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Your Monthly Companion on Tax & Allied Subjects

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The Chamber of Tax Consultants

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

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

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

Unveiled by **Shri S. E. Dastur,** Senior Advocate on 30th January, 2008.

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Editorial

Dear Readers,

One of the busiest seasons for practicing Chartered Accountants viz Tax Audit, got over on 30th September. There was though a short extension of seven days due to last minute glitches in the Income-tax website. As such the extension was inconsequential for the reason that it was announced at about 10 pm on 30th September, by which time, most of the tax audit reports and other statutory forms were uploaded. During the previous two tax audit seasons of 2020 and 2021, due to the Covid 19 pandemic, there were humongous challenges due to Lock Down and other related problems as a result of which there were significant extensions of the compliance due dates. Fortunately after two years of trying period for every citizen of the country, things have come almost back on track.

Due to Covid 19, working from home became a way of life for everyone for two years. Even after normalcy, which arrived due to the end of the pandemic, some of the companies continue to work in hybrid mode viz, partly working remotely and partly physically from office. Some large companies still continue to have their major work force working remotely. In fact that has become a new normal now with some of the companies, as they perceive this to be an efficient working model leading to saving in administrative cost.

However some companies which were propagating remote working due to cost saving and working efficiency are now rethinking about the remote working because the employees, especially the new entrants not visiting their office or not interacting with the mentors or the role models, is not a very healthy situation in the long run. The employees may have only transactional experience and one can't make a leader out of an employee who has limited personal interaction with his colleagues or mentors. Therefore many companies have now made it mandatory for all the employees to work from office at least for a few days in a week and for senior executives for more number of days.

Another very important downside of remote working is issues such as 'moonlighting'-holding one or more jobs during the course of regular employment-, have started surfacing. Instances of professionals enjoying dual benefits have come to light across the sectors especially the IT Sector. There are certain indicators of moonlighting such as increased request for work from

home, avoiding in person meeting, not attending important meetings etc and is indeed an issue of professional integrity and ethics. It's a known fact that one of the prominent IT Companies fired some of its staff for moonlighting. To curb this growing issue of multiple employments, companies must proactively introduce measures by use of technology to identify such cases, staff training, communicating to them about Dos and Don'ts. Needless to mention that this was a warning bell for the companies and they have started taking measures to curb the instances of moonlighting.

While globally the economic scenario remains uncertain and a recessionary trend continues, Reserve Bank of India is trying its best to maintain the tempo of growth in GDP and controlling inflation in India by its monetary policy. Increase in repo rate by 50 basis points in the recent monetary policy is a step in that direction. Recent launch of 5G network in our country is a positive development which will offer wide range of benefits to common people. It will help in providing seamless coverage, high data transmission rate and highly reliable communication. There is a positive development overall and our Country is moving in the direction of becoming one of the strongest economies in the world in the times to come.

It is always the endeavour of the Journal Committee to design special stories not only on Direct and Indirect Tax laws but also on allied subjects. October issue of the Journal is on a very important subject of DEPOSIT. There are a lot of issues relating to deposits under various laws which professionals confront. The issue has been thoughtfully designed covering all the important aspects. I am sure the readers will find the same very useful. My compliments to the Journal committee for having conceptualised this design and brought this issue out. Gratitude to all the learned authors for sparing their valuable time and sharing their knowledge.

After two years of restrictive celebrations of the festivals, this year all the festivals are being celebrated with unprecedented enthusiasm. Celebration of Ganesh festival and Navratri which just got over, says it all ! The biggest festival of the Country, Diwali is round the corner. I am sure that with successful completion of tax audit season and time barring income tax assessments, everyone must have some plans and would be looking forward to celebrate and enjoy the festival of lights with your near and dear ones with great enthusiasm ! As they say work hard and party even harder!! I wish you and your family a very Happy Diwali and a very Happy and Prosperous New Year S.Y.2079!

VIPUL K. CHOKSI
Editor

From the President

Dear Members,

We just completed Tax Audit filings albeit with some glitches and delays in the last few days. What is interesting to note is that before couple of years professionals were demanding extension of timelines whereas nowadays, they have realized that with extension only their work gets prolonged. This time at CTC, we have not received single request to make representation to Government for extension. This is good for professionals.

October month is full of festivities. Starting with Navratri in first week and Diwali towards end of the month. I extend best wishes to all readers on behalf of entire managing council.

Indian economy is moving at rapid pace. Our GST collection for September 2022 is 1.47 lakh crores. 3rd quarter of financial year is expected to be even better. Although India is showing signs of improvement, global signals are showing red flag specially Europe and North America. With increasing rates in USA and Europe, fault lines in global financial systems are visible. Our forex reserves have also shown decline. This decline is combination of actual outflow and devaluation of other currencies, since our reserves are not only in USD but basket of currencies. We hope that global environment improves fast.

At CTC, we just concluded webinar on Anti Abuse Provisions of Income Tax act and have started webinar series on GST refunds. Participations in both the programs is encouraging. We have also announced some more programs on topics like Controversial Transfer Pricing Issues, 2 day course on Black money and Benami Act, and lots of other programs. You all are requested to visit website of Chamber to get updated program list.

We are happy to announce 3 RRCs. Starting with 1st RRC on FEMA at Pune from 2nd to 4th December 2022, 11th RRC on GST at Pune from 5th to 8th January 2023 and 46th RRC of Direct Tax at Indore from 2nd to 5th March, 2023. Papers

at all the RRCs are meticulously planned keeping in mind CTCs tradition of giving papers on contemporary topics and best speakers. Enrollment has started for all the 3 RRCs on first come first serve basis. Do enroll early to take advantage of Early Bird pricing.

This months issue focuses on "Deposits" under various laws. Journal committee deserves big round of applause for conceptualizing an issue on this topic. I thank all the contributors for their timely articles and I am sure members at large will benefit from their knowledge.

I conclude with best wishes to all the readers.

Jai Hind.

PARAG S. VED
President

CS Makarand Joshi

Meaning of Deposit under Companies Act and BUDS Debentures and Deposits under the Companies Act

1. Introduction

India has a large, low-income, rural population with limited access to formal banking facilities. This leads to the absence of two major helplines for poorer people – firstly that of placing their money safely in deposits and secondly, of being able to borrow money for their needs which may be as simple as buying seeds for the next crop or their children's marriage. The second helpline is instead achieved by a web of parallel, informal banking channels in the form of unregulated lending which has existed in India for last various centuries. At its Centre are the moneylenders, mostly unregulated, often also wealthy landlords who used to charge exorbitant rates of interest. To curb this practice, several Moneylenders Acts were enacted by the State Governments of India by the 1950s. However, the unsuccessful attempts to replace the moneylenders gave rise to unscrupulous financial operators that operated Ponzi schemes.

A **Ponzi scheme** is a form of fraud that lures new investors and pays profits to earlier investors through funds received from more recent investors. The scheme leads victims to believe that profits are coming from product sales or other means, and they remain unaware that other newer investors are the source of funds. A Ponzi scheme can maintain the illusion of a sustainable business as long as new investors contribute new funds, and as long as most of the investors do not demand full repayment and still believe in the non-existent assets they are purported to own.

The scheme is named after Charles Ponzi who became notorious for using this technique in the 1920s.

Ponzi schemes catch in their net, highly sophisticated individuals and institutions as well as low-income and middle-income investors. These schemes have attracted investors all over the world - in Russia, England, India, Albania, Romania, Portugal, Costa Rica, and elsewhere.

In the past years, the CBI has lodged about 166 cases related to chit funds and multi-crore scams, with the maximum in West Bengal and Odisha.

As a result of various scams as stated above and the recent Saradha scam, the Standing Committee of Finance suggested the introduction of a comprehensive regulatory framework governing all entities engaged in activities involving acceptance of deposits from the public. It was observed by this Committee that certain entities carrying out these activities were engaged in financial as well as non-financial sectors and therefore it was difficult to identify the appropriate regulator for such entities. There are also cases where some entities fall under the jurisdiction of various regulatory bodies, whereas there are several entities which are not regulated by any regulator.

In view of this observation and suggestions, the gaps were identified in the existing regulatory framework and as a result, it was suggested for the enactment of a comprehensive Central Act to criminalize the solicitation, promotion, acceptance and/or operation of unregulated deposit schemes. In line with the recommendation of the said Committee, the Banning of Unregulated Schemes Deposits Ordinance, 2019 ("Ordinance/BUDS") was promulgated on February 21, 2019.

2. What amounts to deposit?

As defined under BUDS, the term 'deposit' **means** an amount of **money received by way of an advance or loan or in any other form**, by **any deposit taker with a promise to return** whether after a specified period or otherwise, whether in cash or in kind or in the form of a specified service, **with or without any benefit** in the form of interest, bonus, profit or in any other form and excludes certain types of amounts received viz., amounts received as loans/financial assistances from banks, public financial institutions, non-banking finance companies, foreign institutions etc. However, the explanation provided under the definition of 'deposit' under BUDS states that in case of Companies, the definition of 'deposit' under BUDS will not be applicable and the definition of 'deposit' provided under the Companies Act, 2013 ("the Act") will be applicable.

If we refer definition the definition of 'deposit' under the Act, it is an inclusive definition and it starts with the words *"includes any receipt of money by way of deposit or loan or in any other form, by a company but does not include….",* and excludes certain types of amounts received viz. amounts received as loans/ financial assistances from banks, public financial institutions, foreign institutions etc." Here the definition says receipt of money by way of (1) deposit or (2) loan or (3) in any other form. So, a point of the debate can be that how to interpret the words *'in any other form'*? Whether all such amounts received in any form which may not be covered in the exclusions provided in the definition will be considered as deposit? Or whether this term has to be read in the context of receipt of money either as deposit or loan? Here the words 'loan' and 'deposit' and specific words and 'in any other form' are general words. Hence by applying the ejusdem generis rule of interpretation, it can be said that only such amount which is received in the form of loan or deposit, whether named as loan or deposit or having

any other name, will be considered as deposit.

After taking into consideration the definition of deposit and its import, another question may come up that whether the issue of debentures, which is covered in the definition of 'securities' under the Securities Contract (Regulation) Act, 1956, amounts to 'issue of securities' OR whether it will amount to 'receipt of loan' and as a result will be considered as 'deposit'? As discussed above, the term 'in any other form' used in the definition of deposit in the Act has to be read in the context of deposit or loan. If we refer the definition of debentures under Sec. 2(30) of Act, it states that *"debenture" includes debenture stock, bonds or any other instrument of a company* ***evidencing a debt****, whether constituting a charge on the assets of the company or not;"* So after referring definition of 'debenture', it is clear that although the issue of debentures can be considered as 'issue of securities', but money raised by issuing debentures can also be considered as money borrowed by the company. Therefore, it shall amount to deposit, unless specifically excluded from the definition of 'deposit'. Further, whether every kind of debenture will amount to deposit or not is discussed in Para 6 of this document.

The definition of term 'deposit' can be witnessed in other Acts such RBI Act, 1934 and in several State enactments also called as Protection of Interest of Depositors Act, for instance, Maharashtra Protection of Interest of Depositors (In Financial Establishments) Act, 1999 ("MPID Act"). The MPID Act defines 'deposit' as *"it includes and shall be deemed always to have included any receipt of money or acceptance of any valuable commodity by any financial establishment to be returned after a specified period or otherwise, either in cash or in kind or in the form of a specified service with or without any benefit in the form of interest, bonus, profit or in any other form and excludes certain types of amounts received."*

Having elaborated the concept of 'deposit' under various Acts, let's understand the scheme of deposits under the Companies Act, 2013 ("the Act") vis a vis BUDS.

3. Scheme of Deposits under Companies Act, 2013

A. Deposits from Public

Section 73 of the Act read with the Companies (Acceptance of Deposits) Rules 2014 sets some thumb rules with regard to acceptance of deposits as follows:

- Private companies cannot accept deposit from the public. They can accept deposits only from members
- "Eligible Companies" i.e., public companies having a net-worth of not less ₹ 100 crores or a turnover of not less than ₹ 500 crores and which have obtained the prior consent of the members of the company in general meeting by way of special resolution can accept public deposits subject to compliance of provisions of section 76 and the relevant rules of the Companies (Acceptance of Deposit) Rules, 2014.
- The maximum limit up to which an eligible company can accept deposits from the public shall not exceed 25% of the aggregate of the

paid-up share capital, free reserve and securities premium account.

B. *Deposits from Members*

Public companies as well as private companies can accept deposits from members.

Public Companies (including eligible companies as mentioned above) can accept deposits from members not exceeding 35% of aggregate of the paid-up share capital, free reserve and securities premium account subject to fulfillment of conditions prescribed in clause (a) to (e) of sub-section (2) of Section 73 which are stated below.

In case an eligible company is accepting public deposits, then excluding the 25% limit as mentioned above for public deposits, it can accept deposits from members not exceeding 10% of aggregate of the paid-up share capital, free reserve and securities premium account.

A specified IFSC public company i.e., an unlisted public company licensed to operate by RBI/SEBI/IRDA from International Financial Service Centre located in an approved multi services SEZ, can accept deposits from its members not exceeding 100% of aggregate of the paid-up share capital, free reserve and securities premium account

Private Companies can also accept deposits from its members not exceeding 100% of the aggregate of the paid-up share capital, free reserve and securities premium account.

Private companies which are a start-up can accept deposits from members exceeding the above-mentioned 100% limit till 10 years from the date of incorporation.

Other private companies can also accept deposits from members exceeding the above-mentioned 100% limit subject to fulfilling the following conditions prescribed in the Ministry of Corporate Affairs (MCA) notification dated 5th June, 2015 which was modified in 2017 later:

(a) Private Company which is not an associate or a subsidiary company of any other company;

(b) The borrowings of such a company from banks or financial institutions or ant body corporate is less than twice of its paid-up share capital or Rs. 50 crores, whichever is lower; and

(c) Such a company has not defaulted in the repayment of such borrowings subsisting at the time of accepting deposits from members

In the case of private companies which fulfil the above-mentioned three conditions, the compliance prescribed in clause (a) to (e) of sub-section (2) of Section 73 which are stated below are not exempted.

In all other cases of acceptance of deposits from members, the said company has to comply with the conditions prescribed in clause (a) to (e) of sub-section (2) of Section 73 as stated below: -

(a) issuance of a circular to its members including therein a statement showing the financial position of the company, the credit rating obtained, the total number of depositors and the amount due towards deposits in respect of any previous deposits accepted

by the company and such other particulars in Form DPT- 1

(b) filing a copy of the circular along with such statement with the Registrar within thirty days before the date of issue of the circular;

(c) depositing, on or before the 30th of April each year, such sum which shall not be less than 20% of the amount of its deposits maturing during the following financial year and kept in a scheduled bank in a separate bank account to be called deposit repayment reserve account;

(d) certifying that the company has not committed any default in the repayment of deposits accepted either before or after the commencement of this Act or payment of interest on such deposits and where a default had occurred, the company made good the default and a period of five years had lapsed since the date of making good the default and;

(e) providing security, if any for the due repayment of the amount of deposit or the interest thereon including the creation of such charge on the property or assets of the company

Further, every private company and every public company accepting deposits from members as well as from the public has to file return of deposit with the registrar of companies in Form DPT-3 by 30th of June every year with a certificate from statutory auditors of the Company certifying compliance with regard to deposits. There is no exemption from filing this return in any case.

C Exclusions

The definition of term 'deposit' as given in Section 2(31) of the Act seeks to bring in the purview of that term, any receipt of money by way of deposit or loan or any other form by a company. But at the same time, it seeks to exclude certain categories of money which may be received in the form of loan or deposit or otherwise. Such categories of money received are prescribed in clause (i) to (xviii) of Rule 2(1)(c) of the Companies (Acceptance of Deposits) Rules, 2014.

4. Scheme of Deposit under BUDS

As mentioned in the introduction para, the objective behind the enactment of BUDS was to restrain all unregulated deposit schemes being run by fraudulent means. BUDS recognizes two types of schemes - Regulated deposit scheme and Unregulated deposit scheme

BUDS lists out regulated deposit schemes as such schemes which are regulated by MCA, SEBI, RBI etc., such as deposits accepted by companies as per provisions of Companies Act, 2013, collective investment schemes, portfolio management services regulated by SEBI, deposits accepted by NBFCs regulated by Reserve Bank of India, etc.

Unregulated deposits scheme means a scheme or arrangement under which deposits are accepted or solicited by any deposit taker by way of business and which is not a regulated deposit scheme.

Further definition of deposit taker is also specified under BUDS which includes individuals, proprietorship concern, partnership firm, LLP, company, trust, association of persons etc.

