Hon. ITAT has that on perusal of the balance sheet of the assesse as of 31.03.2013 it is noticed that assessee has shown fixed assets under the head tangible assets of ₹ 45,46,616/- and intangible assets of ₹ 11,30,761/- and also shown current asset under the head trade receivable at ₹ 5,61,800/-, cash and cash equivalent ₹ 7,97,69,045/- short term loan and advances ₹ 33,70,647/- and other current assets at ₹ 17,09,240/-. The assessee has also shown current liabilities and trade payable at ₹ 2,13,02,280/- other current liabilities at ₹ 41,32,033/- and short term provision of ₹ 3,07,217/-. As on 31.03.2014 and as on 31.03.2015 the assesse has shown tangible assets and intangible assets under the fixed assets at ₹ 35,46,970/- and ₹ 5,68,537/- for assessment year 2014-15 and ₹ 16,92,491/- and ₹ 11,86,381/- for assessment year 2015-16. The assesse has generated revenue from operation in the assessment year 2014-15 of ₹ 10,20,000/- and in the assessment year 2015-16 of ₹ 55,44,264/- Assesse has demonstrated from the copies of profit and loss account and balance sheet that it had set up its business. On account that business is being set-up, Hon. ITAT dismissed the department appeal and thereby deleted the disallowance of expenses.

2

Dy. CIT Circle 1 vs. Aarav Fragrances and Flavours Pvt. Ltd, Mumbai [ITA No. 546/MUM/2024 dated 27-11-2024 (AY 201-17)]

Section 48– Assessee sold shares of its foreign subsidiary – computed long term capital gain by deducting indexed cost of acquisition – AO took view that assessee could not avail the benefit of cost of inflation index in respect of its foreign assets -denied indexation benefit –assessee was entitled to deduct indexed cost of shares of foreign company while computing long term capital gain – second proviso does not distinguish between assets held in India or foreign countries.

Facts of the case

The assessee company was engaged in the business of manufacture and sale of fragrance compounds and flavours and had two wholly owned subsidiary companies - Aarav ITES Pvt Ltd being an Indian Company and Aarav Suisse SA being a foreign company. During the year under consideration, the assessee sold the shares of its foreign company under buy back scheme and computed long-term capital gain by deducting the indexed cost of acquisition. The Capital Gain was computed by applying cost inflation index. This resulted in a long-term capital loss. The AO opined that the cost inflation index is determined based on the inflation in India and therefore, the assessee cannot avail the benefit of cost of inflation index in respect of its foreign assets held and sold outside India. Accordingly, the AO denied the benefit of cost inflation index and re-computed the long term capital loss. In the appellate proceedings, the CIT(A) allowed the benefit of cost of inflation index to the assessee, thereby allowing the appeal of the assessee. This appeal was filed by the Revenue against the CIT (A) order.

Held

The Hon'ble Tribunal observed that as per the first proviso to section 48, it is applicable only to the non-residents. Since the assessee is a resident, the first proviso will not apply to it. The second proviso gives the benefit of cost inflation index. The said proviso does not distinguish between the assets held in India and held outside India. It was held that once the capital gain is required to be computed as per section 48, the full effect of the said section should be given. Since the Income-tax Act levies tax upon the assessee, the provisions of the said Act should be applied strictly. The Hon'ble Tribunal further emphasised on the principle of interpretation specifying that there is no scope for referring to internal or external aids for interpretation when the language of the section is clear. Only when there is ambiguity, one has to refer to internal aids and external aids for interpreting the provisions. In the instant case since there is no ambiguity in the provisions of second proviso to section 48, the tax authorities are not justified in referring to the intention of giving the benefit of indexation. Further it was also held that second proviso to section 48 of the Act, which grants indexation benefit, does not distinguish assets into assets held in India and in foreign countries and the assessee cannot be denied benefit of cost inflation index in respect of assets held in foreign countries. Thus, the Hon'ble Tribunal affirmed the order passed by the CIT (A) and dismissed the appeal filed by the Revenue.

3 ***Urvi Premal Shah vs. ITO, Mumbai [ITA No. 170/MUM/2024 dated 16.12.2024 (AY 2018-19)]***

Section 68 – Assessee received equity shares of unlisted private company - gift from spouse's brother – AO added the difference in cost and fair market value of shares-unexplained credit – no transfer of gifted shares after receipt – gift is wholly exempt u/s 56(2)(x).

Facts of the case

The assessee's case was selected for limited scrutiny on the consideration that there is a substantial increase in the capital to the tune of ₹ 7.90 crs in comparison to the previous year. Assessee submitted before the AO that the reason for the increase in the capital was due to income earned and the gift of equity shares of unlisted private limited company which was valued at ₹ 7.76 crs received from the brother of assessee's spouse. AO, after examining the ledger account of the donor found that the gift of shares to assessee were shown to be debited as ₹ 2.73 crs. The AO added the difference of ₹ 5.03 crs, being the difference in the cost of shares received by the assessee under gift and that recorded by the assessee, treating it as unexplained credit u/s 68. Aggrieved, the assessee preferred an appeal before CIT (A) who dismissed the assessee's appeal. The assessee preferred an appeal in ITAT against the order of CIT (A).

Held

The Hon'ble Tribunal observed that the main issue involved under appeal is as to whether the difference in the cost of shares gidted by the assessee's relative to assessee and that recorded at 'fair market value' by the assessee, should be treated as unexplained credit u/s 68 of the Act

The assessee submitted before the Hon'ble Tribunal that the shares gifted were recorded in the donor's books at ₹ 2.73 crs bring the cost of acquisition however, these were recorded by assessee in her books of account at the 'fair market value' as on the date of gift deed and that the gift received from the relative of the assessee is wholly exempt under the Act. The Ld. AR further contended that the gifted shares were not sold during the year.

The Hon'ble Tribunal also recorded that CIT(A) had relied on Bombay High Court in case of ***CIT(A) vs. Trikamlal Maneklal (Karta of HUF) [1987] 32 Taxman 479***, however that case relates to the capital gain on the profit or gain that arise on the transfer of the capital asset. Whereas in the assessee's case there was no transfer of capital asset. The facts were easily distinguishable and were not applicable to the present case.

The Hon'ble Tribunal held that assessee received gift of shares from the brother of her spouse, who is a 'relative' as per the explanation attached to Section 56(2). Such a gift is wholly exempt u/s. 56(2)(x) of the Act. There cannot be any profit or gain on the receipt of such gift from relative. The appeal of assessee was allowed.

4 ***Tarun Jain vs. ITO (ITA No. 1629/Mum/2024 dt. 19.12.2024) (AY 13-14)***

Section 68 – Loan Taken – Information received from investigation wing on account that the lender company is managed by Pravin Kumar Jain – Loan taken and repaid within 1 year by lendee – Request made to provide evidences and cross examination – No details provided – Addition directed to be deleted

Facts

Assessee had taken unsecured loan of ₹ 10,00,000/- from M/s Fastline Multi Trade Pvt Ltd and in this regard had submitted in assessment loan confirmation, relevant bank statement, application filed before AO for seeking permission to cross examine and repayment details. The AO made the addition on the ground that one Mr. Praveen Kumar Jain is controlling different companies and is providing accommodation entries in the shape of unsecured loan etc. The AO alleged that M/s Fastline Multi Trade Pvt Ltd is controlled and managed by Mr. Praveen Kumar Jain and hence, addition u/s 68. On appeal, CIT(A) upheld the assessment order. Being aggrieved with the order, appeal is filed by assessee before Hon. ITAT.

Held

Hon. ITAT held that money was advanced in the shape of loan apparently by account payee cheque and was also repaid vide account payee cheque, the least that the revenue should had done was to grant an opportunity to the assessee to meet the case against him by providing the material sought to be used against asessee in arriving before passing the order of reassessment. This not done, the denial of such opportunity goes to the roots of the matter and strikes at the very foundation of the reassessment and therefore renders the orders passed by the Ld. CIT(A) and AO vulnerable. Assessee was bound to be provided with the material used against him apart from being permitting him to cross examine the said Mr. Praveen Kumar Jain. Despite the request dated 14.12.2018 seeking an opportunity to cross examine the said Mr. Praveen Kumar Jain and furnished the asessee with the copies of statement, these were denied. On above basis, appeal filed by the assessee was allowed and therefore additions were confirmed to be deleted.

5

Vinod Kumar Tiwari vs. ACIT [ITA No. 3900/Del/2023 dated 18/12/2024] [AY 2017-18]

Section 69A – Deposits during Demonetization Period - Partially treated as unexplained considering excess cash available after making reasonable estimate of household expenses

Facts

The Assessee, Mr. Vinod Kumar Tiwari, a senior citizen, filed his Income Tax Return for AY 2017-18, reporting a net taxable income of INR 25,85,890/-. During the demonetization period, he deposited INR 36,43,500/- in specified banknotes into his accounts at Axis Bank and National Urban Cooperative Bank. The assessee claimed that these deposits were sourced from cash withdrawals made over the years, totaling to INR 40,65,855 including an opening cash balance of INR 9,25,855/- as on 28/09/2011. He attributed the accumulation of cash to his medical conditions, citing a history of heart problems necessitating readily available funds for emergencies. However, the learned AO treated the cash deposits as unexplained money under Section 69A of the Act. The learned CIT(A) upheld the AO's decision, noting that it was improbable for an individual to hold such large sums of cash for several years without spending them. The assessee preferred an appeal before the Hon’ble ITAT.

Held

The Hon’ble ITAT observed that though the assessee had made huge cash withdrawals from the bank despite having cash balance of ₹ 9,25,855/- as on 28-09-2011, there were no amounts that were allocated towards household expenses by the assessee and accordingly, a reasonable estimate of household expenses is to be made. The onus is on the revenue to prove that the cash balances earlier withdrawn from the bank account had already been deployed by the assessee for some purposes and the same is not available to explain the source of cash deposits made at a future date. This is conspicuously absent in the orders of both the lower authorities in the instant case. Considering the same, the Hon'ble ITAT computed the unexplained money under section 69A as follows:

(a) The assessee had an opening cash balance of INR 9,25,855/- as of 28/09/2011

(b) The total cash withdrawals are of INR 31,40,000/- over the years

(c) Reasonable estimate of household expenses can be made at INR 21,60,000/- from AY 2012-13 to AY 2017-18

(d) Thus, the net cash available comes at INR 20,05,855/-. Whereas, the cash deposit during the demonetization period are of INR 36,43,500/-.

Accordingly, the Hon'ble ITAT determined a shortfall of INR 16,37,645/- (INR 36,43,500/- - INR 20,05,855) and directed the AO to treat only this shortfall as unexplained cash deposit under Section 69A, thereby partially allowing the appeal of the assessee.

6 *Beachwood Properties Pvt. Ltd. vs. DCIT (ITA No. 5510 to 5515/Mum/2024) (AY 14-15 to AY 19-20)*

Section 69C/153C - Unexplained Expenditure – Cash Payment made – Source of cash already Taxed in case of search person – Addition to be deleted

Facts

A search and seizure action was undertaken on 20.08.2019 u/s. 132 of the Act in the case of Oberoi Realty Ltd. and its related/associated entities commonly referred to as Oberoi Realty Group. Owing to this search, certain incriminating material was found and seized, which according to the ld. Assessing Officer was pertaining to the assessee. Accordingly, notice u/s. 153C was issued. It was alleged that certain incriminating material were found during search and it was found that assessee has incurred cash expenses and therefore additions was proposed to be made u/s 69C as unexplained expenditure. Therefore, AO has held that assessee had failed to explain the nature and character of the said payments, the aforesaid sum of ₹ 44,76,800/- was treated as unexplained expenditure u/s. 69C. On further appeal, CIT(A) dismissed assessee's appeal. Being aggrieved with the order, appeal is filed by assessee before Hon. ITAT.

Held

Hon. ITAT had held that impugned assessment has been completed u/s. 153C r.w.s. 143(3) as assessee is not a searched person but "other person" as contained in section 153C of the Act. Mr. Vikas Oberoi is a searched person who has accepted the impugnedtransaction as his personal expenses and went into settlement before the ld. Settlement Commission, explaining the nature and source thereof, which has been accepted in the order passed by IBS u/s. 245D(4). It has further held that the source from which the unaccounted expenditure was incurred has already been considered and taxed in the hands of Mr. Vikas Oberoi, the Director and substantial share holder of the assessee company as held in the settlement order. The notings of undisclosed expenditure had been fully explained by furnishing the cash flow statement which has been accepted by the ld.

IBS. Thus, cash receipt was offered to tax and out of that cash receipt, cash expenditure was incurred. Addition of such cash expenditure in the hands of the assessee would tantamount to double taxation, firstly as cash income in the hands of Mr. Vikas Oberoi in the settlement proceedings and again in the hands of the assessee as cash expenditure. Once the source of cash is taxed, it cannot be further taxed as unexplained cash expenditure. The issue regarding addition of unexplained expenditure in the hands of assessee is squarely covered and considered by the order of ld. IBS while disposing the settlement application of Mr. Vikas Oberoi wherein ld. IBS has accepted the explanation on the source of unexplained expenditure. Therefore on above basis, addition u/s 69C was deleted and appeal filed by the assessee was allowed.

7

ACIT vs. Manish Financial [ITA No. 5055/MUM/2024, dated 02.12.2024 (AY 2015-16 & 2016-17)]

Section 149 & 151 – For AY: 2015-16, TOLA does not apply – time limit for reassessment expired on 31.03.2022 – notice u/s. 148 issued on 29.07.2022 was barred by limitation.

For AY: 2016-17 – the appropriate authority to grant sanction u/s. 151 was Pr.CCIT/CCIT -- more than three years elapsed from end of relevant assessment year– sanction from Pr. CIT for notice issued u/s. 148 on 30.07.2022 is invalid

Facts of the case

The assessee's case was reopened by issuing a notice u/s. 148 of the Act for AY 2015-16 and AY: 2016-17 dated 29.06.2021 and 23.04.2021 respectively on the reasons that the assessee has derived fictitious loss in the trading of equity derivatives and the assessee is a beneficiary of bogus capital gains. The said notice was considered as deemed show cause notice as per the directions of the Hon'ble Supreme Court in the case of ***Union of India vs. Ashish Agrawal (138 taxmann.com 64)***. Subsequently, the order was passed u/s. 148A(d) of the Act and notice was issued u/s. 148 on 29.07.2022 and 30.07.2022 respectively. The assessment was completed u/s. 147 of the Act alleging the loss claimed by the assessee as non-genuine. In both these appeals, the assessee filed an appeal before CIT(A), wherein the additions were deleted considering the merits of the case. Against the said order, the department has filed an appeal. Against the said order, the department has filed an appeal and the assessee has filed cross objections before the Hon'ble Tribunal. The assessee has filed cross objections before the Hon'ble Tribunal against the department appeal.