A relevant question here, might be whether BUDS will be applicable to regulated deposit takers like companies?

5. **Whether BUDS will be applicable to Companies?**

The definition of 'deposit' under BUDS is not applicable in case of companies as the explanation to the definition of 'deposit' under BUDS provides that, *"for Companies, deposit shall have the same meaning as assigned under Companies Act, 2013."*

However, deposit taker is defined under BUDS which includes companies. Further Section 4 of BUDS states that *"No deposit taker, while accepting deposits pursuant to a Regulated Deposit Scheme, shall commit any fraudulent default in the repayment or return of deposit on maturity or in rendering any specified service promised against such deposit."*

It can be inferred from above that if the deposit is accepted by companies with due compliance of all the applicable provisions of Companies Act, 2013, then it will be treated as "regulated deposit" under BUDS and it will not to fulfill any other requirements under BUDS except intimation of business by deposit taker to designated authority under Section 10 of BUDS.

6. **Whether amounts received by companies in the nature of deposits which do not fall under regulated deposits becomes unregulated deposits?**

Any receipts of money in the nature of loan or deposit or any other form by companies which are categorized as exclusions under clauses (i) to (xviii) of Rule 2(1)(c) of the Companies (Acceptance of Deposits) Rules, 2014, but actually do not fulfill the conditions mentioned in the relevant clauses, cannot be considered as exclusions and may be considered as deposits if they are received in the nature of loan or deposit or in any other form (in that context). In such cases, since the procedure prescribed in the Act for acceptance of deposits would not have been followed, they may be considered as 'unregulated deposits.' Few examples are as follows:

(a) Amount received from person resident outside India but not in compliance of provisions of Foreign Exchange Management Act, 1999 (clause (ii) of Rule 2(1)(c))

(b) If loan is taken from a limited liability partnership which is not a member (only amount received from other company is excluded under clause (vi) of Rule 2(1)(c))

(c) If loan is taken by a private company from a partnership dirm where all partners are not directors or relatives of directors (clause (viii) of Rule 2(1)(c))

(d) If private company accepts loan from its directors and/or relatives or public company accepts loan from its director(s) and the lender does not provide a declaration at the time of giving such loan that the amount is not being given out of funds acquired by him by borrowing or accepting loans or deposits from others. (Proviso to clause (viii) of Rule 2(1)(c))

(e) If private Company accepts loan from its director(s) or their relatives or public company accepts loan from its director(s) and the fact

about above-mentioned declaration is not disclosed in Board's report under section 134 of the Act (Proviso to clause (viii) of Rule 2(1)(c))

(f) If private company accepts loan from such individuals who may be a distant relative of any director but does not fit into definition of 'relative' as provided in section 2(77) of the Act, with regard to any director of the Company. (clause (viii) of Rule 2(1)(c))

(g) If a private company, being subsidiary of public company, or a public company accepts loan from relatives of director. (clause (viii) of Rule 2(1)(c))

(h) Failure on part of company to refund or allot securities within 60 days from the date of receipt of application money. (Clause (vii) of Rule 2(1)(c))

(i) If any amount received as an advance for the supply of goods/services and such advance is not appropriated against supply of goods/services within a period of 365 days, depending upon the nature of advance. (Clause (xii) of Rule 2(1)(c))

(j) Receipt of amount by a Company under long term projects for supply of capital goods other than immovable property, but actually it was not appropriated for the same, depending upon the nature of advance (Clause (xii) of Rule 2(1)(c))

)k) The amount brought in by the promoters of the company by way of unsecured loan and in pursuance of the stipulation of any lending bank and if the same continues after the loan is repaid. (Clause (xiii) of Rule 2(1)(c))

(l) If a company issue unsecured non-convertible debentures are issued to any person not covered under any of the other exclusions to Rule 2(1)(c), unless they are listed on a recognized stock exchange in accordance with SEBI Regulations (clause (ixa) of Rule 2(1)(c))

(m) Issue of unsecured and unlisted debentures which are fully compulsorily convertible into shares (CCDs) after 10 years from date of allotment to any person not covered under any of the other exclusions to Rule 2(1)(c) (clause (ix) of Rule 2(1)(c))

(n) Issue of any kind of unlisted and non-convertible or optionally convertible debentures which are not secured by first charge or a charge ranking pari passu with the first charge on any assets referred to in Schedule III of the Act excluding intangible assets of the company to any person not covered under any of the other exclusions to Rule 2(1)(c) (clause (ix) of Rule 2(1)(c))

(o) Issue of unlisted and non-convertible or optionally convertible debentures which are secured by first charge or a charge ranking pari passu with the first charge on any assets referred to in Schedule III of the Act excluding intangible assets of the company, but exceed the market value of the assets so assessed by a registered valuer, to any person not covered

under any of the other exclusions to Rule 2(1)(c) (Proviso to clause (ix) of Rule 2(1)(c))

In the above examples, if the above-mentioned money is received in the nature of loan or deposit or in any other form (in the context thereof), as Company would not have complied with the applicable provisions provided under Chapter V of Companies Act, 2013, it may be categorized as unregulated deposit.

Since money raising under unregulated deposit scheme is an offence, the Company will face several consequences. What can be the consequences and under which laws it can be caused and why this subject is of so much important can be understood by referring the consequences as stated below.

7. Consequences in case of unregulated deposits accepted by companies:

The main intent behind enacting any law relating to deposit is to keep a check on illicit deposit scheme from duping people of their hard-earned money and take a stringent action against such deposit taker in such a way that the depositors will get their hard-earned money back as early as possible and this acts as a strong alert for other deposit takers too..

The consequences under the provisions of the Act do not get attracted for the deposits duly accepted for legitimate business transactions or which fall within deposits taken in normal course of business after complying with the provisions of law.

The position of law w.r.t. consequences are narrated below:

A. Consequences under Companies Act, 2013

Companies Act specifically provides consequences in case of failure to comply with applicable provisions under chapter V which deals with deposits.

Sections 76A specifies severe consequence in case of any failure and it is non-compoundable offence.

Section 76A states that, if a company:

- Accepts or invites behalf any deposit in contravention of the manner or the conditions prescribed under section 73 or section 76 or rules made thereunder; or
- Allows or causes any other person to accept or invite on its behalf any deposit in contravention of the manner or the conditions prescribed under section 73 or section 76 or rules made thereunder; or
- Fails to repay the deposit or part thereof
- Fails to pay any interest due thereon within time

the company shall be punishable with fine which shall not be less than 1 Crore or twice the amount of deposit accepted by Company which is lower but which may extend to 10 crore rupees. This is in addition to the repayment of the amount of deposit or part thereof and the interest due.

Further every officer in default shall be punishable with imprisonment which may extend to 7 years **and** with fine ranging between 25 lakhs to 2 crore and in case it is proved that the officer has contravened such provisions knowingly

or willfully with the intention to deceive the company or its shareholders or depositors or creditors or tax authorities, he shall be liable for action under section 447.

B. *Consequences under BUDS*

If we refer the definition of 'deposit taker' under BUDS, it includes 'Company' as well. Hence if company accepts deposits without complying with necessary provisions of Companies Act, 2013, it may be treated as 'unregulated deposit' and it can get covered under purview of BUDS as well. As discussed above, the intent behind enacting BUDS is to curb all unregulated deposit schemes. So, in such cases, in addition to the Companies Act, 2013, the penal consequences under BUDS can also applicable.

Section 21 of BUDS lays down stringent penalties for violation, in case any deposit taker including company:

Default	***Punishment***
• Solicits deposits under unregulated deposit scheme; or • Directly or indirectly, promote, operate, issue any advertisement, soliciting, participation or enrolment in or accept deposits in pursuance of an Unregulated deposit scheme.	punishable with Imprisonment for a term ranging between 1 to 5 years; **and** Fine ranging between 2 lakh to 10 lakhs
• Accepts deposits under unregulated deposit scheme	punishable with Imprisonment for a term ranging between 2 to 7 years; *and* Fine ranging between 3 lakh to 10 lakhs
• Accepts deposits and fraudulently defaults in repayment of deposits	punishable with Imprisonment for a term ranging between 3 to 10 years; *and* Fine – Minimum – 5 lakhs –may extend to twice the amount of aggregate funds collected in Unregulated deposit scheme

C. *Consequences under State enactments*

Further as mentioned in Para 2 above, several states in India have enacted a special law usually called as Protection of Interest of Depositors in Financial Establishment Act to safeguard the interest of common citizens against exploitation by unscrupulous financial establishments.

In Maharashtra it is in name and style of 'Maharashtra Protection of Interest of Depositors (In Financial Establishments) Act, 1999'. As per this Act, in case

of any financial establishment which fraudulently defaults any repayment of deposit on maturity along with any benefit in the form of interest, bonus etc. as promised against the deposit, on conviction, every person or an employee responsible for the management of or conducting business or affairs of such financial establishment is punishable with imprisonment for a term up to 6 years **and** with fine which may extend to one lakh of rupees and such financial establishment shall be liable for a fine which may extend to one lakh.

8. Conclusion

There are various State enactments as well as Central enactments governing one subject i.e., "deposit". Generally, in such situations, Central law prevails over State laws as per doctrine of occupied field or repugnancy., Hence whether this doctrine of occupied field or repugnancy will be applicable in this case too and whether action can be taken against such illicit schemes under State law OR Central law OR under both laws, is a matter of debate.

If we refer matter of *K.K. Baskaran vs. State*, represented by Secretary, Tamil Nadu dealing with same subject, in this case the Supreme Court has upheld the constitutional validity of similar state law i.e. of Tamil Nadu and it was held that:

"The Tamil Nadu Act was enacted to find out a solution for the problem of the depositors who were deceived on a large scale by the fraudulent activities of certain financial establishments. There was a disastrous consequence both in the economic as well as social life of such depositors who were exploited by false promise of high return of interest.

These financial institutions/establishments did not come either under the Reserve Bank of India Act or the Banking Regulation Act, and hence they escaped from public control.

By the Act, the State not only proposed to attach the properties of such fraudulent establishments and the mala fide transferees, but also provided for the sale of such properties and for distribution of the sale proceeds amongst the innocent depositors. Hence, in our opinion, the doctrine of occupied field or repugnancy, has no application in the instant case.

The Reserve Bank of India Act, the Banking Regulation Act and the Companies Act do not occupy the field which the impugned Tamil Nadu Act occupies, though the latter may incidentally trench upon the former. The main object of the Tamil Nadu Act is to provide a solution to wipe out the tears of several lakhs of depositors to realize their dues effectively and speedily from the fraudulent financial establishments which duped them or their vendees, without dragging them in a legal battle from pillar to post."

Hence, going by this Order, it appears that the action may be taken against such companies under the Companies Act, 2013, BUDS along with other State and Central enactments dealing with the subject matter!!!

Sharad Abhyankar
Advocate

Concept of Deemed Public Issue – a case study of Sahara India Judgement of the Supreme Court of India

"acta exterior indicant interiora secreta" (external action reveals inner secrets)

Leap of faith for advancement of corporate law in India – 15 June 1988 and 13 December 2000

Companies (Amendment) Act, 1988 came into effect on 15 June 1988. This amendment made certain revolutionary changes in the best interest of the stakeholders of a public company. W.e.f. 15 June 1988, any public company intending to make a public issue of shares or debentures was required to file an application for listing of such securities. The requirement of filing an application for listing brought the essential mandate of making significant disclosures about the promoters, business, financial statements, current state of affairs. The Amendment also obligated the companies to refund the share application money with interest if the company failed to procure a listing approval. The eligibility criteria for companies to get listed on recognized stock exchanges reduced the risk of undesirable or unsuitable companies from raising funds from the public.

This amendment, however, did not deter public companies from adopting a by-pass route of making multiple private placements/ preferential allotments to specific persons. Further, there was no limit on the number of such preferential offers that a company could make in a financial year.

It however took more than 12 years thereafter for the Government of India to take cognizance of such mischievous conduct by India Inc. By Companies (Amendment) Act, 2000, the concept of a deemed public issue was introduced by inserting a numeric threshold of persons to whom the shares or securities could be allotted by a company was introduced under s. 67(3) of the Companies Act to legally assume such issue as a public issue of securities.

The above changes marked the statutory introduction of corporate governance principles. Either of these legislative amendments obligated issuers of securities to discharge higher burden of corporate responsibility, transparency and accountability towards the stakeholders. Timely and appropriate disclosures pertaining to corporate information and performance, essential for an investor to make an informed decision was

implemented. These changes also expected a change of mindset from the Indian corporates by instilling financial discipline in their affairs and adherence to norms of compliance towards contributors of financial resources.

It was unfortunate that instead of embracing the spirit of law governing the transparency and accountability while making public issues, the misdemeanour of adopting aggressive interpretations and avoiding compliance of statutory provisions continued. It did not however, go unnoticed. SEBI and Department of Company Affairs stepped in to enforce appropriate compliance. Such compliance actions were challenged before different courts and tribunals. The binding interpretation of 'deemed public issue' was settled by the Supreme Court of India in the case of Sahara Real Estate Corporation Limited.

Introduction – Genesis of 'private placements'

Sahara India Real Estate Corporation Limited (**"SIRECL"**) and Sahara Housing Investment Corporation Limited (**"SHICL"**), (conveniently called **"Saharas"**), are the companies controlled by Sahara Group. SIRECL was originally incorporated as Sahara India C Junxion Corporation Limited on 28.10.2005 as a public limited company under the Companies Act and it changed its name to SIRECL on 7.3.2008. As per the Balance Sheet of the company as on 31.12.2007, its cash and bank balances were ₹ 6,71,882 and its net current assets worth ₹ 6,54,660. Company had no fixed assets nor any investment as on that date. SIRECL's operational and other expenses for the three quarters ending 31.12.2007 were ₹ 9,292 and the loss carried forward to the Balance Sheet as on that date was ₹ 3,28,345.

SIRECL, in its extraordinary general meeting held on 3.3.2008, resolved through a special resolution passed in terms of section 81(1A) of the Companies Act, 1956 (equivalent to s. 62(1)(c) of the Companies Act, 2013) to raise funds through unsecured Optionally Fully Convertible Debentures (**"OFCDs"**) by way of "private placement" to "friends, associates, group companies, workers/employees and other individuals associated/affiliated or connected in any manner with Sahara Group of Companies" (**"Sahara Group"**) without giving any advertisement to general public. SIRECL authorized its Board of Directors to decide the terms and conditions and revision thereof, namely, face value of each OFCD, minimum application size, tenure, conversion, and interest rate. Board of Directors, consequently, held a meeting on 10.3.2008 and resolved to issue unsecured OFCDs by way of private placement, the details of which were mentioned in the Red Herring Prospectus ("RHP") filed with the Registrar of Companies ("RoC"), Kanpur. SIRECL had specifically indicated in the RHP that they did not intend to get their securities listed on any recognized stock exchange, and that only those persons to whom the Information Memorandum ("IM") was circulated and/or approached privately who were associated/affiliated or connected in any manner with Sahara Group, would be eligible to apply. Further, it was also stated in the RHP that the funds raised by the company would be utilized for the purpose of financing the acquisition of townships, residential apartments, shopping complexes etc. and construction activities would be undertaken by the company in major cities of the country and also would finance other commercial activities/projects taken up by the company within or apart from the above projects. RHP also indicated that the intention of the company was to carry out infrastructural activities and the amount collected from the issue would be utilized in financing the completion of projects, namely, establishing/constructing the bridges, modernizing or setting up of airports, rail system or any other projects which might be allotted to the company from time to time in future. RHP also highlighted the intention of the company

to engage in the business of electric power generation and transmission and that the proceeds of the current issue or debentures would be utilized for power projects which would be allotted to the company and that the money, not required immediately, might be parked/invested, inter alia, by way of circulating capital with partnership firms or joint ventures, or in any other manner, as per the decision of the Board of Directors from time to time. SIRECL, under Section 60B of the Companies Act, filed the RHP before the RoC, Uttar Pradesh on 13.3.2008, which was registered on 18.3.2008. SIRECL then in April 2008, circulated IM along with the application forms to its so-called friends, associated group companies, workers/employees and other individuals associated with Sahara Group for subscribing to the OFCDs by way of private placement. Then IM carried a recital that it was private and confidential and not for circulation. It would be relevant to refer to the statements made by SIRCEL in the IM:

Private & Confidential (Not for Circulation) Information Memorandum for Private Placement of Optionally Fully Convertible Unsecured Debentures (OFCD)

This Memorandum of Information is being made by Sahara India Real Estate Corporation Limited (formerly Sahara India 'C' Junxion Corporation Limited) which is an unlisted Company and neither its equity shares nor any of the bonds/debentures are listed or proposed to be listed. This issue is purely on the private placement basis and the company does not intend to get these OFCD's listed on any of the Stock Exchanges in India or Abroad. This Memorandum for Private Placement is neither a Prospectus nor a Statement in Lieu of prospectus. It does not constitute an offer for an invitation to subscribe to OFCD's issued by Sahara India Real Estate Corporation Limited. The Memorandum for Private Placement is intended to form the basis of evaluation for the investors to whom it is addressed and who are willing and eligible to subscribe to these OFCD's. Investors are required to make their own independent evaluation and judgment before making the investment.