Held

For AY: 2015-16, the Hon'ble ITAT held that the test for checking validity of notices issued u/s. 148 of the new regime for AYs 2021-22 or prior years is whether the period of six years has expired at the time of issue of such notice. The time limit of ten years as per the amended provisions of section 149(1)(b) can be applied only prospectively. In assessee's case, the period of six years expired on 31.03.2022 and therefore the notice u/s. 148 of the Act dated 29.07.2022 is invalid and is barred by limitation. Reliance was placed on para 19(f) of the decision of the Hon'ble Supreme Court in the case of ***Rajeev Bansal (167 taxmann.com 70)*** where the revenue had themselves conceded that re-assessment for AY: 2015-16 is not valid, and on paras 46 and 49 where the SC has affirmed that Resultantly, a notice under Section 148 of the new regime cannot be issued if the period of six years from the end of the relevant assessment year has expired at the time of issuance of the notice. The Tribunal considered the SC decision of Rajeev Bansal and Co-ordinate bench decision in the case of ***Pushpak Realties Pvt. Ltd [ITA no. 4812/ Mum/2024***] to hold that the notice issued under section 148 is time barred.

For AY: 2016-17, the AR argued that the AO had not obtained sanction from the appropriate authority specified under the amended Section 151(ii) of the Act. Reliance was placed on the decision of Rajeev Bansal wherein it was held that Section 151 of the new regime does not prescribe a time limit within which a specified authority has to grant sanction; rather, it links up the time limits with the jurisdiction of the authority to grant sanction. The Hon'ble ITAT held the period of three years elapsed on 31.03.2020 and the notice u/s. 148 was issued beyond three years on 30.07.2022. The approval should have been obtained under the amended provisions of section 151(ii) of the Act i.e. of Pr.CCIT whereas the approval was obtained from Pr.CIT. It was held that the notice u/s. 148 was invalid, as being issued without proper approval, and the consequent assessment u/s. 147 was quashed.

8 ***Oasis Landmark LLP vs. Deputy Commissioner of Income Tax [ITA No. 580/MUM/2024) dated 29/11/2024] [AY 2018-19]***

Section 234B - Interest computation for period post payment of self-assessment tax – Only amount of interest discharged alongwith self-assessment tax under section 140A to be appropriated towards interest on assessed liability and balance towards tax payable – Resulting into lower charge for such period

Facts

The assessee filed its return of income for AY 2018-19 under Section 139(1) of the Act, post payment of self-assessment tax ('SA Tax'). The said return was processed by the CPC under Section 143(1) of the Act. In the said intimation, a demand was raised, interalia, on account of interest under Section 234B of the Act. The CPC appropriated SA Tax entirely towards interest payable first and thereafter adjusted it against the principal tax for the purpose of computing interest for the subsequent period. Aggrieved by the said order, the Assessee filed appeal before the learned CIT(A), wherein the Assessee contended that for the purpose of computing interest under section 234B(1) for the period post payment of SA Tax, only interest paid alongwith such SA Tax needs to be appropriated towards interest. The learned CIT(A) did not grant any relief for additional interest levied under Section 234B of the Act. Aggrieved by the said order, the Assessee filed an appeal before the Hon'ble ITAT.

Held

The Hon'ble ITAT concluded that Section 234B(1) of the Act deals with a general method of calculating interest for default/ delay in payment of advance tax as it provides for levy of interest for the period commencing from 1st April of the assessment year to the date of determination of total income under Section 143(1) of the Act or regular assessment, as the case may be. Section 234B(2) of the Act provides for calculation of interest in cases where the tax is paid before determination of total income under Section 143(1) or before the completion of regular assessment. As per Section 234B(2)(i) of the Act, the interest is to be calculated in the manner provided for Section 234B(1) of the

Act upto the date of payment and thereafter, the interest so computed is to be reduced by the interest, if any, 'paid' under Section 140A of the Act towards the interest chargeable under Section 234B of the Act.

The Hon'ble ITAT then perused section 140A(1) of the Act wherein it is said that an Assessee is required to pay tax along with interest before filing the return of income. Explanation to Section 140A(1) of the Act contains the rule of appropriation which comes into application in case the amount paid by an Assessee falls short of aggregate tax and interest payable as per the returned income.

The Hon'ble ITAT held that the rule of appropriation contained in Explanation to Section 140A(1) of the Act would be attracted only at the time of payment of SA Tax as per the return of income. Hence, while giving effect to the provisions contained in Section 234B(2)(i) of the Act, the amount actually paid as interest alongwith SA Tax shall be reduced from the interest computed under Section 234B(1) of the Act. Hence, the Hon'ble ITAT concluded that the Assessing Officer cannot change the amount of interest paid under Section 234B of the Act at the time of filing return of income under Section 140A of the Act and the same is required to be adjusted or appropriated towards interest payable upon determination of income under Section 143(1) or Section 143(3) of the Act.

The Hon'ble ITAT relied upon the decisions of the co-ordinate Bench in the case o***f M/s. Great Easter Shipping Co. Ltd vs. DCIT, CC-47 (ITA No.2282/M/2005)*** and in the case of ***Patson Transformers Ltd. vs. Deputy Commissioner of Income Tax [2006] 6 SOT 673 (AHD).*** Considering the above, the Hon'ble ITAT deleted the demand raised on account of interest under Section 234B of the Act.

9

Shri Subhash Tyagi (Prop. Krishna Construction) vs. DCIT [ITA No. 1044, 1342/Del/2021 & CO No. 59/Del/2023 dated 09/12/2024] [AY 2016-17]

Section 271AAB – Penalty on undisclosed income – Conditions specified under section 271AAB(1)(a) not satisfied – Higher penalty @30% restored

Facts

The assessee, Mr. Subhash Tyagi, is a proprietor of 'M/s Krishna Constructions' and is engaged in the business of construction and related activities. A search operation under Section 132 of the Income Tax Act, 1961 ('the Act'), was conducted on 11/08/2016 during which certain incriminating documents were seized. These documents revealed liabilities under the head "creditors for material," amounting to INR 102.56 crores, of which INR 52 crores were admitted by the assessee as fictitious liability on account of bogus purchases. The assessee acknowledged the same in his statement under section 132(4) of the Act and offered an amount of INR 52 crore as undisclosed income alongwith payment of taxes in the return of income.

The learned AO passed a penalty order imposing penalty @ 30% under section 271AAB(1)(c) of the Act. On appeal, the learned CIT(A) reduced the penalty to 10% (as applicable under section 271AAB(1)(a)) citing that the assessee has satisfied the conditions specified under clause (a) since the assessee has submitted that income is generated out of cessation of liability and also substantiated the manner by providing the list of creditors and their credit balances.

The Department filed an appeal challenging the reduction of penalty from 30% to 10% under section 271AAB of the Act. Whereas, the Assessee filed an appeal as well as Cross Objections challenging the order of the learned CIT(A) on the ground that (a) Pre-requisite under section 271AAB of the Act is not satisfied since there is no allegation of existence of undisclosed income (b) The learned AO failed to specify the limb for initiation of penalty under the provisions of section 271AAB of the Act.

Held

The Hon'ble Tribunal first dealt with the appeal and cross objections of the Assessee. While dismissing the same, the Hon'ble Tribunal held as follows:

(a) Regarding satisfaction of condition of undisclosed income - The assessee has, by his express conduct, has rather accepted the existence of undisclosed income. The plea of assessee towards non-existence of any 'undisclosed income' per se seeks to obfuscate reality and thus cannot be accepted.

(b) Regarding not citing the limb at the time of initiation of penalty proceedings -A nuanced reading of different limbs/clauses of s. 271AAB(1) would show that penalty is leviable in all circumstances with varied rate depending on gravity of conduct of the assessee. The quantum of imposable penalty thus depends on appreciation of facts after taking the response of the assessee in account. It is, at times, difficult to pre-conceive and show cause the assessee qua the exact quantification of penalty at the initial stage of issue of show cause notice. Noticeably, for the purposes of s.271AAB, there is no requirement in law to form any 'satisfaction' before initiating penalty proceedings. The provisions of s. 271AAB thus cannot be read pari materia with that of s. 271(1)(c) of the Act.

The Hon'ble Tribunal allowed the appeal of the Department and reversed the order of the learned CIT(A), thereby confirming the levy of penalty @30% under section 271AAB(1)(c) of the Act. In doing so, the Hon'ble Tribunal observed that a presentation of bare list of creditors cannot ipso facto be regarded as sufficient compliance of twin burden cast upon the assessee, namely 'manner' of deriving undisclosed income and 'substantiation' thereof. The benefit of lesser penalty under clause (a) is contingent upon the compliance of conditions laid therein, which have not been met in the facts of the present case. Hence, the action of the AO applying clause(c), in the absence of necessary compliance of cumulative pre-requisites of clause (a) by the Assessee, requires to be restored. Accordingly, the tribunal dismissed the Assessee's appeal and allowed the revenue's appeal, restoring the penalty @ 30% under section 271AAB(1)(a) of the Act.

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Dr. CA Sunil Moti Lala
Advocate

INTERNATIONAL TAXATION
Case Law Update

A. SUPREME COURT

1 ***CIT (LTU) vs. Whirlpool of India Ltd. - [2024] 169 taxmann.com 95 (SC)***

Revenue's SLP was dismissed against order of High Court holding that where revenue had been unable to demonstrate by some tangible material that there was an international transaction involving AMP expenses between Indian subsidiary and foreign parent, revenue could not proceed to determine ALP of AMP expenses by inferring existence of an international transaction based on bright line test.

B. HIGH COURT

2 ***DIT International vs. Western Union Financial Services Inc. - [2024] 169 taxmann.com 461 (Delhi)***

Where assessee, a US based company, engaged in business of rendering money transfer services, established a liaison office (LO) in India, the Hon'ble HC upheld the order of the Hon'ble Tribunal holding that since activities undertaken by LO were merely preparatory or auxiliary in character and far removed from core business of assessee, LO would not constitute a PE. Permission granted by RBI proscribed LO from undertaking any commercial trading or industrial activity in India and since activities undertaken by LO were far removed from core business of assessee tests of 'preparatory' and 'auxiliary' as embodied in Article 5(3)(e) stood satisfied and, thus, LO would not constitute a PE. Further, since LO did not have any authority to conclude contracts, it could not be classified as a DAPE.

3 ***PCIT vs. CIENA Communications India (P.) Ltd. - [2024] 169 taxmann.com 660 (Delhi)***

The Hon'ble HC upheld the order of the Hon'ble Tribunal holding that where on-call advisory services provided to assessee by its US based AE through call did not make available technical knowledge and experience or skill to assessee, consideration paid by assessee to AE was neither taxable in India u/s 9(1)(vii) of the Act nor under Article 12 of the India-US DTAA.

4 *PCIT. vs. Fluor Daniel India (P.) Ltd. - [2024] 169 taxmann.com 508 (Delhi)*

Where assessee was rendering engineering and related services (as a subcontract limited to specific functions as per requirement of its affiliate), the Hon'ble HC upheld the order of the Hon'ble Tribunal rejecting the following companies as comparables.

a. A company having highly technical capabilities of executing infrastructure development projects.

b. A company working in divisions like infrastructure, tourism, aviation, IT services, HRD and financial services, which were not similar to functions performed by assessee.

c. A company engaged in providing high end technical services with prestigious urban infrastructure facilities such as Airports, Railways and metropolis engineering consulting projects.

d. A company playing vital role in development of fertilizers industry in India.

5 *PCIT. - 4 vs. Symphony Marketing Solutions India (P.) Ltd. - [2024] 169 taxmann.com 548 (Delhi)*

Where the assessee was providing call centre services to its AE, the Hon'ble HC upheld the order of the Hon'ble Tribunal rejecting the following companies as comparables

a. A company providing business process management services.

b. A company providing knowledge process outsourcing services.

C. Tribunal

6 *TBEA Shenyang Transformer Group Company Ltd. vs. DCIT, International Taxation. - [2024] 169 taxmann.com 145 (Ahmedabad – Trib.) (SB)*

Transactions between foreign enterprise and its PE in India can be considered as international transaction for purpose of section 92B and, accordingly, be subject to 'arm's length price' adjustment. In the instant case, where Head Office (HO), situated in China had complete control over funds of assessee-PE and its revenue were determined by agreement signed by HO and furthermore assessee-PE was incurring loss, it was held that such an arrangement would be subject matter of transfer pricing.

Facts

i. The assessee, was a Project Office (PO) in India of TBEA, a company incorporated in China. Power Grid Corporation of India Ltd., (PGCIL) awarded a contract to TBEA to build sub-stations in India, comprising of off-shore supply, on-shore supply, and on-shore Services, governed by separate agreements. Under the on-shore services agreement, TBEA was to provide certain onshore services in the nature of inland transportation and civil work services to PGCIL within India. In order to provide these services, pursuant to the agreement with PGCIL, the TBEA set up a Project Office (i.e., assessee) in India to provide the onshore services. The onshore services were accordingly provided by the TBEA through its PO/PE including sub-contracting a part of the work to independent third-party contractors. The HO in China had made/received certain payments on behalf of the PO as the PO did not have a bank account in India at the relevant time.

ii. The TPO took a view that since the original onshore service contract was executed between head office in China and PGCIL, the act of carrying out execution of the contract by the PO in India on behalf of head office in China and consequent incurring of expenses by it was required to be considered as the international transaction between the HO in China and PO. The TPO observed that the per unit civil work rate received from PGCIL was lower than the rate paid to sub-contractor. The TPO held that the PO was not adequately compensated for the onshore activity and had incurred losses. Therefore, the TPO held that the TP provisions were applicable to transactions between PO and its HO in China.

iii. On appeal to the Tribunal, the Division Bench referred the following question to the Special Bench, "Whether or not the transactions between a foreign enterprise outside India and its Indian permanent establishment can be considered as an international transaction for the purpose of section 92B of the Act, and accordingly can be subjected to the 'arm's length price' adjustment".