The contents of this Memorandum for Private Placement are intended to be used by the investors to whom it is addressed and distributed. This Memorandum for Private Placement is not intended for distribution and is for the consideration of the person to whom it is addressed and should not be reproduced by the recipient. The OFCD's mentioned herein are being issued on a private placement basis and this offer does not constitute a public offer/ invitation. SIRECL issued Abode Bond, Real Estate Bond and Nirmaan Bond with tenure ranging from 48 months to 120 months and convertible into equity shares at the option of the investor.

SIRCEL floated the issue of the OFCDs as an open ended scheme and collected Rs 19,400 crore from 25.4.2008 to 13.4.2011 from 2,21,07,271 investors.

SHICL, also convened an Annual General Meeting on 16.9.2009 and passed a special resolution to raise funds by issue of OFCDs, by way of private placement, to *"friends, associated group companies, workers/employees and other individuals associated/affiliated or connected in any manner with the Sahara Group companies". Consequently, a RHP was filed on 6.10.2009 under Section 60B of the Companies Act with the RoC, Mumbai, Maharashtra, which was registered on 15.10.2009. Later, SHICL issued OFCDs of the nature of Housing Bond; Income Bond, Multiple Bond.*

SEBI steps in

SEBI had come to know of the large scale collection of money from the public by Saharas through OFCDs, while processing the RHP submitted by Sahara Prime City

Limited, another Company of the Sahara Group, on 12.1.2010 for its initial public offer. When SEBI sought a clarification from Enam Securities Private Limited, merchant bankers of Sahara Prime City Limited about the complaint received from one Roshan Lal alleging that Sahara Group was issuing Housing bonds without complying with Rules/Regulations/ Guidelines issued by RBI/MCA/NHB. The Merchant Banker replied that SIRECL and SHICL were not registered with any stock exchange and were not subjected to any rule/ regulation/guidelines/notification/directions framed thereunder and the issuance of OFCDs were in compliance with the applicable laws. Following the above, another letter dated 26.2.2010 was also sent by the Merchant Banker to SEBI stating that SIRECL and SHICL had issued the OFCDs pursuant to a special resolution under Section 81(1A) of the Companies Act, 1956 passed on 3.3.2008 and 16.9.2009 respectively. Further, it was also pointed out that they had issued and circulated an IM prior to the opening of the offer and that RHP issued by SIRECL dated 13.3.2008 was filed with RoC, U.P. and Uttarakhand and RHP issued by SIHCL dated 6.10.2009 was filed with RoC, Maharashtra.

Based on preliminary review, SEBI informed SIRECL and SHICL that the issuance of OFCDs was a public issue and, therefore, securities were liable to be listed on a recognized stock exchange under Section 73 of the Companies Act. It was pointed out that the issuance of OFCDs by Saharas was prima facie in violation of Sections 56 and 73 of the Act and also various clauses of DIP Guidelines and SHICL had also prima facie violated Regulations 4(2), 5(1), 6, 7, 16(1), 20(1), 25, 26, 36, 37, 46 and 57 of ICDR 2009. Both the companies were, therefore, directed to show cause why action should not be initiated against them including issuance of direction to refund the money solicited and mobilized through the prospectus issued with respect to the OFCDs, since they had violated the provisions of the Companies Act, SEBI Act, erstwhile DIP Guidelines and ICDR 2009.

Ministry of Corporate Affairs also initiated independent investigations against Saharas in respect of the alleged violations.

Sahara questions SEBI's legal authority

From the very inception of the scheme to issue OFCDs through the hearings before the Supreme Court, Saharas maintained its stance that -

(i) Saharas had made private placement of OFCDs to persons who were associated with Sahara Group and such issues were not public issues;

(ii) OFCDs issued were in the nature of hybrid as defined under the Companies Act and SEBI did not have jurisdiction to administer those securities since Hybrid securities were not included in the definition of 'securities' under the SEBI Act, SCR Act etc.

(iii) such hybrids were issued in terms of Section 60B of the Companies Act and, therefore, only the Central Government had the jurisdiction under Section 55A(c) of the Companies Act;

(iv) Sections 67 and 73 of the Companies Act could not be made applicable to Hybrid securities, so also the DIP Guidelines and ICDR 2009; and

(v) Saharas had raised funds by way of private placement to friends, associates, group companies, workers/employees and other individuals associated/ affiliated with Sahara Group, without giving any advertisement to the public and RoC, Kanpur and Maharashtra had registered those RHPs without any demur and, therefore, it was unnecessary to send it to SEBI.

SEBI Final Order and Conclusions

SEBI passed its final order through its whole-time member (WTM) on 23.6.2011. SEBI examined the nature of OFCDs issued by Saharas and came to the conclusion that OFCDs issued would come within the definition of securities as defined under Section 2(h) of SCR Act. SEBI also found that those OFCDs issued to the public were in the nature of Hybrid securities, marketable and would not fall outside the genus of debentures. SEBI also found that the OFCDs issued, by definition, design and characteristics intrinsically and essentially, were debentures and the Saharas had designed the OFCDs to invite subscription from the public at large through their agents, private offices and information memorandum. SEBI concluded that OFCDs issued were in fact public issues and the Saharas were bound to comply with Section 73 of the Companies Act, in compliance with the parameters provided by the first proviso to Section 67(3) of the Companies Act. SEBI took the view that OFCDs issued by Saharas should have been listed on a recognized stock exchange and ought to have followed the disclosure requirement and other investors' protection norms. Having found so, SEBI directed Saharas to refund the money collected under the Prospectus dated 13.3.2008 and 6.10.2009 to all such investors who had subscribed to their OFCDs, with interest.

SEBI's final order summarized its salient conclusions as under:

1. OFCDs are hybrid instruments and are `debentures.

2. The definition of `securities under Section 2(h) of the SCR Act is an inclusive one and can accommodate a wide class of financial instruments. The OFCDs issued by the two Companies fall well within this definition.

3. The issue of OFCDs by the two Companies is public in nature, as they have been offered and issued to more than fifty persons, being covered under the first proviso to Section 67(3) of the Companies Act. The manner and the features of fund raising under the OFCDs issued by the two Companies further show that they cannot be regarded to be of a domestic concern or that only invitees have accepted the offer.

4. Section 60B deals with the issue of information memorandum to the public alone. Therefore the same cannot be used for raising capital through private placements as the said provision is exclusively designed for public book built issues. When a company files an information memorandum under Section 60B, it should apply for listing and therefore has to be treated as a listed public company for the purposes of Section 60B(9) of the Companies Act. Further, Section 60B has to be read together with all other applicable provisions of the Companies Act and cannot be adopted as a separate code by itself for raising funds, without due regard to the scheme and purpose of the Act itself. The same evidently has never been the intention of the Parliament.

5. The two companies, in raising money from the public, in violation of the legal framework applicable to them, have not complied with the elaborate investor protection measures, explained in paragraph 25 above. This, inter alia, also means that the rigorous scrutiny carried out by SEBI Registered intermediaries on any public issue by a public company have been subverted in the mobilization of huge sums of money from the public, by the two Companies.

6 The two Companies have not executed debenture trust deeds for securing the issue of debenture; failed to appoint a debenture trustee; and failed to create a debenture redemption reserve for the redemption of such debentures.

7. The two Companies have failed to appoint a monitoring agency (a public financial institution or a scheduled commercial bank) when their issue size exceeded Rs 500 cr., for the purposes of monitoring the use of proceeds of the issue. This mechanism is put in place to avoid siphoning of the funds by the promoters by diverting the proceeds of the issue.

8. The two companies failed to enclose an abridged prospectus, containing details as specified, along with their forms.

9. The companies have kept their issues open for more than three years/ two years, as the case may be, in contravention of the prescribed time limit of ten working days under the regulations.

10. The two companies have failed to apply for and obtain listing permission from recognized stock exchanges.

Proceedings before Securities Appellate Tribunal – SAT upholds SEBI Final Order and directs refund

Aggrieved by the order of SEBI, Saharas filed appeals before the Securities Appellate Tribunal (SAT). SAT upheld the Order passed by SEBI and passed a common order on 18.10.2011. SAT held that OFCDs issued were securities within the meaning of Clause (h) of Section 2 of SCR Act, so also under SEBI Act. Tribunal also noticed that RHP issued by SIRECL was registered by the RoC on 18.3.2008, though information memorandum (IM) was issued later in April 2008 in clear violation of Section 60B of the Companies Act.

SAT further held that IM was issued through 10 lakh agents and more than 2900 branch offices to more than 30 million persons inviting them to subscribe to the OFCDs which amounted to invitation to public.

SAT also found fault with the RoC as it had failed to forward the draft RHP to SEBI since it was a public issue and hence violated Circular dated 1.3.1991 issued by the Department of Company Affairs, Government of India.

SAT concluded that having made a public issue, Saharas cannot escape from complying with the requirements of Section 73(1) of the Companies Act on the ground that the companies had not intended to get the OFCDs listed on any stock exchange. SAT also examined the scope and ambit of Sections 55A of Companies Act read with Sections 11, 11A and 11B of SEBI Act and took the view that a plain reading of those provisions would indicate that SEBI has jurisdiction over the Saharas since OFCDs issued were in the nature of securities and hence should have been listed on any of the recognized exchanges of India.

SAT confirmed the SEBI Order against Saharas to refund a sum of ₹ 17,400 crore approximately on or before 28th November, 2011.

Saharas appeal before the Supreme Court of India

Aggrieved by the Order passed by SAT, Saharas preferred an appeal before the Supreme Court. Based on the submissions, various questions of laws were raised before the Supreme Court. Following cardinal issues concerning "deemed public issue" principles came up for consideration before the Supreme Court:

Questions of Law Framed

(i) *Whether Section 67 of the Companies Act implies that the company's offer of shares or debentures to fifty or more persons would ipso facto become a public issue, subject to certain exceptions provided therein and the scope and ambit of the first proviso to Section 67(3) of the Act, which was inserted w.e.f. 13.12.2000 by the Companies (Amendment) Act, 2000;*

(ii) *What is the scope and ambit of Section 73 of the Companies Act and whether it casts an obligation on a public company intending to offer its shares or debentures to the public, to apply for listing of its securities on a recognized stock exchange once it invites subscription from fifty or more persons and what legal consequences would follow, if permission under sub-section (1) of Section 73 is not applied for listing of securities;*

(iii) *Scope of Section 73(2) of the Companies Act regarding refund of the money collected from the Public.*

Questioning the interpretation of the provisions of the Companies Act and SEBI Act, Saharas argued that:

(a) After the insertion of the definition of securities in Section 2(45AA) as including hybrid and the definition of hybrid in Section 2(19A) of the Companies Act, the provisions of Section 67 were not applicable to OFCDs which have been held to be hybrid. Various bonds issued by Saharas, were never shares or debentures but hybrids, a separate and distinct class of securities. Section 67, it was submitted, speaks only of shares and debentures and not hybrids and, therefore, Section 67 would not apply to OFCDs issued by SIRECL.

(b) Referring to various terms and conditions of the Abode Bond, Nirmaan Bond and Real Estate Bond Saharas submitted that they are convertible bonds falling with the scope of Section 28(1)(b) of the SCR Act, in view of Section 9(1) and Section 9(2)(m) of that Act and are not listable securities within the meaning of Section 2(h) of the SCR Act and hence there is no question of making applications for listing under Section 73(1) of the Companies Act was also submitted that three Registrars of Companies West Bengal, Kanpur, and Mumbai had, at different point of time, registered the RHPs at different places over a period of nine years. Registrars of Companies could have refused registration under Section 60(3) of the Companies Act as well, if there was non-compliance of the provisions of the Companies Act. Saharas pointed out that having not done so, it is to be presumed that private placement under Section 60B of the Companies Act was permissible and hence no punitive action including refund of the amounts is called for and the order to that effect be declared illegal.

Intriguing Arguments by Saharas

An intriguing argument was advanced by Saharas that any act of compulsion on Saharas to list their shares or debentures on a stock exchange would make serious inroad into their corporate autonomy. According to Saharas, the concept of autonomy involves the rights of shareholders, their free speech, their decision making and all other factors.

Secondly, SEBI's insistence that Saharas ought to have listed their shares or debentures on a recognized stock exchange in accordance with Section 73 of the Companies Act would necessarily expose shareholders and debenture holders to the risks of trading in shares and

would also compel unlisted companies to seek financial help from investment bankers. Relying upon the judgment of this Court in ***Union of India vs. Allied International Products Ltd. & Anr. (1970) 3 SCC 594*** Saharas submitted that Section 73(1) was enacted with the object that the subscribers would be ensured the facility of easy convertibility of their holdings when they have subscribed to the shares on the representation in the prospectus that an application for quotation of shares had been or would be made. It is the obligation on the company which has promised the members of the public that their shares would be marketable or capable of being dealt with in the stock exchange. In support of this argument, Saharas referred to Section 51 of the Companies Act, 1948 (U.K.) and the judgment in ***In re. Nanwa Gold Mines Ltd. (1955) 1 WLR 1080*** and submitted that the object of Section 51 was to protect those persons who had paid money on the faith or the promise that their shares would be listed.

Other principal submissions by Saharas

(a) Sub-section (1) of Section 73 is qualified by the term intending, which means Section 73(1) deals with companies that want to issue new shares or debentures to be listed, and which have declared to the investors that they intend to have those shares or debentures dealt with on the stock exchange. In such a case, Section 73(1) obliges those companies to make an application to one or more recognized stock exchanges for permission for the shares or debentures to be dealt with on the stock exchange or each such stock exchange, before the issue of a prospectus.

(b) The role of Section 73(1) is narrow and limited and those companies which do not intend to list their securities on a stock exchange are not covered by this provision. Further, the expression to be dealt in on stock exchange occurring in the heading of Section 73 must be read in the text of that Section, to reach the understanding that it is not merely the invitation of shares or debentures to the public which warrants the application of Section 73, but it is only when such companies intend to have their shares or debentures listed on the stock exchange that the prescription under Section 73 shall apply. Saharas' contended that the company's freedom to contract under the Constitution as well as the Law of Contracts needs to be safeguarded and that persons who belong to the lower echelons of society, while it is necessary that they must never be duped, ought not be prevented from investing in measures which would add to their savings and that to deprive them of such an opportunity would be a serious infraction.

(c) Referring to Section 64 of the Companies Act, Saharas submitted that the expression "deemed to be prospectus" indicates that whenever shares or debentures which are allotted can be offered for sale to the public, such a document is deemed to be a prospectus and has legal consequences. Section 73 operationalizes the intention of a company which is allotment of shares with a view to sell to the public as contemplated in Section 64 of the Act. So, while Section 64 refers to the documents containing such an offer as a prospectus, Section 73 requires the company to make an application before the issue of the prospectus.

(d) Mere filing of prospectus is not reflective of the intention to make a public offer. The purpose of issue of prospectus is to disclose true and correct statements and it cannot be

characterized as an invitation to the public for subscription of shares or debentures. Filing of the prospectus or the administration of Section 62 on account of misstatement in a prospectus should be undertaken by the Central Government on account of explanation to Section 55A of the Companies Act.

(e) The manner in which a listed public company will offer its shares would be determined under the SEBI Act as well as the SEBI Regulations.

(f) Section 60B of the Companies Act, as such, does not presuppose or prescribes an intention to list. Section 60B enables a prospectus to be filed where a company is not a listed public company.

(g) IM or RHPs can be filed although an offer of shares may be made by way of private placement or to a section of the public or even to the public, but yet without intending it to be listed and that the stand of SEBI that where there is an offer of shares or debentures by way of prospectus, it amounts to an offer of shares to the general public and, therefore, to be dealt with on a stock exchange, is completely flawed and that Section 73 cannot be interpreted to impinge upon the corporate autonomy of the company.

(h) Section 67 of the Companies Act does not imply that a company's offer of shares or debentures to fifty or more persons would ipso facto become a public issue. In order to determine whether an offer is meant for the public at large or by way of private placement, what is relevant is the intention of the offeror. In other words, the numbers are irrelevant, it is only the intention to offer to a select or identified group which will make the offer a private placement. The proviso to sub-section (3) of Section 67 of the Companies Act should be appreciated in that background.