Decision

i. The SB noted the assessee's contention that the provisions of India-China tax treaty override the provisions of the IT Act and as per Article 9 of the treaty and that TP provisions were not applicable in the instant case. The SB held that having relied on Article 9 of the tax treaty, the assessee had lost sight of Article 7(2) of India-China Tax Treaty. In the context of a PE in India of a foreign enterprise, Article 7(2) provides that profits, which the PE might be expected to make if it were a distinct and separate enterprise engaged in the same or similar activities shall be attributed to India. So, PE has to be treated as a distinct and separate enterprise. So even if profit attribution has to be done as per treaty, PE has to be treated as a distinct and separate enterprise from the HO. Therefore, even under the tax treaty, the PE is a separate enterprise.

ii. Since, PE is a separate enterprise from the HO for the purpose of transfer pricing provisions, the decisions relied by the assessee to contend that one cannot generate income by dealing with self are not applicable in given context. The transfer pricing provisions are applicable to transactions between two enterprises and not between two persons.

iii. The assessee contended that there is no income arising out of international transactions in the current case as there is only fund movement between HO and PE and actual transactions are between PE and third parties. The SB held that the fundamental question that arose in this context was whether in an independent party scenario whether an enterprise would permit its receipts and payments to be routed through third party. The HO had complete control over the funds of PE. The revenue of assessee-PE were determined by agreement signed by HO. These all aspects have influence on the taxable income that is to be determined in the hands of assessee-PE. The understanding of income in the context of transfer pricing has to be in commercial and business sense.

iv. Further, the word 'transaction' in the context of transfer pricing has to be understood as per the clause (v) of section 92F, which is wider than the normal understanding of word 'transaction'. Thus, transaction includes arrangement, understanding or action in concert. The arrangement or understanding between two enterprises may also give rise to income or loss and it may be subject matter of transfer pricing. In the instant case, the arrangement between the HO and the assessee-PE is giving rise to loss in the hands of PE and thus such an arrangement is subject matter of transfer pricing. The assessee-PE has undertaken obligation of rendering onshore services to which the HO had agreed. The funds of assessee-PE were controlled and managed by HO. If the income or loss in the hands of PE was not due to arrangement with HO, then such a case would not be covered which was not so in the instant case.

v. Section 92 brings income arising from international transaction within the ambit of transfer pricing provisions. The international transaction is between the associated enterprises. As held above it is viewed that PO and HO are separate enterprises. Further, as per Article 7(2) of the India-China DTAA and paras 15, 16 & 17 of the commentary on Article 7 on Model tax convention published by OECD in 2010 also states that permanent establishment is to be treated as a functionally separate entity. PO and HO have transaction between them which has an impact on 'income'. Both are non-residents and thus, satisfy the basic test of section 92B.

vi. The question which is before Special Bench covers both sub-sections (1) and (2) of section 92B. In the instant case, the PO has undertaken the obligation of rendering onshore services on behalf of HO and at same terms and conditions which the HO agreed with the PGCIL. The PE incurred substantial losses in executing such services. The crux of the matter is whether unrelated party would have taken up the obligation of rendering onshore services, which at the threshold itself results in loss. Whether PO was made to accept the term of onerous contract by the HO. If this be the fact pattern, provisions of section 92B(2) may be applicable in such kind of cases. The SB directed that the Division Bench may analyse the applicability of section 92B(2) in accordance with law.

vii. The SB noted that the assessee had submitted that as per the provisions of section 90, the provisions of the DTAA (to the extent it is beneficial to the assessee) override the provisions of the Act. It was further submitted that as per Article 9 of India-China DTAA, the profits derived by the one enterprise would be subject to transfer pricing and determination of ALP, only where one of the two Enterprises was a resident of the other contracting state (India). It was submitted that neither the HO nor the PE can be termed as resident and thus transactions between them shall not be subject to transfer pricing considering provisions of Article 9 of DTAA.

viii. The Hon'ble SB held that the purpose of Article 9 is limited to only confirm that broadly similar rules exist in domestic law. Article 9(1) does not, in itself fulfil any necessary function, as it only formulates rules that may already exist in domestic laws. Article 9(1) does not bar an adjustment of profits under the domestic law even under conditions that differ from those of

Article 9(1) but the intention is to have economic double taxation covered by the convention. Assuming that argument of the assessee that DTAA provisions in Article 9 override the Act is correct, then one needs to attribute profits to the PE as per provisions of Article 7 of the Treaty. Thus, one would also have to apply Article 7(2) of India-China Tax Treaty.

ix. In the context of a PE of a foreign enterprise in India, the Article 7(2) provides that profits that will be attributed to PE shall be profits which the PE might be expected to make if it were a distinct and separate enterprise engaged in the same or similar activities under the same or similar conditions and dealing wholly independently with the enterprise of which it is a PE. Article 7(2) of the India-China DTAA leads to the conclusion that determination of profits under the hypothesis of the PE being a distinct and separate enterprise, dealing wholly independently with the enterprise of which it is a PE, is nothing but adherence with the arm's length principles. The underlying philosophy of TP provisions and Article 7(2) is same wherein both try to analyse as to how third parties would have dealt with each other under uncontrolled conditions. Thus, contention of the assessee that there is conflict between Article 9 of the DTAA and domestic TP provisions was rejected.

x. In light of aforesaid reasoning, it concluded that the transaction between foreign enterprise and its PE in India could be considered as an international transaction and be subject to ALP adjustment. The Hon'ble SB directed that the matter be placed before the Division Bench to give effect to the direction of this order.

7 *Manab Chandra Ghosh vs. ACIT - [2024] 169 taxmann.com 449 (Kolkata – Trib.)*

Where assessee, non-resident employee of an Indian company, was sent to Indonesia for rendering services and he received foreign assignment allowances for services rendered in Indonesia, the Hon'ble Tribunal held that since assessee was a non-resident and services were rendered outside India, said allowances were not taxable in India.

Facts

i. The assessee, an employee of IBM India Pvt. Ltd. had undergone a short-term assignment to Indonesia and consequently, the assessee claimed to be a non-resident for the assessment year 2016-17 as per the provisions of the Income Tax Act.

ii. The assessee filed his return of income (declaring total taxable income of Rs.49,590) claiming that the income received and accrued in Indonesia for rendering service outside India, was not taxable under section 5(2). The assessee also claimed a refund of the TDS.

iii. The AO rejected the claim of the assessee as he had failed to produce the valid tax residency certificate (TRC) from Indonesia.

iv. The CIT(A) dismissed the appeal of the assessee.

v. Aggrieved, the assessee filed appeal to the Tribunal.

Decision

i. Based on the passport details, the Hon'ble Tribunal noted that the assessee was present in India for only 61 days during the financial year 2015-16 which qualified him as a non-resident under section 5(2) and only income received or deemed to have accrued or arisen in India, is taxable for a non-resident.

ii. It is undisputed that the assessee was a non-resident employee in IBM India Pvt. Ltd. (an Indian Company) and was sent abroad to Indonesia for rendering services there.

iii. There was no dispute that the services were rendered in Indonesia and the foreign assignment allowances received by the assessee was for services rendered in Indonesia and no evidence suggested that income accrued or arose in India.

iv. The assessee failed to produce the TRC before the AO, which was a procedural lapse and did not negate the substantive compliance.

v. After considering the facts and circumstances of the case and following the decision in the case of ***DCIT vs. Sudipta Maity [2018] 96 taxman.com 336 (Kolkata-Trib.),*** the Hon'ble Tribunal deleted the addition made by the AO based on the fact that the income related to services rendered & received outside India was not taxable in India. The AO was accordingly directed to allow the refund as claimed by the assessee.

8 ***Avtec Ltd. vs. ACIT, LTU - [2024] 168 taxmann.com 692 (Delhi-Trib.)***

The Hon'ble Tribunal held that where assessee made payment to a non-resident independent warehouse service provider based in USA for space utilization of warehouse outside India, and non-resident had no business activity in India, the Hon'ble Tribunal held that payment made by assessee was not an income within ambit of section 9 and was not exigible to tax in India. Also, since no technology had been transferred, 'make available' conditions were not complied with and, therefore, payment made to non-resident did not fall under description of FTS under Article 12 of the India-US DTAA.

9 ***Anand NVH Products (P.) Ltd. vs. DCIT - [2024] 169 taxmann.com 684 (Delhi- Trib.)***

The Hon'ble Tribunal held that Corporate guarantee is an international transaction and commission charged by a commercial bank under bank guarantee cannot be a benchmarking parameter and suitable comparable for determination of arm's length price of alleged international transaction. Since in financial year 2016-17, assessee had paid 1 per cent as cost of extending SBLC (Standby Letter of Credit) to AE, it directed the AO/TPO to consider rate of 1 per cent to be ALP for this international transaction.

INDIRECT TAXES
GST


CA Naresh Sheth CA Jinesh Shah

A. WRIT PETITIONS

1 *Bharti Airtel Ltd. vs. Commissioner, CGST APPEALS-1, DELHI [2024] 169 taxmann.com 390 (Delhi) – High Court Of Delhi*

Facts and issues involved

GST Authorities raised demands of tax along with consequential interest and penalty on various entities operating in the telecommunication sector on the ground that ITC availed by them on Input and Input Services used for setting up telecommunication towers falls within the ambit of clause (d) of Section 17(5) of the CGST Act and hence it is disallowed.

The entities preferred a writ petition at the Hon'ble High Court of Delhi for resolving the issue justly.

Petitioner's Submissions

The assertion of the writ petitioners is that telecommunication towers are moveable items of essential equipment used in telecommunications which can be dismantled at site and thus capable of being moved. It is asserted that the erection of those towers on a concrete base is essentially for the purposes of rendering stability to the towers and that in itself would not detract from their basic characteristic of being items of equipment which are principally moveable.

According to the writ petitioners, the question of whether telecommunication towers are liable to be treated as immovable property is no longer res integra and stands conclusively settled in light of the recent decision rendered by the Supreme Court in ***Bharti Airtel Ltd vs. Commissioner of Central Excise, Pune 2024 SCC OnLine SC 3374.*** It was submitted that telecom towers, as the Supreme Court in Bharti Airtel holds, are intrinsically moveable items and were liable to be treated as capital goods entitled to be viewed as inputs under Rule 2(k) of the 2004 Rules.

Discussions by and Observations of Delhi High Court

GST Authorities are distinguishing the decision made by the Supreme Court in light of the explanation which stands appended at the end of Section 17 of the CGST Act and the exclusion of telecommunication towers specifically in terms thereof. Hon'ble Supreme Court in its judgment had noted that it would be incorrect to characterize mobile towers as immovable property since they would not satisfy the test of permanency or be liable to be viewed as something attached to the earth. The following precepts were identified by the Hon'ble Supreme Court to help determine the nature of the property as follows:

1. Nature of annexation – How firmly a property is attached to the earth?
2. Object of annexation – Whether the attachment is to enjoy the benefit of land permanently or whether it is solely to facilitate use of the item itself?
3. Intendment of the parties – Whether the intention of the parties is to use it as a permanent attachment or not?
4. Functionality Test – Whether the article is fixed to the ground to enhance the operational efficacy of the article?
5. Permanency Test – Whether the property can be dismantled and relocated without any damage?
6. Marketability Test – Whether the property can be removed from the earth and sold in the market?

If we consider the nature of annexation of the tower to the earth, it is seen that the annexation is not for permanent annexation to the land or the building as the tower can be removed or relocated without causing damage to it. Further, the attachment of the tower to the building or the land is not for the permanent enjoyment of the building or the land. The tower is fixed to the land or building for enhancing the operational efficacy and proper functioning of the antenna which is fixed on the tower by making it stable and wobble free. Also, the fact that the tower, if required, can be removed, dismantled and sold in the market is not disputed. Therefore, by applying the tests of permanency, intendment, functionality and marketability, it is quite clearly evident that these items are not immovable but movable. It is, thus, apparent that in Bharti Airtel, the Supreme Court has conclusively held that telecommunication towers cannot be construed as being immovable property. While arriving at that conclusion, the Supreme Court reaffirmed the concept of immovable property as was lucidly explained in ***Commissioner of Central Excise, Ahmedabad vs. Solid and Correct Engineering Works & Others. (2010) 5 SCC 122.***

Tested on the aforesaid precepts, it becomes apparent that the stand taken by the respondents, namely, of telecommunication towers being viewed as immovable property is rendered wholly untenable. The specific exclusion of telecommunication towers from the scope of the phrase "plant and machinery" would not lead one to conclude that the statute contemplates or envisages telecommunication towers to be immovable property. Telecommunication towers would in any event have to qualify as immovable property as a pre-condition to fall within the ambit of clause (d) of Section 17(5). Their exclusion from the expression "plant and machinery" would not result in it being concomitantly held that they constitute articles which are immoveable.

In view of the aforesaid, there is no hesitation in coming to the conclusion that telecommunication towers would not fall within the ambit of Section 17(5)(d) of the CGST Act. Consequently, the denial of input tax credit cannot be sustained.

Decision of Delhi High Court

The writ petition is allowed.

2

Empire Foundation vs. Union of India & Others [2024-TIOL-1898-HC-AHM-GST] – Gujarat High Court

Facts and issues involved

Petitioner is providing exempted education services but, at the same time, the petitioner uses various taxable inputs, capital goods and input services and GST on such inputs, capital goods and input services is borne by the petitioner which adds to the cost to the petitioner.

It is the case of petitioner that it is entitled to the refund of the GST borne by it on inputs, capital goods and input services. However, as per the provision of section 54(3)(ii) of the CGST Act, the petitioner is not entitled to get the refund of the input tax credit. Petitioner, therefore, inter alia, prays for declaring section 17(2) of the CGST Act as unconstitutional and ultra vires Article 14 of the Constitution of India to the extent it restricts the refund under the inverted duty structure.

Petitioner's submissions

When the petition was filed, heavy reliance was placed on the decision of ***VKC Footsteps India Pvt. Ltd vs. Union of India and others [TS-585-HC-2020 (Guj.)***]. However, same was reversed by the Hon'ble Supreme Court wherein it categorically held that the provisions of the Act or the rules cannot be held to be ultra vires. However, the Hon'ble Supreme Court directed the GST Council to consider the anomaly in the format prescribed in Rule 89(5) of the CGST Rules.

It was submitted that similar directions may be given in this case also, for betterment of the student community at large of the country, to the GST Council to consider prayer made by the petitioner to permit the refund of the GST input tax credit paid by the educational institution though the same is exempt under the provisions of the GST Act and necessary directions may be issued by the Council to that effect

Discussions by and Observations of Gujarat High Court

Section 54(3)(ii) of CGST Act clearly stipulates that the refund of the input tax credit is not payable even when the credit has accumulated on account of credit of tax or inputs being higher than the rate of tax on output supplies other than fully exempt supplies. Admittedly, the education service provided by the petitioner and other educational institution falls in category of fully exempt supply and therefore, the petitioner would not be entitled to the input tax credit.

Sub-clause (ii) of section (3) applies to the inverted rate structure only whereas, in the zero-rated supply, nil Rated supply or exempted supply, the same would not be applicable as the very basis of inverted rate structure would not be applicable as the entire GST paid on the inputs would be liable to be refunded in such cases.

Therefore, the legislature has rightly provided that the tax credit which has accumulated on account of rate of tax on inputs being higher than the output tax would not cover the supplies having Nil rate or exempted supplies to entitle the service provider or the manufacturer to avail the refund of the input tax credit.

In view of above dictum of law , when the provisions of Section 54(3) of the CGST Act provides for refund in terms of the first proviso to section 54(3) categories which are governed by clauses (i) and (ii) and there is no constitutional entitlement to seek a refund as in clause (i) of the first proviso allowed a refund of the unutilized ITC in the case of zero-rated supplies made without payment of tax whereas under clause (ii) of the first proviso, refund of unutilized ITC is available where the credit has accumulated on account of the rate of tax on inputs being higher than the rate of tax on output supplies other than inputs utilized for output being Nil rate or exempted.

Therefore, when there is neither a constitutional guarantee nor a statutory entitlement to refund, the claim of the petitioner to grant refund of ITC on output service exempt from tax cannot be accepted.

Decision of Gujarat High Court

No interference is called for by granting any relief as prayed for and the petition is accordingly dismissed.

3 ***Lakhwinder Singh Stone Crusher vs. Union of India and Others [2024-TIOL-1930-HC-HP-GST] - Himachal Pradesh High Court***

Facts and issues involved

Petitioner, a firm engaged in stone crushing, had been issued notices u/s 70 of CGST Act for the payment of GST on the royalty it paid for mining concessions granted by the State.

Petitioner's submissions

Petitioner relied on a seven-judge bench decision of the Supreme Court in ***India Cement Ltd. vs. State of Tamil Nadu*** (referred to as India Cement case), which had previously declared that royalty is a form of tax. The petitioner contended that any demand for GST on royalty would effectively amount to a "tax on tax," which should be beyond the competence of the government authorities.

Discussion by and Observation of Himachal Pradesh High Court

Honorable Supreme Court's ruling in India Cement's case had been overruled by a nine-judge bench in a more recent decision of Mineral Area Development Authority vs. Steel Authority of India (2024). In the said landmark judgment, Court has clarified that royalty is not a tax, but a contractual payment made by the lessee to the lessor under the mining lease agreement. Honorable Supreme Court further held that the States have the constitutional power to levy taxes on mineral rights, and that there is no provision in the Mines and Minerals (Development and Regulation) Act (MMDR Act) that restricts the taxing powers of the States over minerals. Further, the Court also observed that the limitations on royalties u/s 9 of the MMDR Act do not curtail the State's taxing powers. Thus, the respondents are well within their rights to levy GST on the royalty paid by the mineral concession holder for any mining concession granted by the State."

Decision of Himachal Pradesh High Court

Consequently, the orders impugned herein and summons are upheld and the instant petition is accordingly dismissed.

4 ***Haries Muhammed vs. The Assistant Commissioner [2024-TIOL-1952-HC-Kerala-GST] – Kerala High Court***

Facts and issues involved

Petitioner received a consolidated show cause notice invoking Section 74 of the CGST/SGST Acts spanning the tax periods from 2017-18 to 2021-22. Petitioner claimed that while there had been non-compliance in 2017-18 due to failure to file returns, for the subsequent years (2018-19 to 2021-22), the necessary returns were filed, and taxes were remitted at a rate of 5%. Despite this, the respondent authorities invoked Section 74 to impose penalties and initiate proceedings for the entire period covered in the notice.

Petitioner's submissions

The petitioner argued that issuing a consolidated show cause notice for multiple years under Section 74 of the CGST/SGST Acts was unwarranted. Since a consolidated notice has been issued under Section 74 of the CGST/SGST Acts, the petitioner will be unnecessarily subjected to penalty and other proceedings under Section 74 of the CGST/SGST Acts. The consolidated notice treated all years alike, even though for the years after 2017-18, returns were filed and taxes were paid.

Further, proceedings u/s 74 for the period from 2018-19 to 2021-22 should not be initiated, given that the error was only in the rate of tax and that this mistake did not constitute suppression of facts or fraud. Therefore, he requested that the competent authorities issue separate notices for each of the years, allowing him to present his case distinctly for each period.

Discussion by and Observation of Kerala High Court

The court acknowledged the petitioner's argument that, for the years 2018-19 to 2021-22, the taxes had been paid, and there was no fraud or suppression of facts. Hence, the court directed the authorities to consider each year separately and evaluate whether invoking Section 74 for these periods was justified.

The court directed the competent authority to finalize proceedings separately for each year and consider the petitioner's specific contentions for each period. It was emphasized that while a consolidated show cause notice may have been issued, the authorities must treat each year independently when passing their orders.

Importantly, the court ordered that the petitioner must be afforded an opportunity for a personal hearing before the final orders were passed. This would ensure that the petitioner could present any evidence or arguments in defense of each tax year.

The court made it clear that any taxes paid by the petitioner, including those made to rectify the incorrect rate of tax, must be credited to the petitioner's account while finalizing the proceedings.

Decision of Kerala High Court

The writ petition was dismissed with above directions.

5 ***Ashish Traders vs. State of UP and 2 Others (WP(C) No. 1882 of 2019) [2024-TIOL-1931-HC-ALL-GST] – Allahbad High Court***

Facts and issues involved

This petition is directed against order dated 23.08.2024 passed by the Deputy Commissioner, State Tax, Azamgarh u/s 73 of the CGST Act 2017 whereby demand has been created against the petitioner.

Submission has been made those notices issued u/s 73 of the Act, were uploaded on 'Additional Notices and Orders' Tab of the GGST Portal and consequently, the petitioner being unaware of issuance of the notices as well as passing of the order, could neither appear before the authority nor question the validity of the impugned order within the period of limitation.

Discussion by and Observation of Allahabad High Court

Relying on its earlier decision in ***Ola Fleet Technologies Pvt. Ltd. vs. State of U.P.***, the Court noted that a similar portal issue had previously warranted a remand. Court held that the petitioner was entitled to the benefit of the doubt regarding non-receipt of notices through the proper channel. It was further observed that the GST Network's system design might have contributed to the issue and directed the authorities to address such errors.

Decision of Allahabad High Court

Court quashed the impugned order and directed the Assessing Officer to issue fresh notices with a minimum of 15 days' clear notice for compliance.

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INDIRECT TAXES
Service Tax

CA Rajiv Luthia

CA Keval Shah

1 ***M/s Bharti Airtel Ltd vs. CCE, Pune 2024-(11)-TMI-1042-Supreme Court***

Backgrounds and facts of the case

- The issue involved was whether mobile service providers (MSPs) can claim CENVAT credit on excise duties paid for mobile towers and prefabricated buildings (PFBs) as "capital goods" or "inputs" under the CENVAT Credit Rules, 2004.

- The MSPs typically provide SIM cards to the subscribers either in physical or electronic form, on activation of which the subscribers are able to enjoy wireless telecommunication service. For rendering these services, the service providers usually own and operate the infrastructure such as Cell Towers, Base Transceiver System (BTS) along with accompanying network equipment and structures like prefabricated building (PFBs), electricity generating sets (gensets), battery back-up and stabilisers for uninterrupted power supply to ensure seamless telecom service to the subscribers.

- With respect to claim of CENVAT credit, conflicting views have been given by two High Courts, namely the High Court of Bombay and High Court of Delhi. Bombay HC in case of appellants themselves Bharti Airtel decided on 26.08.2014, the High Court has ruled against the MSPs, favouring the Revenue, holding that MSPs are not entitled to CENVAT credit on mobile towers and prefabricated buildings. whereas, the Delhi High Court in case of Vodafone Mobile Services Limited decided on 31.10.2018 has held to the contrary extending the benefit of CENVAT credit to the MSPs. The decisions of both the High Courts have been challenged before this Court by the respective aggrieved parties, by way of the present set of appeals.

- The mobile towers are bought and brought at the site either in completely knocked down condition (CKD) or semi-knocked down condition (SKD) by the service provider. The tower is installed at an appropriate site based on technological viability. It is on this mobile tower that the antenna which receives and transmits the electromagnetic signal is hoisted and fixed at an appropriate height as may be technically determined. The mobile tower, in turn, is fixed to the ground or on the top of a building to provide stability and make it wobble free as the antenna cannot function effectively if the same is not kept at a particular height and is not stable and prevented from shaking due to wind, rain or any other reason.

Decision of the Bombay High Court

- In SCN, it was alleged that a tower, after erection, becomes immovable property having been fixed to the earth and thus, cannot be considered to be a "good" and hence was not "capital good" within the meaning of the CENVAT Rules. It was alleged that the tower even in CKD or SKD condition would fall under Chapter 7308 of the CE Tariff Act, 1985 which does not find mention either in clause (i) or clause (ii) of Rule 2(a)(A) or in Rule 2(k) of the CENVAT Rules. It was also alleged that tower or parts of the tower cannot be claimed for CENVAT Credit as these are not components, spares or accessories of "capital goods"
- As regards prefabricated buildings (PFBs), it was alleged that these are used as shelter for protecting transmission devices etc. and not for providing output service.
- It was also alleged that these cannot be said to be "inputs" for providing mobile service within the meaning of Rule 2(k).
- While examining the aforesaid issues framed the following questions of law:-

  "*1. Whether in the facts and circumstances of the case, the Appellate Tribunal was correct and justified in holding that the Appellant was not entitled to credit of duty paid on tower parts, green shelter?*

  2. Whether in the facts and circumstances of the case, the Appellate Tribunal was correct and justified in holding that the Appellant was not entitled to credit of duty paid on tower parts, green shelter on the ground that tower/green shelter is "immovable property" and hence, do not qualify as "capital goods" or "inputs" as defined under the CENVAT Credit Rules, 2004?

  3. Whether in the facts and circumstances of the case, the Appellate Tribunal was correct and justified in holding that tower would not qualify as "part" or "component" or "accessory" of the capital goods i.e. antenna?"

- In deciding the abovementioned issues, the Bombay High Court considered the following aspects:

  (i) That the aforesaid goods are not "capital goods" within the meaning under Rule 2(a)(A) of the CENVAT Rules, since these are immovable property.

  (ii) That these goods are not the components/accessories of antenna within the meaning of Rule2(a)(A) (iii).

  (iii) That these goods are not "inputs" within the meaning of Rule 2(k).

- The Bombay High Court, after considering the definition clauses in the CENVAT Rules, took the view that the goods in question i.e. tower and parts thereof which are fastened and fixed to the earth after their erection become immovable properties and therefore, these cannot be goods and hence not capital goods within the meaning of the CENVAT Rules.

Decision of the Delhi High Court

- The Assessee -Vodafone appealed to the CESTAT, by which time the Bombay High Court had already rendered its decision in Bharti Airtel (supra). The two member Bench of the Delhi CESTAT had difference in opinions, and the matter was referred to a larger bench of the CESTAT. The Larger decided in favour of the Revenue by holding that goods in question were neither "capital goods" and nor "inputs". The Appellants preferred an appeal before the Delhi High Court.