(i) A private placement is not authorized by interpretative provision in Section 67(3) but is in fact the will of the company reflected in a Special Resolution under Section 81(1A) of the Companies Act which deals with preferential allotment. Saharas' argued that when there is a private placement, irrespective of the number, then the offer of shares need not take place through a prospectus but can even take place through a letter or a memorandum.

SEBI's contentions

It was submitted on behalf of SEBI that Saharas' basic assumption that they are covered by 2003 Rules was erroneous. A public issue would not become a preferential allotment by merely labelling it as such and the facts on record show that the issue could not be termed as a preferential allotment. A preferential allotment is made by passing a special resolution under Section 81(1A) and is an exception to the rule of rights issue that requires new shares or debentures to be offered to the existing members/holders on a pro rata basis. Once the offer is made to more than forty-nine persons, then apart from compliance with Section 81(1A), other requirements regarding public issues have to be complied with.

After insertion of the proviso to Section 67(3) in December, 2000, private placement as allowed under Section 67(3) was restricted up to forty nine persons only and 2003 Rules were framed keeping this statutory provision in mind and were never intended for private placement/preferential issue to more than forty nine persons and the amendments to these rules made in the year 2011 merely made

the said legal position under the 2003 Rules, explicit.

OFCDs are 'debentures' by name and the nature and the definition of 'debenture' as given under Section 2(12) of the Companies Act includes any other securities. SEBI maintained that the securities as defined in Section 2(45AA) of the Companies Act includes hybrids and, therefore, hybrids fall in the definition of debentures and are amenable to the provisions of Sections 67 and 73 of the Companies Act.

Supreme Court rules

The Supreme Court noted that the documents produced before the apex court and before the fact- finding authorities do not show the relationship Sahara Group had with the investors. Claim of Saharas was that the investors were their friends, associated group companies, workers/employees and other individuals who were associated/affiliated or connected with Sahara Group. Saharas, in the bonds, sought for a declaration from the applicants that they had been associated with Sahara Group. No details had been furnished to show what types of association the investors had with Sahara Group. Bonds also required to name an introducer, whose job evidently was to introduce the company to the prospective investor. If the offer was made to those persons related or associated with Sahara Group, there was no necessity of an introducer and an introduction. Burden of proof is entirely on Saharas to show that the investors are/were their employees/ workers or associated with them in any other capacity which they have not discharged. Fact finding authorities have clearly held that Saharas had not discharged their burden which is purely a question of fact.

The Supreme Court did not find any perversity or illegality in the findings of SEBI or SAT which call for interference by the apex court sitting in appeal under Section 15Z of the SEBI Act. The Supreme Court therefore fully concurred with the Tribunal that the money collected by Saharas through their RHPs dated 13.3.2008 and 6.10.2009, through the OFCDs, were from the public at large and the same would amount to collection of money by way of issue of securities to the public, a finding which calls for no interference by this Court sitting under Section 15Z of the SEBI Act.

Lifting of Corporate Veil

The Supreme Court took a special note of the fact that through this dubious method SIRECL had –

(i) utilized the services of its staff in 2900 branches/service centres;

(ii) utilized the services of more than one million agents/representatives;

(iii) approached more than thirty million investors;

(iv) out of 30 million persons approached, 22.1 million persons invested in the OFCDs;

(v) SIRECL raised nearly 20,000 crore

and concluded that the Court can, in such circumstances, lift the veil to examine the conduct and method adopted by Saharas to defeat the various provisions of the Companies Act read with the provisions of the SEBI Act.

Supreme Court concludes on Deemed Public Issue

Based on the above facts and circumstances, the Supreme Court fully endorsed the findings recorded by SEBI and SAT that the placement of OFCDs by Saharas was nothing but issue of debentures to the public, resultantly, those securities should have been listed on a recognized stock exchange.

The Supreme Court noted that Section 67dealt with the offer of shares and debentures and

invitation to subscribe to the same to the public. It further stated that no offer or invitation shall be treated as made to the public, or to any section of the public, if the offer or invitation is not being calculated to result, directly or indirectly, in the shares or debentures becoming available for subscription or purchase by persons other than those receiving the offer or invitation or otherwise as being a domestic concern of the persons making and receiving the offer or invitations.

The first proviso to Section 67(3) was inserted by the Companies (Amendment) Act, 2000 w.e.f. 13.12.2000, which clearly indicates, nothing contained in Sub-section (3) of Section 67 shall apply in a case where the offer or invitation to subscribe for shares or debentures is made to fifty persons or more. Resultantly, after 13.12.2000, any offer of securities by a public company to fifty persons or more will be treated as a public issue under the Companies Act, even if it is of domestic concern or it is proved that the shares or debentures are not available for subscription or purchase by persons other than those receiving the offer or invitation. A public company can escape from the rigor of provisions, if the offer is made by companies mentioned under Section 67(3A), i.e. by public financial institutions specified under Section 4A or by non-banking financial companies referred to in Section 45I(f) of the Reserve Bank of India Act, 1934.

Following situations, it is generally regarded, as not an offer made to public.

- Offer of securities made to less than 50 persons;
- Offer made only to the existing shareholders of the company (Right Issue);
- Offer made to a particular addressee and be accepted only persons to whom it is addressed;
- Offer or invitation being made and it is the domestic concern of those making and receiving the offer.

Resultantly, the Supreme Court concluded that if an offer of securities is made to fifty or more persons, it would be deemed to be a public issue, even if it is of domestic concern or proved that the shares or debentures are not available for subscription or purchase by persons other than those received the offer or invitation.

Obligations of the Issuer in case of a deemed public issue

Section 73(1) of the Companies Act casts an obligation on every company intending to offer shares or debentures to the public to apply on a stock exchange for listing of its securities. Such companies have no option or choice but to list their securities on a recognized stock exchange, once they invite subscription from over forty nine investors from the public. If an unlisted company expresses its intention, by conduct or otherwise, to offer its securities to the public by the issue of a prospectus, the legal obligation to make an application on a recognized stock exchange for listing starts. Sub-section (1A) of Section 73 gives indication of what are the particulars to be stated in such a prospectus. The consequences of not applying for the permission under sub-section (1) of Section 73 or not granting of permission is clearly stipulated in sub-section (3) of Section 73. Obligation to refund the amount collected from the public with interest is also mandatory as per Section 73(2) of the Act.

The Supreme Court acknowledged that from the years 1988 to 2000, private placement of preferential allotment could be made to fifty or more persons if the requirements of Clauses (a) and (b) of Section 67(3) are satisfied. However, after the amendment to the Companies Act, 1956 on 13.12.2000, every private placement made to fifty or more

persons becomes an offer intended for the public and attracts the listing requirements under Section 73(1). Even those issues which satisfy Sections 67(3)(a) and (b) would be treated as an issue to the public if it is issued to fifty or more persons, as per the proviso to Section 67(3) and as per Section 73(1), an application for listing becomes mandatory and a legal requirement. Reading of the proviso to Section 67(3) and Section 73(1) conjointly indicates that any public company which intends to issue shares or debentures to fifty persons or more is legally obliged to make an application for listing its securities on a recognized stock exchange.

Intent of the Issuer to make a public issue

Saharas had vehemently argued that the issuer companies announced loudly and clearly time and again through IM, RHP and application forms that they had no intention to get the OFCDs listed on any recognized stock exchanges in India or abroad.

The Supreme Court observed that listing is a legal responsibility of the company which offers securities to the public, provided offers are made to 50 or more persons. In view of the clear statutory mandate, the contention raised, based on Rule 19 of the SCR Rules framed under the SCR Act, has no basis. Legal obligation flows the moment the company issues the prospectus expressing the intention to offer shares or debentures to the public, that is to make an application to the recognized stock exchange, so that it can deal with the securities. A company cannot be heard to contend that it has no such intention or idea to make an application to the stock exchange. Company's option, choice, election, interest or design does not matter, it is the conduct and action that matters and that is what the law demands. Law judges not what is in their minds but what they have said or written or done. ***Lord Diplock in Gissing vs. Gissing (1971) 1 AC 886,*** has said, As in so many branches of English Law, in which legal rights and obligations depend upon the intention of each party, the relevant intention of each party is the intention which was reasonably understood by the other party to be manifested by that partys words or conduct notwithstanding that he did not consciously formulate that intention in his own mind or even acted with some different intention which he did not communicate to the other party. Lord Simon in ***Crofter Hand Woven Harris Tweed Co. Ltd. vs. Veitch [1942] AC 435,*** opined that in some branches of law, intention may be understood to cover results which may reasonably flow from what is deliberately done, the principle being that a man is to be treated intending the reasonable consequences of his acts.

The maxim “acta exterior indicant interiora secreta” (external action reveals inner secrets) applies with all force in the case of Sahara India Real Estate Corporation Limited and Sahara Housing Investment Corporation Limited on matters of fact as well as law. Conduct and actions of Sahara Group of Companies indicated their intention. Such so called intention must be judged from their subsequent conduct. In the case of Sahara India, the Supreme Court of India observed that subsequent illegality shows that Sahara Group of Companies contemplated illegality. A person’s inner intentions are to be read and understood from his acts and omissions. Whenever, in the application of an enactment, a person’s state of mind is relevant, the above maxim comes into play. (***Ref. Bennion on Statutory Interpretation, 5th Edn., p. 1104***)

State of mind and its manifestation – critical for assessment of corporate conduct

The Supreme Court observed that what is intended is a matter of the mind. Therefore, unless actions speak for themselves, no presumption can be drawn on the intent of a party. Intent as one commonly understands

is something aimed at or wished as a goal; it is something that one resolves to do; it is a will to achieve as an end; it is a direction as one's course; it is planning towards something to be brought about; it is something that an individual fixes the mind upon; it is a design for a particular purpose. When a party expresses its design repeatedly in writing, as it is the case of Saharas, no contrary assumption should normally be drawn. But then, there is also one simple fundamental of law, i.e. that no-one can be presumed or deemed to be intending something, which is contrary to law. Obviously therefore, intent has its limitations also, confining it within the confines of lawfulness. It has already been concluded above, that SIRECL and SHICL had not invited subscriptions to their respective OFCDs by private placement. It has been held, not only inferentially, but also as a matter of law (on an interpretation of section 67 of the Companies Act), as also, as a matter of fact, that the SIRECL and SHICL had called for subscription to their respective OFCDs by way of an invitation to the public. It has also been deduced that an invitation for subscription from the public, could have been made only by way of listing, through one or more recognized stock exchange(s). It has also been concluded that the purpose sought to be achieved by the two companies (relying on section 60B of the Companies Act) by merely complying with the requirements of the procedure contemplated in section 60B of the Companies Act, is not acceptable in law, as section 60B is not a standalone provision. Section 60B of the Companies Act has to be harmoniously read along with other provisions of the Companies Act (as for instance section 67). Saharas must be deemed to have intended to get their securities listed on a recognized stock exchange, because they could only then be considered to have proceeded legally. That being the mandate of law, it cannot be presumed that the Sahara Group of Companies could have intended, what was contrary to the mandatory requirement of law.

Saharas, according to the Supreme Court, did not follow any of those statutory requirements. On a combined reading of the proviso to Section 67(3) and Section 73(1), it is clear that the Saharas had made an offer of OFCDs to fifty persons or more, consequently, the requirement to make an application for listing became obligatory leading to a statutory mandate which they did not follow.

Action taken by SEBI and upheld by SAT in other cases

The Sahara Judgement has been implemented by SEBI in letter and spirit in several other issues of securities. The Securities Appellate Tribunal in Neesa Technologies Limited vs. SEBI (Appeal No. 311 of 2016) observed that "In terms of Section 67(3) of the Companies Act any issue to '50 persons or more' is a public issue and all public issues have to comply with the provisions of Section 56 of Companies Act and ILDS Regulations. Accordingly, in the instant matter the appellant has violated these provisions and their argument that they have issued the NCDs in multiple tranches and no tranche has exceeded 49 people has no meaning".

In the case of "In re Orion Industries Limited" ("OIL")(In re deemed public issue norms) RPS were issued by OIL to 4,191 investors during the financial years 2011-12 and 2012-13 and OIL has raised total amount of ₹ 5,46,48,000. Since, OIL has allotted RPS to more than forty-nine allottees, SEBI concluded that the offer of RPS is a "public issue" within the first proviso of Section 67(3) of Companies Act and OIL was mandated to comply with the 'public issue' norms as prescribed under the Companies Act.

Missed Opportunities:

While the Supreme Court of India laid down the foundational interpretation of what constitutes a 'deemed public offer', the Supreme Court could have also laid down

some principles regarding the corporate law practices or compliance gaps observed in the case:

1. The special resolutions passed by the Sahara Group of Companies did not fulfil the regulatory expectations of the Companies Act insofar as it lacked the specificity or identity of persons to whom the securities were offered on a private placement basis. Interestingly, the Companies Act mentions 'any persons' to whom the shares would be offered on a preferential allotment basis. The language employed by the statute does not permit the resolution to include a 'select group of persons' to be described by a nebulous unidentifiable class of population. The phrase has now found its way to section 42 of the Companies Act, 2013. The essence of a special resolution under s. 81(1A) of CA 1956 (as well as under section 62 of Companies Act, 2013), would be to name the potential allottees so that the shareholders would be aware of the identity and credentials of persons to whom securities would be offered in priority over the existing shareholders and the extent to which the existing shareholders rights would be diluted.

2. There does not seem to be any discussion about the contents and compliance in relation to the explanatory statement attached to the notices convening general meetings of Saharas. It is quite likely that the explanatory statements fell quite short of the legislative expectation under the then applicable law regarding mandatory disclosures.

3. The nature of securities issued were Optionally Fully Convertible Debentures. If these were to be converted into equity shares of the Sahara entities, the authorized share capital ought to have been increased upfront prior to the opening of the subscription to OFCDs as a prudent compliance norm.

4. Raising funds using OFCDs required enhancement of borrowing powers by the Saharas. It is not clear whether the Sahara Group of Companies had passed any resolution seeking a borrowing limit of ₹ 20,000 crore with the paid up capital continuing at a meagre ₹ 10 Lacs.

5. The OFCDs were optionally convertible securities and were unsecured. To this extent, the amount raised by the Saharas would constitute 'deposits' within the meaning of s. 58A of the Companies Act, 1956 and Rules made thereunder. It is not clear whether the non-compliance of the Companies (Acceptance of Deposits) Rules, 1975 was tested by the Registrar of Companies.

6. The debt-equity ratio for SIRECL or SHICL after raising funds through the issue of OFCDs would have been 20,000 crore: 10 Lacs. This would be an obvious recipe for financial disaster or fraud. Such numbers demonstrate for themselves a complete failure by the board of directors to fulfil the fiduciary obligations towards stakeholders.

Section 42 of the Companies Act, 2013

The concept of 'deemed public issue' as well as mandatory listing requirements have been included under section 42 of the Companies Act, 2013. Under s. 42, a private placement can be made only to 'identified persons' and the total number of such identified persons cannot exceed 200 in a financial year. The interpretative guidance provided by the Supreme Court of India in the Sahara Judgement continues to apply with full force and effect.

Ajay Singh
Advocate

"Loan" and "Deposit" Under Income Tax Act, 1961

The Term ***"Loan" and "Deposit"*** has been referred to in various sections of the Income Tax Act 1961 in different context and purpose. Whether 'deposits' are synonymous with '*loans and advances*' and whether the same be used interchangeably? The terms have to be interpreted considering the object and purpose of the provision.

In the accounting terminology both the terms, namely, *'loan' and 'deposit'* differ materially from each other, both are not the same and are mutually exclusive.

(i) Deposit - The Encyclopaedic Law Dictionary, Second Edn., page 213, defines 'deposit', as under:

"The deposit and loan are mutually exclusive in a sense, a deposit is a loan with the difference that it is a loan with something more. Both are debts repayable. But the point of time when repayment is to be made furnishes the real point of distinction. A loan is repayable the moment it is incurred.

But this is not the case with a deposit. There is no immediate obligation to repay the deposit. A deposit is to keep the money till asked for."

(ii) Loan – According to the Encyclopaedic Law Dictionary page 439, the distinction between loan and deposit is that in the case of a loan, it is ordinarily the duty of the debtor to seek out the creditor and to pay the money according to the agreement. In the case of a deposit, it is the duty of the depositor to go to the depositee and to make a demand for the same.

In the case of ***Housing & Urban Development Corporation Ltd. vs. Jt. CIT [2006] 5 SOT 918 (Delhi) (SB),*** the difference between loan and deposit was expressed by the Special Bench as under:

"*the two expressions loans and deposits are to be taken different and the distinction can be summed up by stating that* ***in the case of loan, the needy person approaches the lender for obtaining the loan therefrom.*** *The loan is clearly lent at the terms stated by the lender.* ***In the case of deposit, however, the depositor goes to the depositee for investing***

his money primarily with the intention of earning interest.

The term loans or deposit has not been defined under the definition clause of the Income-tax Act, 1961 ('the Act'). However, the term interest is defined under section 2(28A) of the Act which reads under:

(28A) "interest" means interest payable in any manner in respect of any moneys borrowed or debt incurred (including a deposit, claim or other similar right or obligation) and includes any service fee or other charge in respect of the moneys borrowed or debt incurred or in respect of any credit facility which has not been utilised ;

The aforesaid definition shall help in understanding/interpret the term loan and deposit for the purpose of the Act. Interest is a term relating to a pre-existing debt, which implies a debtor-creditor relationship.

Unpaid consideration gives rise to a lien over goods sold and not for money lent. This interpretation is supported by the decision in ***Bombay Steam Navigation Co (1953) Pvt Ltd vs. CIT (1963) 56 ITR 52 (SC),*** where interest on unpaid purchase price was not treated as interest on the loan. It is clear from the definition that before any amount paid is construed as interest, it has to be established that the same is payable in respect of any money borrowed or debt incurred.

Where a property was sold in a public auction with the purchaser being allowed to pay the purchase price in instalments and in the interim, was granted possession of the property as a lessee subject to payment of interest on the amount to be paid in instalments till the time of issuance of sale certificate, such interest was held to be a part of the sale consideration and it could only be treated as taxable under the head capital gains in the hands of the seller, as was decided in ***Cauvery Spinning and Weaving Mills Ltd (In Liquidation) DCIT (2012) 340 ITR 550 (Mad).*** In a similar case, the interest paid to allottees of flats for amounts deposited by them due to delayed allotment of flats by the Housing Board was held to be not interest falling under section 2(28A) for purposes of tax deduction at source under section 194A. [***CIT vs. H P Housing Board (2012) 340 ITR 388 (HP)***]

Any payment in the nature of a fee paid to a middleman who arranges or facilitates a loan is not an amount paid to the lender and is not part of a debt or a loan. It is a payment for managerial or consulting service, to be not taxable as interest under section 2(28A) or technical fee under section 9(1)(vii) [***Idea Cellular Ltd vs. DIT (Asst) (International Taxation) (2015) 41 ITR (Trib) 338(Mum)***]

In the case of ***Mohan Karkare vs. Dy. CIT [1995] 52 ITD 236 (Indore)*** – the father of the Assessee provided ₹ 70,000 to the assessee so that he may settle down in life. This amount was held to be neither a loan nor a deposit and there was nothing to suggest that the assessee was under an obligation to return the amount.

Penal Provisions

According to clause (iii) of Explanation to section 269T, 'loan or deposit' means any loan or deposit of money which is repayable after notice or repayable after a period and, in the case of a person other than a company, includes loan or deposit of any name.

Further, as per clause (iii) of Explanation to the section 269SS of the Act

"loan or deposit" means loan or deposit of money;

The above-stated Explanation was inserted by the Finance Act, 2003, with retrospective effect from June 1, 2002.

These provisions deal with the mode of taking or accepting certain loans or deposits and specified sum and repayment of the same. If a person fails to comply with the provision, such person shall be liable for penalty u/s. 271D and 271E of the Act. The provision was brought on the statute to counteract evasion of tax. The scope and rationale behind the introduction of these sections have been explained by the Board in ***Circular no 387 dated 6th July 1984 (1985) 152 ITR St 22.***

In the context of the above-referred provision, there is a clear distinction between a deposit and a loan and as per the statute, i.e. the Finance Act, 2002, the term 'loan' was inserted in the provisions of section 269T with retrospective effect from June 1, 2002. Further, 'deposit' is not synonymous with 'loan' for the purpose of sections 269T and 271E. 'Loan' came within the purview of section 269T in June 2002 and penalty provisions of section 271E only after amendment by the Finance Act, 2003. The amendment was not simply clarificatory. The fact that there was no change in the meaning assigned to the term 'deposit' in the Explanation is wholly inconsequential. Reference can be made to the decision of Delhi High Court in case of ***CIT vs. Vikramajit Singh [2007] 292 ITR 274/ 158 Taxman 360 (Delhi).***

Further, Earnest Money is not a loan or deposit for the purpose of levy of penalty u/s. 271E as held in the case of ***Commissioner of Income-tax –VI vs. Madhav Enterprise (P.) Ltd. [2013] 356 ITR 588 (Gujarat)***

Deeming Provisions

The word 'income' is defined in section 2(24) and includes dividends. Sub-section (22) of Section 2 defines the term "Dividend" in an inclusive manner. It not only includes dividends in general parlance but also includes certain specific distributions/ payments within its sweep. Clause (e) is one of the clauses whereby the payment of a loan or an advance by a company, not being a company in which the public is substantially interested, is considered to be dividend subject to certain conditions. The clause is an anti-abuse provision in as much as a loan or an advance given by a closely held company to a shareholder having substantial interest or to a concern in which such shareholder is having substantial interest, may be taxed as deemed dividend". Such loans or advances can be taxed to the extent of accumulated profits of the company. A similar provision was also there in the 1922 Act in section 2(6A)(e).

'Dividend' in its ordinary meaning is a distributive share of the profits or income of a company given to its shareholders [***Kantilal Manilal vs. CIT (1996) 41 ITR 275 (SC)***]. It is a sum of money or portion of divisible thing to be distributed according to a fixed scheme being what the shareholder earns as return on his investment; it is his share of corporate earnings credited to his account.

The term 'dividend' is defined in clause (22) of section 2 as inclusive of various items and exclusive of certain others. It means dividend as normally understood and includes in its connotation several other receipts set out in the definition.

Under this clause, certain amounts which are actually not distributed are brought within the net of 'dividend' for the purpose of taxability. Therefore, it must receive a strict interpretation [***CIT vs. Martin Burn Ltd (1982) 136 ITR 805 (SC)***].

Where the managing director used a low-paid employee to obtain a loan from a mill and

pass it on to him, the provisions of section 2(22) were applicable in the hands of the assessee managing director on the ground that the loan taken by the employee was actually on behalf of and for benefit of the assessee. ***[Alagusundaram Chettiar (L) vs. CIT (2001) 252 ITR 893 (SC)]***

Where loans are granted by a money-lending company to its shareholders in the ordinary course of its business, such loans would not be 'dividend' within the meaning of sub-clause (e). Where loans are granted by such a company to its shareholders, not in the ordinary course of its business, but are so arranged as to defeat tax liability, such loans would still be treated as dividends and would be liable to tax. It follows that where the company has no money lending activity, a loan falls under the purview of deemed dividend.

In ***Rugmini Ram Ragav Spinners (P.) Ltd.'s case ([2008] 304 ITR 417 (Madras)*** the assessee had received cash, over a period of time, as an advance towards allotment of shares from 16 persons without stipulating any time for frame to return/refund of money without interest, in case of non-allotment of shares either fully or partly. During the year, the assessee had repaid some of the share application money that it had received earlier in cash violating the provisions of section 271E. The Madras High Court held that the money retained by the company was neither a deposit nor a loan, but it was only a return of share capital advance and hence, penalty under section 271E could not be levied.

Conclusion

Thus, on the basis of overall view of the issue and decisions or orders discussed above, it is clear that Loan and deposit have been used in the Act with a specific objective or purpose and therefore, cannot mean as understood under general parlance.

The fact that the term 'deposit' cannot mean a 'loan' and that the terms 'loan' and 'deposit' are two different distinct terms is evident from the Explanation to section 269T as also section 269SS of the Act where both the terms are used. Once it is an accepted fact that the terms 'loan' and 'deposit' are two distinct terms which have distinct meanings then if only the term 'loan' is used in a particular section, the deposit received by an assessee cannot be treated as a 'loan' for that section.

Reference is made to the decision in the case of ***Durga Prasad Mandelia vs. Registrar of Companies [1987] 61 Comp. Cas. 479 (Bom.)*** which settled all controversies by pointing out the distinction between 'deposits' and 'loans' in the context of section 370 of the Companies Act, 1956.

Thus, under 'loans and advances' it is the borrower who approaches the lender for borrowing money. However, to be termed as 'deposit' it is the person advancing the money, who approaches the borrower.

"You cannot believe in God until you believe in yourself."

— *Swami Vivekananda*

CA Bhavesh Vora

What is Deposit under NBFCs/HFCs?

When we hear the word "Deposit", what we understand is any money or property given as a security or collateral for safekeeping. There are many examples of Deposit in our day-to-day life, we give deposit to our goods and services suppliers/vendors in the form of electricity deposit, rent deposit, telephone deposit, etc.

In financial markets the word "Deposit" has altogether a very different meaning and is defined differently under various Regulations. While there are two types of Bank deposits, viz. Time Deposit and Demand Deposit, only certain NBFCs/HFCs are permitted to accept Deposits and that too only of the nature of Time Deposits.

The regulatory environment for a Deposit accepting NBFC/HFC w.r.t. Deposits is primarily governed by following Regulations:

A. Provisions of Companies Act, 2013

B. Reserve Bank of India Act, 1934

C. Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 2016

D. Non-Banking Financial Company – Housing Finance Company (Reserve Bank) Directions, 2021

The relevant extracts of the definitions of "Deposit" are as under:

1) Section 2(31) of Companies Act 2013 defines deposit as "deposit includes any receipt of money by way of deposit or loan or in any other form by a company, but does not include such categories of amount as may be prescribed in consultation with the Reserve Bank of India"

   The provisions of Chapter V of the Companies Act, 2013 deals with the aspect of Acceptance of Deposits by Companies.

2) Section 45I(bb) of RBI Act, 1934 defines deposit as "deposit includes and shall be deemed always to have included any receipt of money by way of deposit or loan or in any other form, but does not include-

   (i) amounts raised by way of share capital;

(ii) amounts contributed as capital by partners of a firm

(iii) amounts received from a scheduled bank or a co-operative bank or any other banking company as defined in clause (c) of section 5 of the Banking Regulation Act, 1949

(iv) any amount received from: -

a. a State Financial Corporation,

b. any financial institution specified in or under section 6A of the Industrial Development Bank of India Act, 1964

c. any other institution that may be specified by the Bank in this behalf:

(v) amounts received in the ordinary course of business, by way of–

a. security deposit

b. dealership deposit

c. earnest money

d. advance against orders for goods, properties or services

(vi) any amount received from an individual or a firm or an association of individuals not being a body corporate, registered under any enactment relating to money lending which is for the time being in force in any State

(vii) any amount received by way of subscriptions in respect of a chit.

Explanation I: ''Chit'' has the meaning assigned to it in clause (b) of section 2 of the Chit Funds Act, 1982.

Explanation II: Any credit given by a seller to a buyer on the sale of any property (whether movable or immovable) shall not be deemed to be deposit for the purposes of this clause.

3) Reserve Bank of India, in Para 3(xiii) of its Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 2016 & Para 4.1.30 in its Non-Banking Financial Companies – Housing Finance Company Reserve Bank) Directions, 2021 defines "Public Deposits" as under:

"public deposit" means a deposit as defined under section 45-I(bb) of the Reserve Bank of India Act, 1934 (as defined in 2 above), excluding the following:

a. any amount received from the Central Government or a State Government or any amount received from any other source and whose repayment is guaranteed by the Central Government or a State Government or any amount received from a local authority or a foreign Government or any other foreign citizen, authority or person;

b. any amount received from the Industrial Development Bank of India established under the Industrial Development Bank of India Act, 1964, or the Life Insurance Corporation of India established under the Life Insurance Corporation Act, 1956 (Act 31 of 1956), or the General Insurance Corporation of India and its subsidiaries established in pursuance of the provisions of section 9 of the General Insurance

Business (Nationalisation) Act, 1972 (Act 57 of 1972), or the Small Industries Development Bank of India established under the Small Industries Development Bank of India Act, 1989, or the Unit Trust of India established under the Unit Trust of India Act, 1963, or National Bank for Agriculture and Rural Development established under the National Bank for Agriculture and Rural Development Act, 1982, or an Electricity Board constituted under the Electricity (Supply) Act, 1948, or the Tamil Nadu Industrial Investment Corporation Ltd., or the National Industrial Development Corporation of India Ltd., or the Rehabilitation Industries Corporation of India Ltd., or the Industrial Credit & Investment Corporation of India Ltd., or the Industrial Finance Corporation of India Ltd., or the Industrial Investment Bank of India Ltd., or the State Trading Corporation of India Ltd., or the Rural Electrification Corporation Ltd., or the Minerals and Metals Trading Corporation of India Ltd., or the Agricultural Finance Corporation Ltd., or the State Industrial and Investment Corporation of Maharashtra Ltd., or the Gujarat Industrial Investment Corporation Ltd., or Asian Development Bank or International Finance Corporation or a company incorporated under the Companies Act, 1956 (Act 1 of 1956); or a Corporation established by or under any Statute; or a cooperative society registered under the Cooperative Societies Act of any State and any other institution that may be specified by RBI in this behalf;

c. *any amount received by a company from any other company;*

d. *any amount received and held pursuant to an offer made in accordance with the provisions of the Companies Act, 2013, towards subscription to any securities, including share application money or advance towards allotment of securities pending allotment, to such extent and for such period as permissible under the Companies (Acceptance of Deposit) Rules, 2014 and as amended from time to time;*

e. *any amount received from a person who at the time of receipt of the amount was a director of the company or any amount received from its shareholders by a private company or by a private company which has become a public company under section 43A of the Companies Act, 1956 and continues to include in its Articles of Association provisions relating to the matters specified in clause (iii) of sub-section (1) of section 3 of the Companies Act, 1956 (Act 1 of 1956):*

***Provided** that the director or shareholder, as the case may be, from whom the money is received furnishes to the company at the time of giving the money, a declaration in writing to the effect that the amount is not being given out of funds acquired by him by borrowing or accepting from others;*

Provided further, *that in the case of joint shareholders of a private company, monies received from or in the name of the joint shareholders except the first named shareholder shall not be eligible to be treated as the receipt of money from the shareholder of the company;*

f. *any amount raised by the issue of bonds or debentures secured by the mortgage of any immovable property of the company; or by any other asset or which would be compulsorily convertible into equity in the company provided that in the case of such bonds or debentures secured by the mortgage of any immovable property or secured by other assets, the amount of such bonds or debentures shall not exceed the market value of such immovable property/other assets;*

g. *any amount raised by issuance of non-convertible debentures with a maturity more than one year and having the minimum subscription per investor at Rs.1 crore and above, provided that such debentures have been issued in accordance with the guidelines issued by the Bank as in force from time to time in respect of such non-convertible debentures.*

h. *any amount brought in by the promoters by way of unsecured loan in pursuance of stipulations of lending institutions subject to the fulfilment of the following conditions, namely:*

(i) *the loan is brought in pursuance of the stipulation imposed by the lending public financial institution in fulfilment of the obligation of the promoters to contribute such finance,*

(ii) *the loan is provided by the promoters themselves and/or by their relatives, and not from their friends and business associates, and*

(iii) *the exemption under this sub-clause shall be available only till the loan of financial institution is repaid and not thereafter;*

i. *any amount received from a Mutual Fund which is governed by the Securities and Exchange Board of India (Mutual Funds) Regulations, 1996;*

j. *any amount received as hybrid debt or subordinated debt the minimum maturity period of which is not less than sixty months provided there is no option for recall by the issuer within the period;*

k. *any amount received from a relative of a director of the NBFC.*

Note*: The deposit shall be accepted only on an application made by the depositor containing therein that as on the date of deposit, he is related to the specific director in the capacity of a relative as defined under Companies Act, 1956;*

l. *any amount received by issuance of commercial paper, in accordance with the guidelines issued by the Bank, vide Circular No.IECD.3/08.15.01/2000-2001 dated October 10, 2000;*

m. *any amount received by a Systemically important non-deposit*

taking nonbanking financial company by issuance of 'perpetual debt instruments' in accordance with guidelines issued in this regard by the Bank and as amended from time to time;

n. *any amount raised by the issue of infrastructure bonds by an Infrastructure Finance Company, as specified in the notification issued from time to time by the Central Government under section 80CCF of the Income Tax Act, 1961.*

As can be seen above, the definition of "Deposit" and "Public Deposit" is very wide and comprehensive. For NBFCs/HFCs accepting Deposits, stringent regulations such as Rating Requirements, Prudential Norms, Corporate governance, Liquidity Norms, Disclosure Norms, etc. have been prescribed by RBI.