- In deciding the said appeal, the Delhi High Court framed the following questions of law:-

  i) *Whether the CESTAT was right in concluding that the towers, shelter and accessories used by the Appellants for providing telecom are immovable property?*

  ii) *Whether the Appellants are entitled to claim CENVAT credit on the towers, shelter as 'accessories' either as capital goods or input goods in terms of Rule 2(a) or 2(k) of the CENVAT Rules?*

  iii) *Whether the CESTAT erred in applying nexus test with reference to MS Angles and Channels, whereas according to the Appellants what was brought to the site were towers, shelter and accessories for providing services?*

  iv) *Whether the Appellants were justified, in terms of Rule 4 (1) of the CENVAT Rules, in claiming CENVAT credit of excise duty paid by the manufacturer of towers and shelters after receipt of such towers and shelters at their premises (i.e. tower sites)?*

- The Delhi High Court examined the aforesaid issues framed, in the following manner

  i) Applied the permanency test to come to the definitive finding that the entire tower and shelter are fabricated in the factories of the respective manufacturers and thereafter, are supplied in CKD condition to the mobile service providers. It was also held that tower and PFB can be unbolted and reassembled without any damage and relocated to a new site. These are thus not permanently annexed to the earth for the beneficial enjoyment of the land of the owner.

  ii) The Delhi High Court then concluded that tower and PFB/ Shelter support the BTS for effective transmission of mobile signals and therefore, enhance the efficiency of BTS and antenna. The towers and shelters, therefore, act as components and parts and in alternative as accessories to the BTS and antenna and thus are covered by the definition of "capital goods".

  iii) The Delhi High Court ruled in favour of the Assessee that it is entitled to the credit immediately on receiving the inputs irrespective of the subsequent treatment i.e. by way of fastening, bolting etc. whether or not it results into an immovable property, by holding that the subsequent treatment of capital goods or inputs after receipt by the provider of output service is not relevant for the purpose of availing credit in terms of Rule 3(1) of the CENVAT Rules

Decision of the Supreme Court

- Issues before Supreme court were as under:
  - o What emerges from the above discussion is that the Bombay High Court and Delhi High Court differed fundamentally on the issue as to whether towers, parts thereof and pre-fabricated buildings, with which we are primarily concerned in the present proceedings, are "capital goods" within the meaning of CENVAT Credit Rules, 2004.
  - o The other area of disagreement is that even if these items themselves may not qualify as "capital goods", but if they are found to be accessories or components of "capital goods", they would be covered by the deeming provision of "capital goods" under Rule 2(a)(A)(iii)
  - o Further, another aspect where the two High Courts differed is whether these goods can be considered as "inputs" for the "output" of services rendered by the service providers for if these are treated as "inputs", the mobile service providers can claim CENVAT credit for the output services
- While examining the attributes of "capital goods" for these items to be considered as "capital goods", these must first have the traits of "goods". The word "goods" has not been defined in the CENVAT Rules. The definition under the Sales of Goods Act, 1930 seems to be the basis of the term "goods" in other Statutes.
- The items in consideration viz., towers and prefabricated buildings are neither actionable claim nor money, nor do they come within the inclusive clause of the definition, viz., stocks, shares, growing crops grass, and things attached to forming part of the land which are agreed to be severed before sale or under contract of sale.
- If these items are movable properties, these will be "goods", in which case our further enquiry will be to examine whether these belong to the category of "capital goods" as enumerated in Rule 2(a)(A) only under which the Assessees will be entitled to claim CENVAT credit under the Rules.
- It has been defined under Section 3(26) of the General Clauses Act, though not exhaustively, but in an inclusive manner by providing that "immovable property" shall include "land, benefits to arise out of land and things attached to the earth, or permanently fastened to anything attached to the earth. Further, what amounts to "attached to earth" as mentioned under Section 3(26) of the General Clauses Act, has been explained under Section 3 of the Transfer of Property Act, 1882 to mean as rooted in the earth, as in the case of trees and shrubs; imbedded in the earth, as in the case of walls or buildings; or attached to what is so imbedded for the permanent beneficial enjoyment of that to which it is attached.
- The Apex Court, in case of Solid and Correct Engineering, applied the

intendment and functionality test to determine whether any article is movable or immovable. The issue in the said case was whether the asphalt drum/hot mix plant, though apparently appearing to be immovable and fixed to the structure embedded to the earth, can be considered to be movable. This Court found that the machine was fixed and attached to the earth primarily for the purpose of providing wobble-free operation of the machine and held that there was no necessary intent to make the same permanent, thus, it does not amount to permanently fixing, embedding as attachment in the sense that would make the machine a part and parcel of the earth permanently..

- In Triveni Engineering, the Supreme Court applied the marketability test, in which it took the view that if the goods in question are capable of being taken into the market and sold, the same cannot be treated to be as immovable but movable property. This Court observed that "marketability" itself indicates movability of the property in issue.

- The case of Sirpur Paper Mills Ltd., Supreme Court again applied the test of marketability. The issue which arose for consideration in the said case was whether paper machines assembled at site were liable for duties under the Excise Act. It was the plea of the Assessee that since the machine was embedded in concrete base, it became an immovable property though embedding was for providing a wobble-free operation of the machine. This Court rejected the plea and held that merely because the machine was attached to the earth for efficient working and wobble- free operation, it did not per se render the said property immovable since the said machine can be sold in the market.

- In the present case, while mobile tower cannot be shifted to another location without dismantling it, it is to be noted that mobile tower itself was bought and brought in a completely knocked-down (CKD) or semi-knocked-down (SKD) condition and it was erected and installed at the site after assembling the parts. If the said mobile tower is to be shifted to another location, it obviously has to be dismantled and restored to its SKD or CKD condition and thereafter re-erected, which however, would not entail any damage to it.

- There can no dispute that if the newly set up BTS/BSC is relocated to another site it may entail certain damages. However, what is important to be noted is that the damage is qua the BTS/BSC or cables connecting the various components, but not the tower itself or PFB with which we are concerned. If the tower or the PFB can be dismantled and relocated in another site without causing any damage to either the tower or PFB, the mobility or the marketability of these items is retained. Thus, as far as the tower and PFBs are concerned, these exhibit the character of a movable property.

- The Supreme Court summarised some of the principles applied by the Courts in the decisions referred to above to determine the nature of the property as follows:

  1. *Nature of annexation:* This test ascertains how firmly a property is attached to the earth. If the property is so attached that it cannot be removed or relocated

without causing damage to it, it is an indication that it is immovable.

2. *Object of annexation:* If the attachment is for the permanent beneficial enjoyment of the land, the property is to be classified as immovable. Conversely, if the attachment is merely to facilitate the use of the item itself, it is to be treated as movable, even if the attachment is to an immovable property.

3. *Intendment of the parties:* The intention behind the attachment, whether express or implied, can be determinative of the nature of the property. If the parties intend that the property in issue is for permanent addition to the immovable property, it will be treated as immovable. If the attachment is not meant to be permanent, it indicates that it is movable.

4. *Functionality Test:* If the article is fixed to the ground to enhance the operational efficacy of the article and for making it stable and wobble free, it is an indication that such fixation is for the benefit of the article, such the property is movable.

5. *Permanency Test:* If the property can be dismantled and relocated without any damage, the attachment cannot be said to be permanent but temporary and it can be considered to be movable.

6. *Marketability Test:* If the property, even if attached to the earth or to an immovable property, can be removed and sold in the market, it can be said to be movable

- Secondly, it is on the tower that the antennas are mounted and affixed at proper height, to make these stable. Since the antennas are used for receiving and sending radio signals, these need to be attached at a certain height, and these are required to be stable and wobble-free. It is not in dispute that the mobile tower is attached and fastened to the earth or building to provide stability to the same and to make antennas unshakable due to wind, rain or any other external force(s). Same is the case with prefabricated buildings

- If we thus apply the functionality test, it can be stated that the attachment of tower to the earth/building is not for the benefit of the land or the building but for better functioning of the antenna which is fixed on the tower. Thus, based on functionality test it can be said that tower is a movable property, as also held in Municipal Corporation of Greater Bombay case.

- The Court also noticed is that the Bombay High Court has held that since the towers and parts thereof are fastened and fixed to the earth and after their erection, they become immovable, and therefore, these cannot be classified as goods. While this conclusion is based on the classic definition of immovable property based on one criterion, as noticed earlier, that may not be the sole consideration to determine whether a property is immovable or movable. Even if the property is embedded to the earth and appears ex-facie immovable, if there are other indicators which show the characteristics of a movable property, as for instance, susceptibility to removal of the property from the fixture without causing any damage to its basic structure and change in character, ability of relocation to a new location and if the same can be sold thereby showing marketability, and lack of intention to make it a permanent fixture, in spite of the said property being embedded to the earth by way of fixing, the property may still be considered to be movable as has been held in many of the cases referred to above including in Solid and Correct Engineering. The Supreme Court also observed that the decision of this Court in Solid and Correct Engineering was not brought to the notice of the Bombay High Court and thus escaped consideration.

- Further, the tower and PFBs, after being dismantled without being damaged, can be relocated or sold, thereby possessing the character of marketability.

- However, it may be noted that neither tower nor prefabricated shelter/building (PFB) finds mention under any of the Chapters/Heading specified under sub-clause (i), nor these are pollution control equipment to fall within sub-clause (ii). Hence, these items on their own cannot be said to be "capital goods" within the meaning of sub-clause (i) and (ii) of Rule 2(a)(A).

- But it is the case of the Assessees that the mobile tower is an accessory of "antenna" which is part of "BTS" and since antenna and BTS fall under Chapter 85 which are "capital goods", mobile tower being accessory of antenna and BTS is to be treated as "capital good" by virtue of sub-clause (iii) of Rule 2(a)(A). Similar is the case with PFBs. In contrast to this, it is to be noted that the stand of the Revenue is that the towers and PFBs have independent functions and existence and have specific utilities and thus these cannot form part of a composite system or a single unit and hence they cannot be considered to be accessories of the antenna or BTS.

- What comes out from the above dictionary meaning of "accessory" is that any such item which adds to the beauty, convenience or effectiveness of some other items can be said to be accessory of that other thing and it may or may not be essential for functioning of main machinery. Seen from the above perspective what is evident is that the tower is a structure fixed to the earth or building on which microwave antenna is fastened to provide the necessary height and stability to the antenna by making it steady and wobble free. The function of antenna as part of the BTS is to receive and transmit radio signal and is used for providing mobile telecom service to the subscribers. The tower itself is not an electrical component of microwave antenna per-se, yet it is necessary and helps in keeping the antenna at proper height and in a stable position so that the antenna can transmit signals for ensuring uninterrupted and seamless services to the subscribers. It is with the aid of the tower that the potential of the antenna is fully realised, making it function optimally. Without tower, antenna cannot effectively function for the purpose itis used. Hence, there can be no doubt that tower is to be considered as an accessory of antenna.

- Similarly, the PFB houses other BTS equipment and alternative electricity source in the form of diesel generators and other equipment to provide alternative and uninterrupted power supply to the antenna so that in the event of failure of main power supply, the generator can instantly provide backup electricity supply to the antenna and BTS. The PFBs house electric cables, other equipment related to antenna, BTS and generator. Thus, PFBs enhance the efficacy and functioning of mobile antenna as well as BTS and accordingly, PFBs can also be considered as accessories to the antenna and BTS which are "capital goods" falling under Chapter 85 of the Schedule to the Central Excise Tariff.

- In the considered opinion of the Supreme Court, a component of any good would also mean to include those which make the good fully functional and make such a good more effective as observed in M/s. Annapurna Carbon Industries, wherein the Supreme Court held that an accessory would mean an object or a device that is not essential in itself but that adds to the beauty or convenience or effectiveness of something else or is supplementary or secondary to something of greater or primary importance, which assists in operating or controlling the said good, and thus serves as its accessory.

- The Supreme Court, therefore, agreed with the conclusion arrived at by the Delhi High Court that towers and shelters (PFBs) support the BTS/antenna for effective transmission of mobile signals and thus enhance their efficiency and since these articles are components/ accessories of BTS/antenna which are admittedly "capital goods" falling under Chapter 85 within sub-clause (i) of Rule 2(a)(A) of CENVAT Rules.

- The alternative plea taken by the Assesses is that these items, viz., mobile tower and the prefabricated buildings (PFBs) are "inputs' used for providing output service of telecommunication and hence, being "inputs" under Rule 2(k) which are used for providing output service.

- It may be also noted that there must be "use" of such goods to qualify as "inputs". Without stretching too much the meaning of the words "use" and "input", it can be said, without any doubt, that tower and PFBs are used for providing output service by way of inputs. The use of tower and PFB cannot be said to be so remotely connected with the output of service that these goods will go beyond the ordinary meaning of "use". Their usage in providing the output service is not remote but proximate. In fact, without the use of tower and PFB, it is inconceivable that the service provider can provide mobile services effectively. Rather, towers and PFBs are indispensable being accessories of antenna for providing mobile services.

- Having held that the tower and pre-fabricated buildings (PFBs) are "goods" and not immovable property and since these goods are used for providing mobile telecommunication services, the Supreme Court came to a conclusion that the said goods would also qualify as "inputs" under Rule 2(k) for the purpose of credit benefits under the CENVAT Rules.

- The Supreme Court agreed with the conclusions arrived at by the Delhi High Court allowed the claim of CENVAT Credit.

CS Makarand Joshi

CORPORATE LAWS
Case Law Update

CASE-1 Companies Act

In the matter of *M/s. Murlidhar Vincom Pvt. ltd. vs. M/s. Skoda (India) Pvt. Ltd.* NCLAT Principal Bench, New Delhi order dated 26th November 2024.

Facts of the case

- M/s Skoda (India) Pvt Ltd ('hereinafter called Company') is the corporate debtor and M/s Murlidhar Vincom Pvt Ltd ('hereinafter called Appellant') argues to be the financial creditor of the company.
- In the financial year 2009-10, the Appellant gave an amount of 6.6 Lakhs to the Company against which the Company allotted shares to the Appellant. Thereafter, in years 2011 and 2012, the Appellant gave ₹ 1.32 crores to the company, out of which, the Company could repay only 40 Lakhs and agreed to issue shares against the remaining amount of 92 Lakhs if the Appellant infuses more funds in the company.
- Therefore, the Appellant infused a further amount of ₹ 79.6 lakhs in the company. But the Company neither allotted shares against this amount, nor returned the same.
- Therefore, the Appellant sent a demand notice to the Company demanding the refund of money along with the interest as provided under section 42(6).
- Since the Company could not refund the said money, the Appellant filed an application before Hon'ble National Company Law Tribunal ['NCLT'] under section 7 of the Insolvency and Bankruptcy Code, 2016 ('IBC') for initiating the CIRP process against the company.
- However, the Hon'ble NCLT rejected the application for the reason that the share application money against the un-allotted shares cannot be treated as financial debt under section 5 of IBC.

Appellant's contentions

- As per section 42 of the Companies Act 2013 ('the Act'), the shares must be allotted against share application money within 60 days from receipt of such money and if such allotment is not made within 60 days, then the application money has to be returned within 15 days from the end of 60th day.
- As per sub-section (6) of section 42 of the Act, if the money is not refunded

within 15 days from the end of 60^{th} day, then interest has to be paid on such money and as per the companies (Acceptance of Deposit) Rules, 2014 (CADR rules) the said money if not refunded within 15 days, shall be treated as a deposit.

- Since in the given case, the share application money was not refunded by the Company, it should be treated as a deposit and hence should be considered as financial debt under section 5(8) of IBC.
- Placing reliance on the judgment of this Tribunal in the case of ***Kushan Mitra vs. Amit Goel and Ors. in CA(AT) (Ins) No. 128 of 2021***, it was submitted by the Ld. Counsel for the Appellant that this Tribunal in the Kushan Mitra judgment supra clearly held that share application money in the event of non-allotment of share attracts interest under sub-section (6) of section 42 of the Act and therefore falls within the ambit of financial debt under sub-section (8) of section 5 of the IBC.
- The Adjudicating Authority had erred by relying upon the judgment of this Tribunal in the case of ***Promod Sharma vs. M/s Karanaya Heart Care Pvt. Ltd. in CA(AT)(Ins) No. 426 of 2022*** as it was based on distinguishable facts as in that case the principal amount had already been refunded and Section 7 application was filed only on the outstanding interest amount.