It may be noted that all NBFCs/HFCs are not entitled to accept public deposits. Only those NBFCs to which the RBI has given a specific authorization and have an investment grade rating are allowed to accept/hold public deposits, that too up to a prescribed limit based on Net Owned Fund.

Apart from specific directions for NBFCs/HFCs above, other regulatory provisions have been prescribed for regulating acceptance of deposits by entities other than a Company, namely Section 45 S of the Reserve Bank of India Act, 1934 as well as the Banning of Unregulated Deposit Schemes Act, 2019. The respective states have also enacted laws governing the acceptance of deposits.

Unincorporated bodies like individuals, partnership firms, and other association of individuals are prohibited from carrying on the business of acceptance of deposits as their principal business. Such unincorporated bodies are prohibited from even accepting deposits if they are carrying on financial business. For non-deposit taking NBFCs, Para 107 of "Non-Banking Financial Company - Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016", provides for raising the money through Private Placement of Debentures by applicable NBFCs.

Reserve Bank of India's overarching concern while supervising any financial entity is protection of depositors' interest. Depositors place deposit with any entity on trust unlike an investor who invests in the shares of a company with the intention of sharing the risk as well as return with the promoters. Protection of depositors' interest thus is supreme for the financial regulator. As of now only 49 NBFCs (Including HFCs and others) as on 31st July 2022 permitted to accept deposits. Given the regulatory arbitrage between Banks and NBFCs, RBI has slowly but surely restricted the Deposit acceptance amongst NBFCs and no new license has been issued for deposit taking NBFCs from 1997.

"Neither seek nor avoid, take what comes."

— *Swami Vivekananda*

CS Dipti Chheda

Deposit: Private Companies

Background

Deposits are one of the sources available to a company to raise funds to meet the short term or long term requirements of the company. Section 73 to 76 of the Companies Act, 2013 read with Companies (Acceptance of Deposits) Rules, 2014 made under Chapter V of the Act regulate the invitation and acceptance of deposits. In addition, the Act provides for stringent penalty for any violation in complying with the provisions of this Act.

Every deposit accepted by a company under section 73(2) of the Companies Act, 2013 shall be repaid with interest, following the terms and conditions of the agreement. However, to protect the interest of the depositors and to stop the malpractices adopted by companies accepting deposits, Companies can accept the Deposits subject to condition mentioned under the companies Act, 2013 read with Companies (Acceptance of Deposit) Rules, 2014 (herein after called 'the Rules') made under Chapter V.

Deposit in general sense means

- A deposit is money you put into your bank account.
- You should deposit money in a bank to create savings and earn interest on it.
- A demand deposit is made for funds you can withdraw anytime.
- A time deposit is a long-term investment.
- A deposit could also be the collateral amount you pay when you take on a loan.
- One definition of deposit refers to when a portion of funds is used as security or collateral for the delivery of goods or services.

Meaning of Deposit under Companies Act 2013

Section 2 (31) of Companies Act and Rule 2(1)(v) defines deposit as 'Deposit' includes any receipt of money by way of deposit or

loan or in any other form, by a company but does not include such categories of amount as may be prescribed in consultation with the Reserve Bank of India.

Definition of Deposit as per the Rule (Acceptance of Deposits) Rules, 2014

MCA vide notification No. G.S.R 256(E) dated 31.03.2014 notified Companies (Acceptance of Deposits) Rules, 2014 with effect from 1st day of April, 2014. Deposit includes any receipt of money by way of deposit or loan or in any other form, by a company, but does not include amount received and falling under the category prescribed by the RBI –

(i) ***Receipt from Government/Statutory Authorities***

Any amount received from the Central Government or a State Government, a local authority, or a statutory authority constituted under an Act of Parliament or a State Legislature or any amount received from any other source whose repayment is guaranteed by the Central Government or a State Government;

(ii) ***Receipt from foreign Governments, foreign or international banks, multilateral financial institutions***

Any amount received from foreign Governments, foreign or international banks, multilateral financial institutions, foreign Governments owned development financial institutions, foreign export credit agencies, foreign collaborators, foreign bodies corporate and foreign citizens, foreign authorities or persons resident outside India subject to the provisions of Foreign Exchange Management Act, 1999;

(iii) ***Loan or facility from any banking company***

Any amount received as a loan or facility from any banking company, or a corresponding new bank, or from a co-operative bank as;

iv) ***Loan or financial assistance from Public Financial Institutions***

Any amount received as a loan or financial assistance from the notified Public Financial Institutions or any regional financial institutions or Insurance Companies or Scheduled;

(v) ***Commercial paper***

Any amount received against issue of commercial paper or any other instruments issued in accordance with the guidelines or notification issued by the Reserve Bank of India;

(vi) ***Intercorporate Loan***

Any amount received by a company from any other company;

(vii) ***Receipt of Share application money or advance towards allotment of Securities***

Any amount received and held pursuant to an offer made in accordance with the provisions of the Act towards subscription to any securities, including share application money or advance towards allotment of securities pending allotment, so long as such amount is appropriated only against the amount due on allotment of the securities applied for.

However, If the securities for which application money or advance for

such securities was received cannot be allotted within sixty days from the date of receipt of the application money or advance for such securities and such application money or advance is not refunded to the subscribers within fifteen days from the date of completion of sixty days, such amount shall be treated as a deposit under these rules. Further, any adjustment of the amount for any other purpose shall not be treated as refund.

(viii) any amount received from a person who, at the time of the receipt of the amount, was a director of the company: Provided that the director from whom money is received, furnishes to the company at the time of giving the money, a declaration in writing to the effect that the amount is not being given out of funds acquired by him by borrowing or accepting loans or deposits from others;

(ix) any amount raised by the issue of bonds or debentures secured by a first charge or a charge ranking pari passu with the first charge on any assets referred to in Schedule III of the Act excluding intangible assets of the company or bonds or debentures compulsorily convertible into shares of the company within five years: Provided that if such bonds or debentures are secured by the charge of any assets referred to in Schedule III of the Act, excluding intangible assets, the amount of such bonds or debentures shall not exceed the market value of such assets as assessed by a registered valuer;

(x) Receipt of money from Employee of the company

Any amount received from an employee of the company not exceeding his annual salary under a contract of employment with the company in the nature of non-interest bearing security deposit;

(xi) Non-interest bearing sums or sums held in trust

Any non-interest bearing amount received or any sums which are held in trust;

(xii) Sums received for business purposes

Any amount received in the course of, or for the purposes of, the business of the company:

(a) as an advance for the supply of goods or provision of services accounted for in any manner whatsoever provided that such advance is appropriated against supply of goods or provision of services within a period of three hundred and sixty five days from the date of acceptance of such advance:

However, that in case of any advance which is subject matter of any legal proceedings before any court of law, the said time limit of three hundred and sixty five days shall not apply.

(b) as advance, accounted for in any manner whatsoever, received in connection with consideration for property under an agreement or arrangement, that such advance is adjusted against the property in accordance with the terms of agreement or arrangement;

(c) as security deposit for the performance of the contract for

supply of goods or provision of services;

(d) as advance received under long term projects for supply of capital goods except those covered under item (b) above:

However, that if the above specified sums becomes refundable (with or without interest) due to the reasons that the company accepting the money does not have necessary permission or approval, wherever required, to deal in the goods or properties or services for which the money is taken, then the amount received shall be deemed to be a deposit under these rules on the expiry of fifteen days from the date they become due for refund.

(xiii) Receipt of Money from Promoters

Any amount brought in by **the promoters of the company** by way of unsecured loan in pursuance of the stipulation of any lending financial institution or a bank subject to fulfilment of the following conditions,

(a) the loan is brought in pursuance of the stipulation imposed by the lending institutions on the promoters to contribute such finance;

(b) the loan is provided by the promoters themselves or by their relatives or by both; and

(c) the exemption under this sub-clause shall be available only till the loans of financial institution or bank are repaid and not thereafter;

(xiv) Receipts by Nidhi Company

Any amount **accepted by a Nidhi company u/s 406 of the Act.-**

(a) received by the company, whether in the form of instalments or otherwise, from a person with promise or offer to give returns, in cash or in kind, on completion of the period specified in the promise or offer, or earlier, accounted for in any manner whatsoever, or

(b) any additional contributions, over and above the amount under item (a) above, made by the company as part of such promise or offer, shall be treated as a deposit;

Non applicability of rule

Section 73-76 of the Companies Act, 2013 contains provisions regarding the acceptance of deposits that apply to all companies barring a few. The above rule is not applicable to the following companies.

i) a banking company;

ii) a non-banking financial company as defined in the Reserve Bank of India Act, 1934 (2 of 1934) registered with the Reserve Bank of India;

iii) a housing finance company registered with the National Housing Bank established under the National Housing Bank Act, 1987 (53 of 1987); and

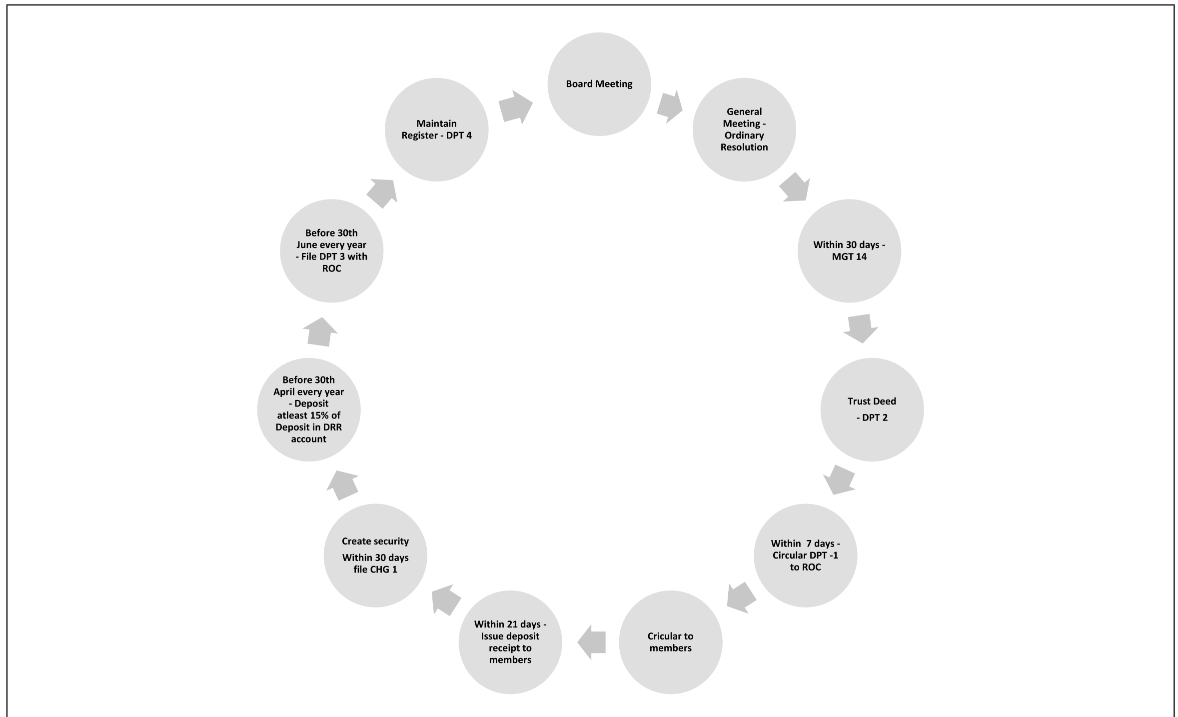
iv) a company specified by the Central Government under the proviso to sub-section (1) of section 73 of the Act.

Any amount received, not treated as deposit, to be disclosed by the company in return of Deposit- DPT-3 and to be filed with Registrar on or before 30th June every year. In case form is not filed within the due date, Form

can be filed post due date along with the applicable late fees.

Act provides that private company should prohibit any invitation to the public to subscribe for any securities of the company. Accordingly, private company can invite and accept deposit from its members only.

How Private Company can invite and accept deposits from its members of the company



The companies intending to invite deposits from its members shall convene a Board meeting to consider and approve the business to propose and accept deposits from members and decide the day, date, time and place of the general meeting.

Issue notice of general meeting to the members of the company

Pass the Resolution in the general Meeting to accept the deposits from the members subject to the fulfilment of the following conditions

a) Issuance of a circular to its members;

b) Filing a copy of the circular along with such statement with the Registrar within thirty days before the date of issue of the circular;

c) Depositing, on or before the 30th day of April each year, such sum which shall not be less than fifteen per cent of the amount of its deposits maturing during the following financial year and kept in a scheduled bank in a separate bank account to be called deposit repayment reserve account and the amount so deposited shall not be utilised for any purpose other than for the repayment of deposits;

Provided that the amount remaining deposited shall not at any time fall below twenty percent of the amount of deposits maturing during the financial year.

d) Certifying that the company has not committed any default in the repayment of deposits accepted either before or after the commencement of this Act or payment of interest on such deposits and where a default had occurred, the company made good the default and a period of five years had lapsed since the date of making good the default and

e) Arranging for the security, if any for the due repayment of the amount of deposit or the interest thereon including the creation of such charge on the property or assets of the company. The Companies inviting secured deposits u/s 73 shall create a charge on its assets, as appearing in the balance sheet under Schedule III, excluding intangible assets for the due repayment of the amount of deposit and interest thereon. Such security (not being pledge), either on movable or immovable property, shall be created in favour of a trustee for the deposit holders. Provided that the amount of such deposit (principal and interest) shall not exceed the market value of the assets on which charge was created. The company shall also ensure that the total value of deposit (principal and interest) is secured by way of creation of charge on the assets. However, in case where a company does not secure the deposits or secures such deposits partially, then, the deposits shall be termed as "unsecured deposits" and shall be so quoted in every circular, form, advertisement or in any document related to invitation or acceptance of deposits.

Exemption for the Private Company:
Above mentioned point no. (a) to (e) shall not apply to private company :-

A. Which accepts from its members monies not exceeding one hundred per cent of aggregate of the paid up share capital, free reserves and securities premium account; or

B. Which is a start-up, for five years from the date of its incorporation; or

C. Which fulfils all of the following conditions:-

- which is not an associate or a subsidiary company of any other company;
- if the borrowings of such a company from banks or financial institutions or any body corporate is less than twice of its paid up share capital or fifty crore rupees, whichever is lower; and
- such a company has not defaulted in the repayment of such borrowings subsisting at the time of accepting deposits under this section:

However, the company referred to in clauses (A), (B) or (C) shall file the details of monies accepted to the Registrar in such manner In the 'Return of Deposit' in the form DPT-3 with Registrar on or before 30th June every year.

f) **Term/ Tenure of Deposit**
Companies shall not accept / renew deposits repayable on demand or upon

receiving a notice within a period of less than 6 months or more than 36 months from the date of acceptance / renewal. The company may accept / renew deposits for less than 6 months, if :-

1. Such deposits do not exceed 10% of aggregate share capital and free reserves; and
2. Minimum tenure of be 3 months

g) **Rate of Interest:**

Rate of interest paid on deposits shall not exceed the maximum rate prescribed by RBI for acceptance of deposits by NBFCs.

h) No terms or conditions of the deposit or trust deed shall be altered or modified after circular is issued and deposits are accepted.

Checklist while Taking Deposit

Board Meeting	Whether the Board Meeting is conducted as per the provision of law
General Meeting	Whether Notice, Approval of Members for Acceptance of Deposits
MGT-14	Whether MGT-14 is filed within 30 days of passing the resolution
Circular Filed with ROC	DPT-1, Filed at least 30 days before the issue
Circular issued to members- Effective date of the circular is the date on which the circular is dispatched.	Validity of circular is 6 months from the last day of the financial year / date on which Financial Statements laid at Annual General Meeting/last date on which the AGM supposed to be held, whichever is earlier
Creation of security	The company shall also ensure that the total value of deposit (principal + interest) is secured by way of creation of charge on the assets.
CHG-1	File CHG-1 with ROC within 30 days of creation of charge.
Trustee	Whether Trustee for Deposits are appointed, wherever applicable.
Trust Deed	Whether DPT-2, executed at least 7 days before the issue of circular
Return of Deposit	On or before the 30th day of June of every year, file with the Registrar, a return in Form DPT-3 and furnish the information contained therein as on the 31st day of March of that year duly audited by the auditor of the company.
Register of Deposit	Shall maintain a register of deposits- DPT-4, entering particulars of each depositor, within 7 days of issue of the deposit receipt.
Issue of Deposit Receipt	Within 21 days of the acceptance of deposit, issue deposit receipt to Depositor, signed by authorised person.