Held

- The point which requires our consideration is, "Whether in the facts of the present case, the share application money which was deposited with the Corporate Debtor by the Appellant fell in the category of Section 5(8) of the IBC?"
- When we look at Rule 2(c)(vii) of the CADR Rules, 2014 and the explanatory clause appended thereto, it becomes clear that it refers to any amount received and held pursuant to an offer made in accordance with the provisions of the Act towards a subscription to any securities, including share application money. It flows therefrom that for the aforementioned CADR Rules to be attracted in respect of share application money, there has to be a clear nexus to show that the share application money amount was advanced in conformity with the relevant provisions of the Act.
- Sub-section (2) of Section 42 of the Act stipulates the requirement to issue of private placement offer letter in such cases. From the records available on file, we do not find that the Corporate Debtor had issued any such private placement offer letter to the Appellant. There is no evidence of any valid concluded agreement between the two parties with respect to the allotment of shares. Hence, the amount which was advanced by the Appellant cannot be treated to be amount in response to the private placement offer.
- Rule 2 of CADR Rules envisages that only if any amount is received pursuant to any private placement offer made in accordance with the provisions of the Act and no shares are allotted, only then the sum becomes a deposit. When no proof of any private placement offer

made in accordance with the provisions of the Act has been placed on record by the Appellant, the CADR Rules cannot be held to be applicable.

- Since the amount advanced cannot be related to Section 42 of the Act, the applicability of sub-section (6) of section 42 cannot be pressed as is being sought by the Appellant in the present case.

- We would also like to add here that the Kushan Mitra judgment supra cannot come to the aid of the Appellant since the above judgment of this Tribunal was challenged before the Hon'ble Supreme Court of India in ***Shobori Ganguly vs. Amit Goel and Ors. in Civil Appeal No. 4333 of 2022*** and a stay has been put on this judgment. On the other hand, the Adjudicating Authority has relied on the precedent laid down in a subsequent three-bench judgment of this Tribunal in Promod Sharma judgment supra wherein it has been held that the amount given as share application money did not constitute a financial debt under Section 5(8) of the IBC.

- In sum, we do not find any infirmity in the order of the Adjudicating Authority rejecting the Section 7 application of the Appellant. It shall however remain open to the Appellant to seek a refund/ recovery of the share application money in appropriate proceedings before an appropriate forum in accordance with law. There is no merit in the Appeal. The Appeal is dismissed.

CASE-2 – SEBI

Securities and Exchange Board of India Adjudication Order in the Matter of Insider Trading in the Scrip of Jagsonpal Pharmaceuticals Limited dated 22 November 2024

Facts of The Order

- M/s Jagsonpal Pharmaceuticals Limited (hereinafter referred to as 'JPL'/'company') made an announcement to the National Stock Exchange (NSE) of the press release (titled '*Intimation for Public Announcement under Regulations 3(1) and 4 read with Regulations 13(1), 14 And 15(1) of SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011*') dated 21 February, 2022 regarding a substantial acquisition of shares by Convergent Finance LLP. This announcement pertained to an open offer for the acquisition of 26% equity shares of JPL. The news of the substantial acquisition of shares was announced pre-market hours on 22 February, 2022.

- It was observed that the said news impacted the price of the scrip of JPL as it registered a rise of around 20% on a close-to-close basis and a rise of 5.96% on an open-to-close basis. Further, it was also observed that the scrip of the company hit a new 52-week high price on 22 February, 2022. Thus, the announcement dated 22 February, 2022 made by JPL to NSE as regards the substantial acquisition of its shares under Regulations 3(1) and 4 read with Regulation 13(1), 14 and 15(1) of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 was observed to be a UPSI under the provisions of Regulation 2(1)(n) of the Securities and Exchange Board of India (Prohibition of Insider Trading), Regulations, 2015 [‘PIT Regulations’]

- Thereafter, a detailed investigation was undertaken by SEBI to ascertain whether the suspected entity/ies traded in the scrip of JPL when in possession of the UPSI and if there were any violations of the provisions of the Securities and Exchange Board of India Act, 1992 and the PIT. The period of investigation was taken from 24 December, 2021 to 31 March, 2022.

- Based on the analysis of trading pattern, Mr. Maneesh Kumar Jain (hereinafter referred to as ‘Mr. Maneesh’/‘Noticee no.1’) was shortlisted by SEBI as a suspected entity. The focus of SEBI’s investigation was to examine whether the aforesaid suspected entity had traded in the scrip of JPL being in possession of UPSI during the investigation period.

- Upon examining the call data records (CDRs) of Noticee No. 1, it was, *inter alia*, alleged that Noticee No. 1, who had traded in the scrip of JPL, had communication/contact, on a frequent basis, with Mr. SV Subha Rao, the Chief Finance Officer (CFO) of JPL (hereinafter referred to as **‘Noticee No. 2’**) during the relevant period.

- On examining the trading pattern of Noticee No. 1 during the relevant period on NSE and BSE, it was alleged that Noticee No. 1 had traded in the scrip of JPL during the UPSI period. Out of the trades executed by Noticee No.1 during the investigation period, it was noticed that his trades in the scrip of JPL were the fourth largest trades in terms of value and the same were executed during the existence of the UPSI i.e. 28 December, 2021 to 21 February , 2022.

- It was alleged that on the basis of the UPSI communicated by the Noticee No. 2, an insider, him being the CFO of JPL, to Noticee No. 1, Noticee No. 1 had traded in the scrip of JPL when in possession of UPSI and thereby, the Noticees allegedly violated the following provisions of securities laws

Charges Levied

- It was alleged that Noticee No.2/ Mr. S.V. Subha Rao (*CFO of JPL*), being an insider, was in possession of UPSI regarding the substantial acquisition of shares of the company and allegedly, communicated the said UPSI to Noticee No. 1/Mr. Maneesh Kumar Jain.

- In view of the same, Noticee No. 2 alleged to have violated the provisions of Regulation 3(1) of PIT Regulations and Section 12A(e) of SEBI Act, 1992.

- Further, it was alleged that Noticee No. 1 procured the UPSI from Noticee No. 2 and traded in shares of JPL, while being in possession of UPSI related to the substantial acquisition of shares in JPL, and made a profit of Rs. 31.39 Lakhs. Therefore, Noticee No. 1 had allegedly violated the provisions of Regulation 4(1) of the PIT Regulations and Sections 12A(d) and 12A(e) of the SEBI Act, 1992.

Contentions by the Noticee

A. Noticee no.1 contended that he traded in the shares of JPL on the basis of his own research:

- Noticee no. 1 submitted that he was a former employee of Value First Digital Media Private Limited and had resigned from the said company in December 2016. Since then, the said Noticee has been an active trader, trading based on his own research and technical analysis of various companies. He has adopted a sector agnostic approach for trading and the average shares sold by Noticee No. 1 annually during the period from F.Y. 2019-20 to F.Y. 2023-24 has been around INR 123 crores. Noticee No. 1 stated that the trades in question in the SCN forms only 2% of the total shares sold by him in the F.Y.

- Noticee no.1 stated that he became acquainted with Noticee no. 2 in and around December, 2021 and met in person in January, 2022 to discuss marriage proposals of their children and based on subsequent meetings, gatherings, calls, discussions, their children got married on December 11, 2022.

- It is further submitted that as alleged Noticee No. 2 has communicated UPSI to Noticee No. 1 and SCN places reliance on particular call data records of January 25-26, 2022 with respect to trades undertaken by Noticee No, 1 on February 10-11, 2022 and telephonic communication on February 20, 2022 with respect to trades undertaken by Noticee No. 1 on February 21, 2022. However, it is the case of the Noticees that for charging entities with the violation of insider trading, any finding of possession and communication of UPSI ought to be based on cogent evidence and not conjectures and surmises. The Noticees have placed reliance on the judgement in the case of ***Balram Garg vs. SEBI (2022 SCC Online SC 472*)** to support their contention.

- In addition, the Noticees have submitted that the SCN has tried to co-relate the call on 20 February, 2022 between the Noticees with the trade of Noticee No. 1 on 21 February, 2022. However, the SCN failed to provide details of the nature of the communication and has relied on two facts to allege the same that the said call was the only call/contact between the Noticee no.1 and Noticee no.2 in the month of February 2022 and that the said telephonic conversation between the Noticee no.1 and Noticee no.2 is of the longest duration.

- Noticee no.1 and Noticee no.2 submitted that considering their impeccable careers, to charge them with violation of the PIT Regulations is very serious and would have a long-term impact on their careers. Further, it was submitted that the only allegation in the SCN was that Noticee No. 2 allegedly violated the provisions of the PIT Regulations for purportedly communicating the alleged UPSI to Noticee No. 1 and that subsequently, Noticee No. 1 had traded based on such alleged communication. However, **there is no material evidence of the alleged communication and the Noticees therefore, deny all the allegations**.

- Contentions by Noticee no.2: Noticee No. 2, submitted that he was a former Chief Financial Officer (CFO) of JPL and retired on February 2024 after working for 31 years with the Company. While in service, there were no disciplinary actions and/or any regulatory proceedings initiated against him in his career.

Submission by Noticee

Contentions by SEBI

- Noticee no. 1 traded in shares of JPL on the basis of his own research: SEBI stated that Further during the investigation, vide email dated January 24, 2023, that JPL had made submissions to SEBI wherein the names of certain individuals who were in possession of the UPSI in the instant case i.e. substantial acquisition of shares of JPL, included the name of Noticee No. 2.. Noticee No. 2 was part of the meetings/discussions wherein UPSI was discussed. Therefore, considering that Noticee No. 2 was one of the persons who was in possession of the information with respect to the acquisition of shares of JPL which has already been established to be a UPSI, there is hesitation to conclude that Noticee No. 2, being the CFO of JPL and on the basis of the aforesaid facts, was an ‘insider’ under Regulation 2(1)(g) of the PIT Regulations.

- SEBI further stated that on analysing the said CDRs it was observed that Noticee No. 1 had communications/contact with the CFO of JPL i.e. Noticee No. 2. The details of the communication between the Noticee no.1 and Noticee no.2 (‘Noticees’) clearly reflected, that the Noticees were in frequent communication with each other during the investigation period and thus, knew each other.

- SEBI further highlighted that Noticees had admitted that they became acquainted with each other in and around December, 2021 and met in person in January, 2022 to discuss marriage proposals of their children and based on subsequent meetings, gatherings, calls, discussions, their children got married on December 11, 2022.

- Hence it is clear that Noticees were knowing each other and were communicating with each other frequently during the relevant period under consideration in the present proceedings.

- Furthermore, from the CDRs it can be seen that Noticee No. 1 had a call with Noticee No. 2 on 20 February , 2022 **for a duration of 530 seconds**. As per the trading data analysis of the trades executed by Noticee No. 1 during the relevant period, on the very next day i.e. 21 February, 2022, it was noted that Noticee No. 1 had bought a significant quantity of shares (90,000 shares) of JPL. It is also noted from the material available on record that, during the whole month of February, 2022, there were no calls between the Noticees apart from the call on 20 February, 2022. As per the CDR, the next telephonic call/contact between the Noticees was made only on 18 March, 2022. On further analysing the trading of Noticee No. 1, it was observed that the said Noticee was registered only with ICICI Securities

Limited and no other trading member. Further, the trading details and the quantum of profit made by Noticee No. 1 by trading in the scrip of JPL after the announcement of the Press Release on 22 February, 2022 was 31,39,000/- (Thirty one Lakhs and thirty nine thousands).

- SEBI further stated that 90.20% of total shares bought by Noticee No. 1 on 21 February, 2022, were bought subsequent to the telephonic call with Noticee No. 2 (*CFO of JPL*) on February 20, 2022.
- Further SEBI stated that the Noticee No. 1 had not traded in shares of any other pharmaceutical companies except in the shares of JPL in such huge quantity i.e. 1,02,000 shares and that the trades executed during the UPSI period by Noticee No. 1 in the scrip of JPL were done for the first time.
- The Noticee No. 1, indeed bought a significant quantity of shares of JPL, that too, post the telephonic conversation with Noticee No. 2 who was in possession of the UPSI during the UPSI period. Further, as already admitted by Noticee No. 1, had not purchased such a quantity of shares in the scrip of JPL before or after the UPSI period.
- The Noticees have not brought on record any cogent evidence or any circumstantial proof to show that the trades undertaken by Noticee No. 1 were not based on the procurement of UPSI to prove their innocence.
- From the facts and circumstances of the case and the circumstantial evidence available, it is logical to conclude that the Noticee No. 1 would have purchased such a quantity of shares of JPL immediately after the telephonic conversation (*on February 20, 2022*) between the said Noticees on the very next day of the conversation i.e. on 21 February 2022. The fact that the Noticee No. 1, bought shares of JPL during the period when the UPSI existed, just before the UPSI became publicly available and was in frequent communication with an insider (*Noticee No. 2*), who was in possession of the UPSI, and the trading pattern which shows that Noticee No. 1 had sold shares in the scrip of JPL post UPSI period are the foundational facts, on which the present proceedings rest, which are inclined towards a strong inference that Noticee No. 2, during the telephonic conversation which took place on 20 February, 2022, had communicated the UPSI with respect to the substantial acquisition of shares which was likely to materially impact the price of the securities of JPL once becoming generally available to the public at large**.**
- Looking into Notice No. 1's trading pattern, summary of trades undertaken by him in different sectors during the relevant time, data of trades executed by Noticee No. 1 only in the pharma sector, the fact that Noticee No. 1 had not bought shares in the scrip of JPL before or after the UPSI period it can be concluded that the trades in the scrip of JPL were executed by Noticee No. 1 to take undue advantage of the price rise once the information becomes

public when in possession of the UPSI which was communicated to him by Noticee No. 2.

Order

- Noticee No. 2, being the *'insider'*, had communicated the UPSI with respect to the substantial acquisition of shares to Noticee No. 1 which led to the execution of a trade by Noticee No. 1 in the scrip of JPL on February 21, 2022 i.e. during the UPSI period, thereby, violating the provisions of Regulation 3(1) of the PIT Regulations and Section 12A(e) of the SEBI Act, 1992 which specifically prohibits communication of UPSI to any other person.

- Noticee No. 1 traded in the scrip of JPL, when in possession of the UPSI (*procured from Noticee No. 2*) relating to the substantial acquisition of shares and thereby made an unlawful gain of ₹ 31.39 lakhs. Therefore, Noticee No. 1 has violated the provisions of Regulation 4(1) of the PIT Regulations and Section 12A(d) and 12A(e) of the SEBI Act, 1992 which prohibit trading when in possession of UPSI.

- In view of the violation of the provisions of the PIT Regulations, 2015 and SEBI Act, 1992 by the Noticees, as noted above, the Noticees be issued with appropriate directions for debarment from accessing the securities market and dealing in securities. Further, a direction under Section 11B(1) of the SEBI Act, 1992 is also warranted to be issued against Noticee No.1 to disgorge an amount of ₹ 31,39,000/- (Rupees Thirty-One Lakh Thirty-Nine Thousand Only) which has been established as the 'unlawful gains' made by the said the Noticee by way of trading in the shares of JPL when in possession of the UPSI during the existence of the UPSI.

- The Noticees are restrained from accessing the securities market and further prohibited from buying, selling or otherwise dealing in securitised (including units of mutual funds), directly or indirectly, or being associated with the securities market in any manner, whatsoever, for a period of one (1) year, from the date of this order;

- Further, the monetary penalties on the Noticees under the provisions of Section 15G of the SEBI Act, 1992 for their respective violations of the provisions of the SEBI Act, 1992 and the PIT Regulations under section 15 G of SEBI Act 1992 was on Maneesh Kumar Jain ₹ 15,00,000/- and ₹ 10,00,000/- on S. V. Subha Rao.

CASE-3 – IBC

In the matter of *Mr. Vidyasagar Prasad - Appellant vs. UCO Bank* - Respondent in the order dated 22 October 2024 passed by the Supreme Court

Facts of the Case

- Kaizen Power Limited - Corporate Debtor/CD. The CD had taken loans and credit facilities from UCO Bank - Financial Creditor/FC and other consortium banks between 2010 and 2012. These funds were intended to support the CD's thermal power plant project. Having defaulted on repayment of principal as well as interest levied thereupon the CDs account was declared as a Non-Performing Asset (NPA) on 5 November 2014.

- Subsequently, FC initiated recovery proceedings under the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act and the Debts Recovery Tribunal (DRT).
- FC also filed an application u/s 7 of the Insolvency and Bankruptcy Code, 2016 (the IBC) to initiate a Corporate Insolvency Resolution Process (CIRP) proceeding against the CD before the National Company Law Tribunal (NCLT). These proceedings were resisted by the CD, primarily on the grounds of limitation.
- The main objection to the initiation of CIRP proceedings on the ground of limitation was rejected by the NCLT on the ground that there is an acknowledgment of debt in the financial statements as well as auditor's report of the CD for the year ending on 31 March 2017.
- The NCLT rejected the CD's contention that the name of the FC was not explicitly mentioned in the relevant balance sheet entry. The tribunal referred to the Explanation to Section 7(1) of the IBC, which clarifies that proceedings can be initiated even if the default by the CD pertains to a Financial Creditor other than the applicant.
- The NCLT admitted the application u/s 7 of the IBC. Aggrieved by the admission, initiation of CIRP and appointment of Interim Resolution Professional (IRP), the appellant preferred an appeal to the National Company Law Appellate Tribunal (NCLAT). The NCLAT dismissed the appeal.
- The appeal in the Hon'ble Supreme Court was filed by Mr. Vidyasagar Prasad, a suspended director of the CD, challenging both the NCLT's and the NCLAT's decisions to admit UCO Bank's application for CIRP.

Arguments of the Appellant

- The appellant, a suspended director, argued that FC's claim was time-barred, as more than three years passed since the CD's account became a NPA in 2014.
- The entries in the balance sheets did not contain a clear and unequivocal acknowledgment of the CD's debt.
- In the absence of clear demarcation regarding the amount owed by the CD to the FC, the said entries cannot be relied upon for extending the period of limitation u/s Section 18 of the Limitation Act. Even, if the entry is taken to be an acknowledgment of debt, it does not support the respondent's case as it fails to specifically mention the name of the FC.

Arguments of the Financial Creditor

- The Balance Sheets of a Company are prepared in the prescribed statutory format as per Section 129, read with Schedule III of the Companies Act 2013, which does not provide for giving specific names of each and every Secured and Unsecured creditor. The *judgment in* ***Asset Reconstruction Company (India) Ltd. vs. Bishal Jaiswal,*** was quoted in support, where it was observed that there was no compulsion for Companies to make any particular admissions in the balance sheet, except for what is prescribed.

Held

- The statutory scheme provides for the commencement of a fresh limitation period from the time of acknowledgment of the debt. Section 238A of the IBC extends the applicability of the Limitation Act to proceedings under the IBC. Consequently, with the Limitation Act applying to IBC proceedings, the benefit of Section 18 of the Limitation Act—relating to the effect of a written acknowledgment of debt—also becomes applicable.
- Having considered the specific facts and circumstances of this case, the NCLT as well as the NCLAT have concurrently held that the entries in the balance sheets amount to clear acknowledgment of debt. The Hon'ble Supreme Court agrees with the findings.
- Furthermore, Note 3.4 appended to the balance sheet entry dated 31 March 2017 stated that "the company has made certain defaults in the repayment of term loans and interest" and referred to a continuing default. The entry also mentioned long-term borrowings. The conclusions drawn by the NCLT and NCLAT regarding the acknowledgment of debt are, therefore, unimpeachable.
- Following the principles as expounded in the case of *Bishal Jaiswal* (supra), the NCLT as well as the NCLAT examined the case in detail and concluded that the entry made in the balance sheet coupled with the note of the auditor of the appellant clearly amounts to an acknowledgment of the liability. The Hon'ble Supreme Court sees no reason whatsoever to take a different view of the matter.
- The findings arrived at by the NCLT and NCLAT are correct in law and fact. There was no merit in the appeal and the appeal was dismissed accordingly.

■●■

"Let miseries come in millions of rivers and happiness in hundreds! I am no slave to misery! I am no slave to happiness!"

— *Swami Vivekananda*

OTHER LAWS

FEMA – Updates and Analysis

CA Hardik Mehta CA Tanvi Vora

In this article, we have discussed the rules and regulations related to Pricing/Valuation Guidelines under Foreign Exchange Management Act, 1999 ('FEMA').

Pricing/Valuation under FEMA is a significant factor in cross border transactions. The capital and exchange control regulations in India do not permit free movement of capital in and out of India in order to control stability of foreign exchange rates and protect the value of the national currency. Accordingly for the purpose of investing into and outside India, The Reserve Bank of India ('RBI') have provided detailed rules and regulations, namely:

A] Foreign Investments – Foreign Exchange Management (Non-Debt Instruments) Rules, 2019 ('NDI Rules') & Foreign Exchange Management (Mode of Payment and Reporting of Non-Debt Instruments) Regulations, 2019 (FEMA 395)

B] Overseas Investments - Foreign Exchange Management (Overseas Investment) Rules, 2022 ('OI Rules') and Foreign Expchange Management (Overseas Investment) Regulations, 2022 ('OI Regulations')

It should be noted that pricing requirements are generally applicable to transactions involving capital instruments. In a general scenario, the rationale behind such rules would ensure that the transactions between persons resident in India (PRII) and persons resident outside India (PROI) are at arms length so that prices are not inflated or deflated to receive less/pay excess foreign exchange in case of such transactions.

In this two-part article, we have explained and analyzed the applicable pricing guidelines including various situations of transfer, methodology and documentation required. The first part of the article covers the rules applicable to Foreign Direct Investment while the second part of the article shall cover the rules applicable to Overseas Direct Investment.

A] Foreign Direct Investment

The extant rules and regulations applicable to FDI (i.e. NDI Rules r.w. FEMA 395), specifically Rule 21, provides the following situations and applicable pricing requirement:

Investment in a Company

i) **Issue of Equity Instruments to a PROI:** *In case of Listed Company* – **Not less than** price worked out in accordance with the relevant SEBI guidelines/in case of a company going through a delisting process as per the SEBI (Delisting of Equity Shares) Regulations, 2009.

In case of Unlisted Company – **Not less than** valuation done as per any internationally accepted pricing methodology for valuation on an arm's length basis duly certified by a Chartered Accountant or a SEBI registered Merchant Banker or a practicing Cost Accountant.

Convertible Instruments - The price/ conversion formula of the instrument is required to be determined upfront at the time of issue of the instrument. Further, the price at the time of conversion should not be lower than the fair value worked out, at the time of issuance of such instruments.

ii) Subscription to Memorandum of Association:

Special dispensation is provided to shares of an Indian company issued to a PROI by way of subscription to Memorandum of Association. Such investments can be made at face value subject to entry route and sectoral caps.

iii) Acquisition through Rights Issue:

In case of a Listed Company - the rights issued to PROI shall be at a price determined by the company.

In case of an Unlisted Company - the rights issued to PROI should **not be at a price less than** the price offered to PRII.

iv) Transfer of Equity Instruments by a PRII to PROI:

In case of Listed Company – **Not less than** price worked out in accordance with the relevant SEBI guidelines/the price at which a preferential allotment of shares can be made under the SEBI Guidelines, as applicable, in case of a listed Indian company or in case of a company going through a delisting process as per the SEBI (Delisting of Equity Shares) Regulations, 2009.

In case of Unlisted Company – **Not less than** valuation done as per any internationally accepted pricing methodology for valuation on an arm's length basis duly certified by a Chartered Accountant or a SEBI registered Merchant Banker or a practicing Cost Accountant.

This follows from the premise that foreign exchange received into India should follow the minimum pricing. Therefore, as such, there is no ceiling under NDI Rules, 2019 on the maximum value for transfers from PRII to PROI. Other laws in India may need to be reviewed for any restrictions.

v) Transfer of Equity Instruments by a PROI to PRII:

In case of Listed Company – **Should not exceed** price worked out in accordance with the relevant SEBI guidelines/the price at which a preferential allotment of shares can be made under the SEBI Guidelines, as applicable, in case of a listed Indian company or in case of a company going through a delisting process as per the SEBI (Delisting of Equity Shares) Regulations, 2009.

In case of Unlisted Company – **Should not exceed** valuation done as per any internationally accepted pricing methodology for valuation on an arm's length basis duly certified by a Chartered Accountant or a SEBI registered Merchant Banker or a practicing Cost Accountant.

Similar to above, this follows from the premise that foreign exchange paid out of India to PROIs should follow the maximum pricing. Therefore, as such, there is no floor under NDI Rules, 2019 on the minimum value for transfers from PROI to PRII. Other laws in India may need to be reviewed for any restrictions.

Assured Return Not Permitted - The person resident outside India should not be guaranteed any assured exit price at the time of making investment/ agreement and shall exit at the price prevailing at the time of exit. Assured return in its general sense means a fixed rate of return to an investor on its investment at the time of exit. This guarantee entails a predetermined return over a specific period of time. The NDI Rules do not provide any further details as to what constitute an 'assured return' and what types of return are exempted from the categorization of assured returns. Indian courts have dealt with this question in several landmark cases, and have laid down certain principles that provide more clarity on this subject:

1. The Hon'ble Delhi High Court in the case of ***NTT Docomo Inc vs. Tata Sons Limited***[1] held that since Tata Sons was unable to find buyers on trigger of put option and therefore had to repurchase the shares from NTT Docomo, put option was held to be more like a downside protection and not an "assured return".

2. The Hon'ble Delhi High Court in case of ***Cruz City 1 Mauritius Holdings vs. Unitech Ltd.***[2] held that put option is not a FEMA violation as the put option was exercisable only on breach of contractual assurances provided to the foreign investor. A similar conclusion was drawn by the Hon'ble Bombay High Court in case of Edelweiss Financial Services vs Percept Finserve Pvt Ltd and Anr (023 SCC OnLine Bom 319), where it was held that when it comes to an "option", a concluded contract arises only upon exercise of the option.

3. In the case of ***GPE (India) Limited vs. Twarit Consultancy Services Private Limited***[3] when the Indian promoters sought to evade the obligation to compensation the investor on trigger of put option (as adjudication by a Singapore Tribunal) by relying on the pricing guidelines of NDI Rules, the Hon'ble Madras High Court ruled that the promoters are liable to compensate the investor (subject to RBI approval) as while executing the contract the promoter

1. (2017) 241 DLT 65
2. (2017) 239 DLT 649
3. 2023 SCC OnLine Mad 46

represented that the covenants are in conformity with Indian law.

4. In case of ***Shakti Nath & Ors. vs. Alpha Tiger Cyprus Investment No. Ltd. & Ors***[4], the Hon'ble Delhi High Court held that unlike the exercise of a put option, a claim for damages is not a FEMA violation.

To summarize, it may be safe to say that Indian courts may not necessarily take an adverse view of put options from the perspective of "assured returns" if the following aspects are clearly drawn out in the shareholder agreement:

1. Exact conditions to trigger a put option
2. Specific method of determination of such a trigger

Also, if it can be proved beyond doubt that the foreign investor initiated a damage claim based on a breach of contract, it would be a good case to argue that the exercise of put option was not to earn "assured returns" but to recover damages and remittance may be made to foreign investor after obtaining RBI approval.

vi) Transfer from PROI to PROI

Pricing guidelines are not applicable to transfer of Indian company shares between two PROIs.

vii) Swap of Equity Instruments

Irrespective of the amount involved in the transaction, valuation will have to be made by a Merchant Banker registered with SEBI or an Investment Banker outside India registered with the appropriate regulatory authority in the host country.

viii) Partly paid shares

The pricing of partly paid shares should be determined upfront at the time of issue.

ix) Share warrants

The pricing and the price/conversion formula of share warrant should be determined upfront. In any case, the price at the time of conversion should not be lower than the fair value worked out, at the time of issuance of such warrants.