Appointment of Debenture Trustee

Unless the company has appointed one or more trustees for depositors for creating security for the deposits, not eligible to issue a circular or advertisement inviting secured deposits

The Company need to obtain a written consent from the trustee for depositors before their appointment and a statement shall appear in the circular or circular in the form of advertisement with reasonable prominence to the effect that the trustees for depositors have given their consent to the company to be so appointed.

The company shall execute a deposit trust deed in Form DPT-2 at least seven days before issuing the circular or circular in the form of advertisement.

No person including a company that is in the business of providing trusteeship services shall be appointed as a trustee for the depositors, if the proposed trustee –

(a) is a director, key managerial personnel or any other officer or an employee of the company or of its holding, subsidiary or associate company or a depositor in the company;

(b) is indebted to the company, or its subsidiary or its holding or associate company or a subsidiary of such holding company;

(c) has any material pecuniary relationship with the company;

(d) has entered into any guarantee arrangement in respect of principal debts secured by the deposits or interest thereon;

(e) is related to any person specified in clause (a) above.

Money received from following person is treated as Loan and not as Deposits

Sr. No.	*Loan From*	*Private Company*
1.	Director	Rule 3(1)(viii) Yes, can accept, but the director will give a Declaration in writing that money is not given out of borrowed funds and company will disclose it in the Board's report.
2	Relative of Director	Rule 3(1)(viii) Yes, can accept, but the relative will give a Declaration in writing that money is not given out of borrowed funds and company will disclose it in the Board's report.
3.	Employee	Yes, can accept up to the employee’s annual salary (there should be a contract of employment with the company) in the nature of non- interest bearing security deposit.
4.	Any other Individual	Can’t accept because it is prohibited by the definition of Private Company.

Sr. No.	*Loan From*	*Private Company*
5.	Proprietorship Firm	Can't accept because it can't be director, Member or relative of Director.
6.	HUF	Can't accept because it can't be director, Member or relative of Director.
7.	Partnership Firm	Can't accept because it can't be director, Member or relative of Director.
8.	Any Company	Yes, can accept
9.	Banks	Yes, can accept
10.	Trust	Yes, can accept, but loan received should be non-interest bearing.
11.	Outside India	Yes, can accept, but subject to the provisions of the Foreign Exchange Management Act, 1999 and rules and regulations made there under.
12.	Govt. Organization	Yes, can accept

Clarification on Receipt of Money from Directors or relative of Director

Money accepted from directors and relatives of the directors of the company, is not considered as deposits so a private company can accept money from directors without attracting the provisions of deposits.

The director of the company or relative of the director of the private company, as the case may be, from whom money is received, has to furnish a declaration in writing, at the time of giving money, to the effect that the amount is not being given out of funds acquired by him by borrowing or accepting loans or deposits from others and the company shall disclose the details of money so accepted in the Board's report.

Limit on quantum of deposits from members

Private companies cannot accept monies exceeding 100% of aggregate of the paid up capital, free reserves and securities premium account.

Limit is not applicable in case of specified private companies. The maximum limit in respect of deposits to be accepted from members shall not apply to following classes of private companies:-

(i) a private company which is a start-up, for five years from the date of its incorporation;

(ii) a private company which fulfils all of the following conditions, namely:-

   (a) which is not an associate or a subsidiary company of any other company;

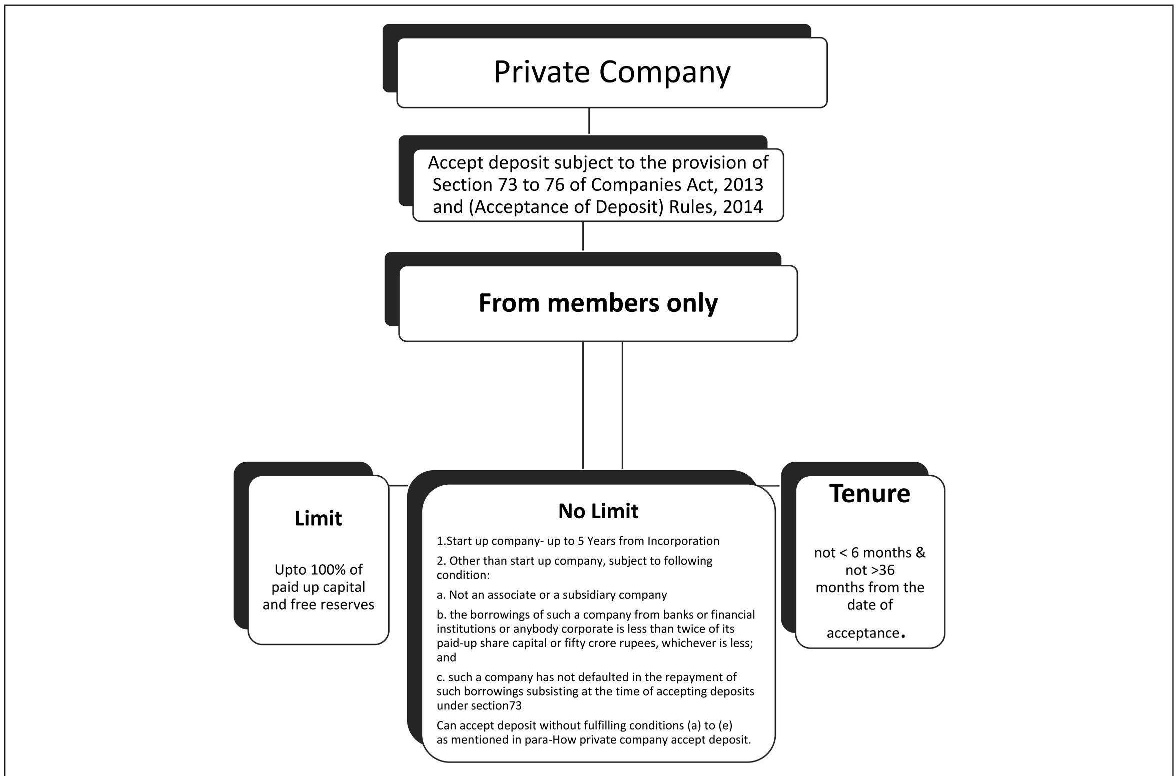
   (b) the borrowings of such a company from banks or financial institutions or any body corporate is less than twice of its paid up share capital or fifty crore rupees, whichever is less; and

   (c) such a company has not defaulted in the repayment of

such borrowings subsisting at the time of accepting deposits under section 73:

However all these companies accepting deposits shall file the details of monies so accepted to the Registrar in Form DPT-3.

Thus the law allows Directors to borrow the money in the form of Deposits from the members to meet the short term fund requirement subject to terms and condition for which Deposit receipt is issued and repay the same with the interest as per the terms and condition of the same.



However every company has to comply with Tenure, Rate of Interest, Return of Deposit (DPT-1), Register of Deposit (DPT-4). Further every deposit accepted by a company under shall be repaid with interest following the terms and conditions of the agreement. DPT-3 Form is return of deposits including exempted deposit. It contains various information like share capital, reserves and surplus, deposits at the beginning of year, credit rating details etc., transactions (increase/decrease/maturities) in deposits during the year, deposits at the end of year, details of sums not treated as deposits, particulars of liquid assets, details of charge, ageing of loans/deposits (including exempted deposits), etc.

Deposit Form DPT-3 has been recently modified vide Notification dated 29th August, 2022. Now form shall contain information therein as on 31st day of March of that year duly audited by auditor of the company and

declaration to that effect shall be submitted by the auditor in Form DPT-3.

Further In the Form DPT 3 and Form DPT-4 further information is to be provided viz. as on Maximum limit of deposits (i.e. 35% of the above in case of all companies other than specified IFSC public companies and private companies), of deposit holders at the beginning of the Financial Year as well as at the end of the Financial Year, Particulars of Deposits existing as on 1st April, amount of deposits renewed during the year, Amount of deposits accepted during the year, Secured deposits, Unsecured deposits, Amount of deposits repaid during the year, Balance of deposits outstanding at the end of the year, Amount of deposits that have matured but not claimed, Amount of deposits that have matured and claimed but not paid, Particulars of liquid assets (Amount of deposits maturing on or before 31st March next year and following next year, Amount required to be invested in liquid assets, Details of liquid assets, Amount in current or other deposits account, free from charge or lien, with any scheduled bank, Unencumbered securities of Central/State Government with their face value as well as Market value, Unencumbered trust securities with their face value as well as market value and under Particulars of receipt of money or loan by a company but not considered as deposits, at the end of financial year, in terms of clause (c) of sub-rule 1 of rule 2 of the Companies (Acceptance of Deposits) Rules,2014 with bifurcations of Opening balance, Additional loan during the year, Repaid during the year, Any other adjustment, Closing balance , with further aging detail such as Loans outstanding for less than or equal to 1 year, Loans outstanding for more than 1 year and less than 3, Loans outstanding for more than 3 years (As explained in table below)

Particulars	*Details of loan (in INR)*					*Ageing of Loan*		
	Opening balance	*Additional loan during the year*	*Repaid during the year*	*Any other adjustment*	*Closing balance*	*Loans outstanding for less than or equal to 1 year*	*Loans outstanding for more than 1 year and less than 3 years*	*Loans outstanding for more than 3 years*
	(i)	*(ii)*	*(iii)*	*(iv)*	*(v)*	*(vi)*	*(vii)*	*(viii)*
Any amount received from –								

Punishment for contravention

There are penal provision also in case of default by the Company and officer in default in payment or repayment of interest or along with principal amount.

Penal provision for company **Where Company Fails to repay the deposit or part thereof or any interest**	**Depositor concerned may make Application to tribunal for an order directing the company to pay the sum due or for any loss or damage in-curred by him**
Where a company accepts or in-vites or allows or causes any oth-er person to accept or invite - in contravention of the manner or the conditions prescribed or if a company fails to repay the de-posit or part thereof or any inter-est due thereon within the time specified as may be allowed by the Tribunal	the company shall, in addition to the payment of the amount of deposit or part thereof and the interest due, be punishable with fine which shall not be less than one crore rupees but which may extend to ten crore rupees;
Penal provision to Officer- in - default	Every officer of the company who is in default shall be punishable with imprisonment which may extend to seven years and with fine which shall not be less than Rs 25 Lacs but which may extend to Rs 2 Crore,
Penal provision to Officer-in – default, when default is knowing-ly or wilfully	If it is proved that the officer of the company who is in default, has contravened such provisions knowing-ly or wilfully with the intention to deceive the com-pany or its shareholders or depositors or creditors or tax authorities, he shall be liable for action under section 447- punishment for Fraud. Any suits or proceedings shall be filed by anyone who has suffered damage due to the failure of the company to repay the deposits.
Penal Rate of Interest	Every company shall pay a penal rate of interest of eighteen per cent per annum for the overdue period where such deposits, whether secured or unsecured, matured and claimed but remaining unpaid.

Conclusion

A private company cannot accept deposits from any person viz. proprietary firm, HUF, LLP etc. unless they are members, subject to prescribed conditions. Considering the default and loss of money of the depositor, receipt of money by way of deposits is being regulated under Companies Act or another laws.

CS Deepti Kulkarni

Advance received in Ordinary Course vs. Deposits

Money plays an essential role in every business. Every business requires fund raising and one of the popular forms is borrowings and when borrowings come into picture, the spotlight directly falls on Section 2(31) of the Companies Act, 2013 which is "Deposits". Deposits is generally returnable, however, sometimes advance received in ordinary course can also be deposits and is regulated under Companies Act, 2013, Banning of Unregulated Deposit Schemes Act, 2019, Maharashtra Protection of Interest of Depositors (in Financial Establishments) Act, 1999, the Reserve Bank of India Act, 1934 and several other statutes. Therefore, it is important to understand this concept of advance received in ordinary course and the regulations around it. We would be discussing about three important statutes, i.e. Companies Act, 2013, Banning of Unregulated Deposit Schemes Act, 2019 and Maharashtra Protection of Interest of Depositors (in Financial Establishments) Act, 1999 in the context of advance received in ordinary course.

What is Deposit?

The term "deposits" is being defined in Companies Act, 2013. "Deposit" includes ***any receipt of money by way of deposit or loan or in any other form by a Company,*** but does not include such categories of amount as may be prescribed in consultation with the Reserve Bank of India. Further, Rule 2 (1)(c) of the Companies (Acceptance of Deposits) Rules, 2014, provides an inclusive definition of deposits. It clearly enlists the transactions that would not be considered as deposits.

As per the abovementioned definition, deposit includes receipt of money by way deposit, or loan or in any other form. Now, in general parlance, any transaction in which money is given with the intention to be returned either with or without interest is termed as loan. However, question arises as to how to interpret "in any other form"? Probably, "in any other form" would mean deposits received by whatever name called is the context. Would it mean all such amounts received by a Company in any form apart from loans and deposits which are not covered under exclusions? Or do we need to interpret it in context of loan or deposit only? Here, the words "loans" and "deposits" are specific words whereas "in any other form" are general words. So, by applying principle of

ejusdem generis (meaning: of the same kind or nature), the words "in any other form" may be interpreted as confined to loans and deposits only. Therefore, in context of this explanation, any money received which with an intention to be returned will be termed as deposits, whatever you may call.

Here, a question arises as to whether advance received would be considered as deposits? Advance is not received with an intention to be returned; it is to be appropriated against the relevant identified transactions. In course of carrying out routine business transactions, a Company may receive advance in mutual interest and there is no legal bar is having such transaction. However, many a times, advances are used for camouflaging loans which no regulator likes. Hence, regulators don't give exemptions without conditions. Let us have a look at the deposits definition which contains exclusions with regards to advances, but with certain conditions. The exclusions are reproduced as under:

(xii) ***any amount received in the course of, or for the purposes of, the business of the Company-***

It is very important to note that this is a very specific clause and not inclusive.

> (a) *as an advance for the supply of* ***goods*** or ***provision*** *of* ***services*** *accounted for* ***in any manner whatsoever*** *provided that such advance is appropriated against supply of goods or provision of services within a period of three hundred and sixty -five days from the date of acceptance of such advance: Provided that in case of any advance which is subject matter of any* ***legal proceedings*** *before any court of law, the said time limit of three hundred and sixty-five days shall not apply:*

The highlighted words are very important and need to be understood carefully in order to understand the clause in detail. If we go through the words, the term "goods" is defined under Sale of Goods Act, 1930 and for others we will have to check other statutes, dictionary meaning or in general common parlance.

The sub rule here, clarifies that any amount received in the ordinary course of business as an advance for supply of goods or provision of services, then such amount has to be appropriated against supply of goods or provision of services within 365 days from the date of acceptance of such advance. Else, it would be considered as deposit.

> (b) *as advance, accounted for* ***in any manner whatsoever,*** *received in connection with consideration for an* ***immovable property*** *under an* ***agreement or arrangement,*** *provided that such advance is adjusted against such property in accordance with the terms of agreement or arrangement;*

Similarly, immovable property is defined under the General Clauses Act, 1987 and for other words again we will have to check other statutes or dictionary meanings in order to understand and evaluate whether a particular case falls under this clause.

This clause refers to advance received against construction or real estate projects. The point to be ascertained here would be that there has to be an agreement or arrangement in place and the advance received has to be appropriated only against the immovable property in the books of the Company. There is no limit of 365 days applicable here.

(c) *as **security deposit** for the **performance of the contract** for supply of goods or provision of services;*

Security deposit is money that is received as a proof of intent and may be used to pay damages. So, any money received as security deposit for the performance of contract pertaining to supply of goods or provision of services is exempted from definition of deposits.

(d) *as advance received under **long term projects** for supply of **capital goods** except those covered under item (b) above:*

In general parlance, any projects which takes development time of more than 3 years is considered as long-term project. Capital goods is defined under revised GST Law. This may include research projects, manufacturing projects, etc. So, any amount received under long term projects other than against immovable properties, shall not be treated as deposits.

(e) *as an advance towards consideration for providing **future services** in the form of a **warranty or maintenance contract** as per **written agreement or arrangement,** if the period for providing such services does not exceed the period prevalent as per common business practice or five years, from the date of acceptance of such service whichever is less;*

There is a specific condition mentioned in this sub-rule. The period for providing future services shall not be in the form of a warranty or maintenance contract shall be as per common business practice or for five years, from the date of acceptance of such service whichever is less. In case, if the period exceeds five years, it would be treated as deposit. For example, if a car manufacturing Company receives money and gives a warranty of 10 years on cars, whether it would be able to claim this exemption?