Investment in a Limited Liability Partnership (LLP)

i) Investment in LLP

Investment in an LLP either by way of capital contribution or by way of acquisition/transfer of profit shares, should **<u>not be less than</u>** the fair price worked out as per any valuation norm which is internationally accepted/ adopted as per market practice and a valuation certificate to that effect should be issued by a Chartered Accountant or by a practicing Cost Accountant.

ii) Transfer of capital contribution/profit share of an LLP

<u>Transfer from PRII to PROI</u> - In case of transfer of capital contribution/profit

4. OMP (Comm) 154/2016

share of an LLP, the transfer should be for a consideration **not less than** the fair price of capital contribution/profit share of an LLP.

Transfer from PROI to PRII - In case of transfer of capital contribution/profit share of an LLP, the transfer should be for a consideration which is **not more than** the fair price of the capital contribution/profit share of an LLP.

Downstream Investments

Indirect foreign investment in colloquial terms is the investment by an Indian company/LLP (that has received FDI) into another Indian entity.

The underlying principle of the downstream investment guidelines is that "what cannot be done directly shall not be done indirectly". Accordingly, downstream investments which are treated as indirect foreign investment are subject to the entry routes, sectoral caps or the investment limits, as the case may be, pricing guidelines, and the attendant conditionalities for such investment as laid down in the NDI Rules.

Accordingly, the pricing guidelines applicable in the case of Downstream Investments is summarized as follows:

Transferor	Transferee	Pricing Guidelines
First Level IndCo/LLP	PROI	Not Applicable
First Level IndCo/LLP	PRII	Applicable
First Level IndCo/LLP	Comparable First Level IndCo/LLP	Not Applicable

Documentation (in relation to pricing guidelines)

The valuation certificate issued by a Chartered Accountant or a SEBI registered Merchant Banker or a practicing Cost Accountant, for application of pricing guidelines, must not be more than ninety days old as on the date of the allotment/transfer.

However, the above wordings created an issue with regard to the 90 days from valuation date or valuation report date. In the past, many AD Banks were insisting both. Recently in our experience with RBI/AD Banks, our understanding is that the 90 days period should be from the date of valuation report and not valuation date. However, clarity from the RBI is much required on the same.

Non applicability of pricing guidelines

- The pricing guidelines are not applicable to investments in equity instruments by a PROI on non-repatriation basis.
- The pricing guidelines will not be applicable for any transfer by way of sale done in accordance with SEBI regulations where the pricing is prescribed by SEBI. A Chartered Accountant's Certificate to the effect that relevant SEBI regulations/guidelines have been complied with has to be attached to the form FC-TRS filed with the AD bank.

Best of The Rest

Rahul Hakani
Advocate

Niyati Mankad
Advocate

HONGKONG AND SHANGHAI BANKING CORP. LTD. VS. AWAZ & ORS. [2024 INSC 1044] [SUPREME COURT]

Consumer Protection Act, 2018 r.w. Section 21A of the Banking Regulation Act - Courts and tribunals lack jurisdiction to interfere with banking operations regulated by the Reserve Bank of India, including decisions on interest rates, which are based on RBI's statutory powers under the Banking Regulation Act

Facts of the Case

The appeals arose from a National Consumer Disputes Redressal Commission (NCDRC) judgment holding that charging interest rates above 30% per annum by banks on credit card dues constitutes an unfair trade practice. The appellants, including several prominent banks, contested the decision, arguing that interest rate determination is under the exclusive purview of the Reserve Bank of India (RBI). The complainants, representing a consumer association, claimed such high rates were exploitative and sought a cap on interest rates. The NCDRC partially upheld their plea but did not establish a benchmark for interest rates.

Issues Involved

1. Does the complainant organization have the locus standi under the Consumer Protection Act?
2. Can the NCDRC intervene in banking practices regulated by the RBI?
3. Is the charging of interest above 30% an unfair trade practice?
4. Does the NCDRC have jurisdiction to impose a cap on interest rates absent RBI directives?

Held

The Supreme Court overturned the NCDRC judgment, emphasizing that banking operations, including interest rates, fall under the RBI's regulatory authority. The court relied on Section 21A of the Banking Regulation Act, which prohibits courts from reopening banking transactions over interest rate concerns. It also referenced cases like ***Central Bank of India vs. Ravindran [(2002) 1 SCC 367]*** and ***Peerless General Finance & Investment Co. Ltd. vs. RBI [(1992) 2 SC 343]*** to affirm that RBI policies are binding. The court held that the NCDRC's directive encroached on RBI's domain and that the terms agreed upon by credit card holders were valid and transparent. By reiterating the statutory bar under Section 21A of the Banking Regulation Act, the judgment underscores the RBI's authority to regulate banking policies in public interest and rejects the notion of courts supplanting RBI's regulatory role. The decision reinforces the principle that consumer disputes must demonstrate a clear deficiency in service or unfair trade practice based on established legal frameworks.

BIJOY KUMAR MONI VS. PARESH MANNA & ANR [2024 INSC 1024] [SUPREME COURT]

Section 138 of the Negotiable Instruments Act, 1881 (for short "NI Act") - A director or authorized signatory of a company cannot be held liable u/s 138 of the NI Act for a dishonored cheque unless the company, as the principal offender, is made a party to the proceedings - The statutory framework requires the complainant to establish liability primarily against the company to invoke vicarious liability under Section 141 - It is only the drawer of the cheque who can be held liable for an offence under Section 138 of the NI Act - Further, an authorised signatory acting on behalf of the principal cannot be said to be the "drawer" of the cheque "on an account maintained by him with a banker" Under Section 138.

Facts of the Case

This appeal arose from a High Court decision acquitting the accused, Mr. Paresh Manna, of charges under Section 138 of the NI Act. The complainant, Bijoy Kumar Moni, alleged that the accused had borrowed ₹ 8,45,000, issuing a cheque that was dishonored due to insufficient funds. While the trial court and the sessions court convicted Mr. Manna, the High Court held that the cheque was drawn on an account maintained by Shilabati Hospital Pvt. Ltd., where Mr. Manna was a director. Since the hospital was not made a party to the case, the High Court concluded that the conviction was unsustainable.

Issues Involved:

1. Whether a director of a company who issues a cheque on behalf of the company can be held personally liable under Section 138 of the NI Act.
2. Whether the absence of the company as an accused invalidates proceedings against the individual signatory.
3. The interpretation of the expression "on an account maintained by him" in Section 138 of the NI Act.

Held

The Supreme Court upheld the High Court's ruling, emphasizing that liability under Section 138 is primarily upon the drawer of the cheque, which, in this case, was the company. Citing precedents like ***Himanshu vs. Shivamurthy*** and N. ***Harihara Krishnan vs. J. Thomas [2017 INSC 830 : (2018) 13 SCC 663],*** the Court reiterated that vicarious liability under Section 141 of the NI Act arises only when the company, as the principal offender, is arraigned. Since Shilabati Hospital Pvt. Ltd. was not made a party, the accused could not be held liable.

The judgment clarified the scope of terms like "drawer" and "account maintained by him," reaffirming the principle of separate corporate personality under the NI Act. Furthermore, the Court interpreted the expression "any debt or other liability" in Section 138 to include situations where a person assumes the responsibility of discharging another's debt and issues a cheque on their account. Such cases would fall under Section 138, provided the payee establishes an arrangement by which the drawer assumed the debt.

CHINA DEVELOPMENT BANK VS. DOHA BANK Q.P.S.C. AND ORS. [2024 INSC 1029] [SUPREME COURT]

Section 5(8) of the Insolvency and Bankruptcy Code, 2016 (for short "IBC") - a charge holder's obligation to pay shortfalls in debt repayment, arising from hypothecation agreements, can qualify as "financial debt" if it includes an undertaking to discharge liabilities of third parties, thereby constituting a guarantee under Section 126 of the Indian Contract Act, 1872.

Facts of the Case

The case involved the classification of Appellants as "Financial Creditors" under Section 5(7) of the Insolvency and Bankruptcy Code, 2016, during the Corporate Insolvency Resolution Process (CIRP) of Reliance Infratel Ltd. (RITL). The Appellants, including China Development Bank and others, claimed their status based on Deeds of Hypothecation (DoH) executed by the RCom group entities, including RITL, which provided pooled security for loans advanced to various RCom entities. The clauses 5(iii) and 16(viii) of the DoH provided that upon the occurrence of an event of default, the Security Trustee was authorised to take steps against the Corporate Debtor without having any obligation to first proceed against the borrower. The National Company Law Appellate Tribunal (NCLAT) overturned the National Company Law Tribunal's (NCLT) recognition of the appellants as Financial Creditors, holding that the DoH did not constitute a guarantee and remanded the matter for consequential action.

Issues Involved

1. Whether the Appellants could be classified as "Financial Creditors" under Section 5(7) of the IBC.

2. Whether the Deeds of Hypothecation, particularly Clause 5(iii), created a guarantee that qualified as "financial debt" under Section 5(8) of the IBC.

3. Whether the moratorium under Section 14 of the IBC extinguished contingent claims arising from the Deeds of Hypothecation.

Held

The Supreme Court restored the NCLT's order recognizing the appellants as Financial Creditors. It interpreted Clause 5(iii) of the DoH, concluding that RITL, as a chargor, undertook to pay any shortfall in the realization of amounts due from other RCom entities. This constituted a "guarantee" as defined under Section 126 of the Indian Contract Act, 1872, and qualified as "financial debt" under Section 5(8) of the IBC. Citing precedents such as ***Phoenix ARC Pvt. Ltd. vs. Ketulbhai Ramubhai Patel [(2021) 2 SCC 799 : 2021 INSC 59]*** and ***Kotak Mahindra Bank Ltd. v. A. Balakrishnan [(2022) 9 SCC 186 : 2022 INSC 630],*** the Court emphasized the inclusive nature of "financial debt" and clarified that a debt's classification did not depend on default. The moratorium under Section 14 did not extinguish claims but only barred their enforcement. The judgment underscores that guarantees arising from hypothecation agreements are valid financial debts and reaffirms the expansive interpretation of "financial debt" in corporate insolvency jurisprudence.

THE CHAMBER NEWS

CA Mehul Sheth
Hon. Jt. Secretary

CA Neha Gada
Hon. Jt. Secretary

Important events and happenings that took place online/physical between **December 1, 2024 to December 31, 2024** are being reported as under:

I. ADMISSION OF NEW MEMBERS

The details of new members who were admitted in the Managing Council Meeting held on December 17, 2024 are as under:

Type of Membership	No. of Members
Life Member	5
Ordinary Member – Half Yearly	1
Student Member	2
Associate	0
Total	**8**

II. PAST PROGRAMMES

Sr. No.	*Date*	*Topics*	*Speakers*
		COMMERCIAL & ALLIED LAWS	
1	5.12.2024	Study Circle - Recent Judgments under Companies Law And SEBI Regulations	CS Gaurav Pingle
2	13.12.2024	Discussion on Benami Law including recent decisions	Advocate Rahul Sarda

Sr. No.	*Date*	*Topics*	*Speakers*
DIRECT TAXES			
1	Webinar Series on Understanding Capital Gains from a Tax Lens		
a	10.12.2024	Controversies around the Joint Development Agreement, including issues under 45(5A)	CA Jagdish Punjabi
b	14.12.2024	Issues in Exemptions under Sec 54, 54EC, 54F, 54G etc	CA Prachi Parekh
c	17.12.2024	Interplay of Sec. 45, 46(2), 47 and 56(2)(x)	CA Vishal Gada
d	18.12.2024	Transfer of shares and Securities – Issues and intricacies of Sec. 112, 112A, Rule 115 and 115A	CA Binoy Parikh
e	24.12.2024	Case Studies on 45(4) and 9B	Adv Devendra Jain
2	26.12.2024	ISG - Recent Important Decisions Under Direct Tax	CA Shashank Mehta
HYDERABAD STUDY GROUP			
1	13.12.2024	Direct Tax Vivad Se Vishwas Scheme, 2024	CA K.A. Sai Prasad CA T. Rama Murthy
STUDY CIRCLE & STUDY GROUP			
1	13.12.2024	Analysis of Vivad se Vishwas Scheme 2024	CA Ketan Vajani
PUNE STUDY GROUP			
1	14.12.2024	Effective strategies to handle TP assessments	CA Tejas Dharwadkar & CA Meenal Sabnis Hardikar
INDIRECT TAXES			
1	16.12.2024	Study Circle - Invoice Management System: Nitty Gritties and Challenges	CA Tapas Ruparelia

Sr. No.	Date	Topics	Speakers
STUDENT			
1	16.12.2024	Udaan – EPISODE 9 ~ Learning Today Leading Tomorrow	Esteemed Guest: Hon'ble Shri. Justice Akil Kureshi, (Retd. Chief Justice of Rajasthan High Court) Host: CA Abhitan Mehta
INTERNATIONAL TAXATION			
1	3rd Residential Refresher Course on Foreign Exchange Management Act at Novotel, Ahmedabad, Gujarat - 20th to 22nd December 2024		
a	International Migration – Implications under FEMA		CA Dr. Anup Shah
b	Sectoral Analysis under FDI (select sectors), Nuances of FDI & Downstream Investment Issues and Reporting		Mr. Moin Ladha, Solicitor
c	Cross-border Structures, M&A, Reverse Flipping & Swap – Issues under FEMA		CA Atul Mittal
d	Q & A – Interactive session on Issues of FEMA practice, Guidance to practitioner & Role of AD-Bank under FEMA		CA Atul Mittal Mr. Suyog Puntamekar (Kotak Bank)
e	Brain Trust Session on various issues/case studies under FEMA.		CA Paresh P. Shah CA Naresh Ajwani CA Manoj Shah Mr. Suhas Bendre Ms. Henal Vora (Kotak Bank)

Glimpses of the 3rd RRC on FEMA 2024 held on 20th – 22nd December 2024 at Novotel, Ahmedabad, Gujarat organised by the International Taxation Committee

Q & A Session – (L-R) CA Paresh P. Shah, CA Atul Mittal, Mr. Suyog Puntamekar, CA Naresh Ajwani & CA Kirit Dedhia

Panel Discussion – (L-R) CA Karishma Phatarphekar, CA Paresh P. Shah CA Naresh Ajwani CA Manoj Shah, CA Vijay Bhatt, Mr. Suhas Bendre, Ms. Henal Vora

View of the Audience

Group photo

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