(f) *as an advance received and as allowed by any* sectoral regulator *or in **accordance with directions of Central or State Government;***

Sectoral regulators in India include SEBI, IRDAI, RBI. So, any advance received and as allowed by sectoral regulators if mentioned under their laws, shall be exempted. A point to note here is that sectoral regulations/laws have to be referred to while ascertaining this subrule.

(g) *as an advance for **subscription towards publication**, whether in print or in electronic to be adjusted against receipt of such publications;*

Any amount received as an advance for subscription of publications viz., newspaper/magazine/media subscriptions shall be appropriated against such subscriptions only.

The clauses (e), (f) and (g) have been inserted as an amendment to the deposit rules with effect from 29th June, 2016. It is further stated that, if the amount received under items (a), (b) and (d) above becomes refundable (with or without interest) due to the reasons that the company accepting the money does not have necessary permission or approval, wherever required, to deal in the goods or properties or services for which the money is taken, then whether the amount received shall be deemed to be a deposit is a question to be evaluated. Also, the amount shall be deemed to be deposits on the expiry of fifteen days from the date they become due for refund. Thus, the all above conditions have to be fulfilled in order to claim exemption from deposits.

Out of the above, clause (a) has a limit of number of years and other clauses do not have limit on number of years. Also, clause (a) above is a general clause and rest all other clauses are specific clauses. So, if multiple clauses are applicable to a certain transaction, then most relevant specific clause should be considered since in general vs. specific, specific will always prevail over general.

Advances in nature of loans

The Companies (Auditor's Report) Order, 2020 (CARO) also provides a mention of the term "advances in nature of loans". CARO is about loan given and not received. Even though it speaks about advance under asset side of the balance sheet, but the terminologies or parameters mentioned therein, can be used for borrowings as well.

Guidance Note on CARO 2020 published by the Institute of Chartered Accountants of India, throws some light on this term. It has been stated that whether advance is in the nature of loan would depend on circumstances in each case. If there is a normal advance received in ordinary course, would not be an advance in nature of loan. However, if an advance is given-

(a) for an amount which is far in excess of the value of an order or

(b) for a period, which is far in excess of the period for which such advances are usually extended as per the normal trade practice,

then such an advance may be in nature of a loan to the extent of such excess. A useful guide in this case would be to consider the period required for execution of the order. If the period required for execution of the order is more than usual trade practice, then such advance would be said to be in the nature of loan unless there is any evidence to the contrary. Also, a stipulation regarding interest may normally be an indication that the advance is in the nature of loan, but this is not conclusive evidence.

In classic case, Hon'ble Supreme Court Reports, ***K. C. Gajapati Narayan Deo and Other vs. the State of Orissa,*** dated 29th May, 1953, it was stated that the whole doctrine of colourable legislation is based upon the maxim that you cannot do indirectly what you cannot do directly. Thus, it is implied that if you cannot accept deposits when eligible, you cannot accept deposits by mere pretence. In fact, this would amount to fraud. Thus, if an advance received, after investigation by auditors, appears to be in the nature of loan, it would be termed as deposits only and here 365 days period will not be of any relevance and none of the exclusions under the definition of deposits under Section 2(c)(xii) would become applicable.

However, is there any defence, if such advance is not in the nature of loan and is actually an advance and goes beyond 365 days? As mentioned in the explanation above, the clauses (e), (f) and (g) under rule 2(1)(c) of the Companies (Acceptance of Deposit) Rules, 2014, pertaining to advance received against warranty, allowed by sectoral regulators and against subscriptions towards publication were inserted vide an amendment notified on 29th June, 2016. Now, since the said clauses were inserted later, an interesting thought to ponder over here is that what would happen to the advances received against warranty provided for more than 5 years or for newspaper subscriptions from the commencement of these rules till the aforesaid amendment became effective? Whether it would be treated as deposit then? Or should a stand be taken as to any amount received by way of deposit,

loan or in any other form, since it is not returnable, be considered as advance only and not deposit? What view should be taken for jewellers who accept advances or hospitality companies who provide holidays on timeshare basis and accept advances, but do not provide services within 365 days? A view can be taken that provision of services or appropriating the advances against such services is sufficient compliance and that it does not fall under the nature of deposits. However, this is a point which is yet to be tested in judicial processes.

Evaluation mechanism

When there are conditions, there also needs to be a control mechanism. The Institute of Chartered Accountants of India, in their publication viz., Guidance Note on Audit of

Debtors, Loans and Advances, have listed down certain valuation techniques. Following is few of the techniques with respect to loans and advances:

1. There should be proper systems
2. There should be proper documentation
3. Documents to be kept in safe custody
4. Periodical reviews to be conducted
5. Non-compliance cases to be highlighted

The guidance note also provides a mention of verification that the auditor is required to do and the representations that is required to be submitted by the Company.

Thus, these are asset side transactions, but it can be relevant for liability side transactions too.

BUDS Act, 2019

As discussed earlier, deposit is regulated at multiple levels under various laws. One recent law that is applicable all over India is the Banning of Unregulated Deposit Schemes Act, 2019 (BUDS). This Act came into force on 21st February, 2019. The definition of deposits under BUDS is again an inclusive definition and refers to **an amount of money received** by way of an **advance or loan or in any other form, by any deposit taker with a promise to return whether after a specified period or otherwise, either in cash or in kind or in the form of a specified service, with or without any benefit in the form of interest, bonus, profit or in any other form.** If we compare this definition with definition of deposit given under the Companies Act, 2013, there is a huge difference as this definition is broader as it refers to money received by way of advance, loan or any other form by the deposit taker. This Act is applicable to every entity and not restricted only to a Company. The definition under Companies Act, 2013 mentioned by way of deposit, loan and in any other form and BUDS clearly mentions the word "advance". Further, this definition in itself has words such as with a promise to return the money, after a specified period, either in cash or in kind or in form of a specified service, with or without any benefit. Thus, this definition also appears to be wider as it involves cash or kind or for any specified services.

The above definition also has few exclusions. Exclusions pertaining to advance are reproduced as below:

(l) ***an amount received in the course of, or for the purpose of, business and bearing a genuine connection to such business including—***

(i) *payment,* ***advance*** *or part payment* ***for the supply or hire of goods or provision of services and is repayable in the event the goods or services are not in fact sold, hired or otherwise provided;***

(ii) ***advance received in connection with consideration of an immovable property under an agreement or arrangement*** *subject to the condition that such advance is* ***adjusted against such immovable property*** *as specified in terms of the agreement or arrangement;*

(iii) ***security or dealership deposited for the performance of the contract*** *for supply of goods or provision of services; or*

(iv) ***an advance under the long-term projects*** *for supply of capital goods except those specified in item (ii):*

This clause is again inclusive like the definition of deposits under BUDS and hence there are no conditions. This gets validated from Section 41 of BUDS Act, 2019 which mentions that the provisions of this Act shall not apply to any deposits taken in the ordinary course of business.

Further, it is also clarified in the explanation to this clause that for Company, deposits shall have same meaning as assigned to it under the Companies Act, 2013 and in respect of a Non-Banking Financial Company (NBFC) registered under the Reserve Bank of India Act, 1934, the term deposits shall have the same meaning under the said Act. Thus, this Act is more relevant for non-corporate entities.

MPID Act, 1999

The Maharashtra Protection of Interest of Depositors (in Financial Establishments) Act, 1999 (MPID) came into force on 29th April, 1999. It is applicable for the State of Maharashtra only. There are similar Acts for other States viz., Tamil Nadu, Pondicherry, Andhra Pradesh, etc. The term deposit is defined in MPID as any receipt of money or valuable commodity by a financial establishment to be returned after a specified period or otherwise, either in cash or kind or in the form of specified service with or without any benefit in the form of interest, bonus, profit or in any other form. This definition is an inclusive definition too and consists of few exclusions. There is a mention of amounts received in ordinary course of business by way of advance against order for goods or services. Financial Establishment is being separately defined to include any person accepting deposit under any scheme or arrangement or in any other manner but does not include a corporation, banking Company or a co-operative society owned or controlled by Government.

A landmark case of the year 2022 may be referred here to understand the definition better. In hon'ble Supreme Court case pertaining to the *State of Maharashtra vs. 63 Moon technologies Limited,* National Spot Exchange Limited (NSEL) was an electronic trading platform which facilitated transactions between buyers and sellers. The question was whether consideration which was not paid to the sellers by NSEL, due to suspension of its trading, was a deposit. It was held that the MPID Act defines deposit in broad terms. Further, according to the definition, the return may be either in money, commodity or service, and it is not necessary that the commodity or the money must be returned in the same form. The definition includes the receipt of money and the return of a commodity, or even the receipt of a commodity and a return in the form of a service. Further, hon'ble Supreme Court also highlighted that Section 2(c) states that the return may be with or without any benefit in the form of interest, bonus, profit or in any other form. The definition does not stipulate that there must be an added benefit,

rather that the added benefit is irrelevant for the purpose of the definition. For the purpose of Section 2(c), the receipt of the commodity or money must be retained by itself. The definition does not provide any such embargo. Rather, the definition is broadly worded to include even the possession of the commodities for a limited purpose. Hon'ble Supreme Court by quoting several judgements also settled constitutional validity of MPID Act.

This judgement will impact lots of business activities as the definition of deposit under MPID increases the scope wider and will require careful studying. The definition of deposits under BUDS is also wider however, the exemptions had narrowed the scope. But, the scope of deposit under MPID does not appear so.

Consequences

Under Companies Act, 2013, the consequences for non-compliance, in addition to the amount of deposit are fine which shall not be less than one crore rupees or twice the amount of deposit accepted by the Company, whichever is lower but which may extend to ten crore rupees. Further, every officer of the company who is in default shall be punishable with imprisonment which may extend to seven years and with fine which shall not be less than twenty-five lakh rupees but which may extend to two crore rupees

Provided that if it is proved that the officer of the company who is in default, has contravened such provisions knowingly or wilfully with the intention to deceive the company or its shareholders or depositors or creditors or tax authorities, he shall be liable for action under section 447 (Punishment for Fraud).

Under BUDS, the consequence for non-compliance is where an offence under this Act has been committed by a deposit taker other than an individual, every person who, at the time the offence was committed, was in charge of, and was responsible to, the deposit taker for the conduct of its business, as well as the deposit taker, shall be deemed to be guilty of the offence and shall be liable to be proceeded against and punished accordingly.

Under MPID, any financial establishment, which fraudulently defaults any repayment of deposit on maturity along with any benefit in the form of interest, bonus, profit or in any other form as promised or fraudulently fails to render service as assured against the deposit, then every person including the promoter, partner, director, manager or any other person or an employee responsible for the management of or conducting of the business or affairs of such financial establishment shall, on conviction, be punished with imprisonment for a term which may extend to six years and with fine which may extend to one lakh rupees such Financial Establishment also shall be liable for a fine which may extend to one lakh of rupees.

Conclusion

One needs comprehensive understanding of these subjects so that he does not attract any trouble and need to take very well studied, updated and wise approach while dealing with advances in ordinary course of business.

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Advocate

Position of Depositors under The Insolvency and Bankruptcy Code 2016

Introduction to Financial Service Providers and Depositors

A. At the time of inception of the Insolvency and Bankruptcy Code, 2016 (hereinafter referred to as the **'Code'**), the processes with respect to insolvency and liquidation of financial service providers (**'FSPs'**) and the treatment of persons depositing their monies with the said FSPs (**'Depositors'**) were not brought into force under the Code. The rationale of the legislature behind such exclusion was rooted in the fundamental difference between other companies and FSPs, wherein the former dealt with independent business operations, while the latter engaged with customers funds/public deposits in its daily business activities. During that time, multiple legislative frameworks viz the Companies Act, 2013, National Housing Bank Act, 1987, Banking Regulation Act, 1949, and the Insurance Regulatory and Development Authority of India Act, 1999, providing for processes and provisions for the resolution and winding up of FSPs were in place, however, the same remained ineffective and untested.

B. In order to provide a unified framework for the resolution of the FSPs and also to ensure that insolvency and liquidation of FSPs is conducted in an efficient and time bound manner while ensuring that the rights of the stakeholders of the FSPs including Depositors are not compromised, Section 227 of the Code empowering the Central Government to notify FSPs for the purpose of their insolvency and liquidation proceedings was promulgated. In this regard, the Central Government has also brought into force the Insolvency and Bankruptcy (Insolvency and Liquidation Proceedings of Financial Service Providers and Application to Adjudicating Authority) Rules, 2019 (**'FSP Rules'**), which are applicable to financial service providers, as may be notified by the Central Government under Section 227 of the

Code, from time to time, for the purpose of their insolvency and liquidation proceedings.

Provisions of The Code and FSP Rules

C. Section 227 of the Code provides that the Central Government may, if it considers necessary, in consultation with the appropriate financial sector regulators, notify FSPs or categories of financial service providers for the purpose of their insolvency and liquidation proceedings, which may be conducted under this Code, in such manner as may be prescribed. The FSP Rules are applicable to such FSPs or categories of FSPs as may be notified by the Central Government under Section 227 of the Code.

D. As per the FSP Rules, the provisions of the Code pertaining to corporate insolvency resolution process of a corporate debtor shall *mutatis mutandis* apply to the insolvency resolution of FSPs with certain modifications including the following:

- insolvency proceedings in the context of a FSP may be initiated only by an appropriate financial sector regulator in terms of the FSP Rules;
- the application of such financial sector regulator shall be treated in a manner akin to an application made by a financial creditor under Section 7 of the Code;
- on such application being made, the adjudicating authority shall appoint an individual of the financial sector regulator's choice as the 'administrator' of the FSP, having powers and functions of an interim resolution profession/ resolution professional/ liquidator;
- an interim moratorium (having effect of Section 14(1), (2) and (3) of the Code) shall commence from the date of filing of application for insolvency of the FSP by the financial sector regulator till the admission or rejection of the said application.
- interim moratorium shall not be applicable to third party assets or properties (including of Depositors) which are in custody or possession of the FSPs (including any funds, securities and other assets required to be held in trust for the benefit of said third parties) and the said custody or possession shall be with the 'administrator'.
- the license or registration of the FSP to engage in the business of providing financial services shall not be suspended or cancelled during the period of interim moratorium or CIRP.

E. Similarly, the FSP Rules provide that provisions of the Code relating to the liquidation process and voluntary liquidation process of the corporate debtor shall, mutatis mutandis apply to the liquidation process and voluntary liquidation process of a financial service provider, respectively, subject to certain modifications.

Status of Depositors and Procedurefor Participation in the Insolvency Resolution Process

F. The term 'deposits' draws its meaning from the Companies Act, 2013 wherein Section 2(31) defines it to include "any receipt of money by way of deposit or loan or in any other form by a company, but does not include such categories of amount as may be prescribed in consultation with the Reserve Bank of India". Under the Code, deposits are included within the ambit of 'financial product' under Section 2(15) of the Code while the process of inter alia accepting deposits by a FSP along with safeguarding and administering assets consisting of financial products belonging to another person, comes under the scope of 'financial service' under Section 2(16) of the Code.

G. During the initial years of the Code, the status of Depositors was uncertain pending decision of adjudicating authorities on classification of Depositors as either financial or operational creditors. This was evident from the NCLAT's decision in ***Hind Motors vs. Adjudicating Authority (Company Appeal (AT) (Insolvency) No. 11 of 2017)*** and ***NCLT's decision in Prabodh Kumar Gupta vs. Jaypee Infratech Limited (CP No. (IB) 68/Ald/2017).*** While in the former, the NCLAT left the question of whether the public depositors qualify as financial creditors undecided; the NCLT in the latter case termed the public depositors as "other stakeholders" and vested the resolution professional ('RP') with the power to take appropriate action towards the Depositors as he/she may deem fit.

H. Considering prevalence of conflicting decisions, the 'Report of The Sub-Committee of The Insolvency Law Committee for Notification of Financial Service Providers Under Section 227 of the Insolvency and Bankruptcy Code, 2016' dated 4 October 2019 ('Report') specifically addressed that the amounts deposited by Depositors with an FSPs will be treated as financial debt and as such depositors will be classified as financial creditors and will be treated accordingly under the Code. The position of law in this regard has also been clarified by various judicial precedents to include Depositors as financial creditors under the Code.

I. As such, the procedure for submission of claims by a Depositor is identical to that of a financial creditor and covered under Regulation 8 of the CIRP Regulations. The procedure of the same may be encapsulated as follows:

(i) the Depositor shall submit claim with proof to the interim resolution professional ('IRP') in electronic form in Form C of the Schedule-I of the CIRP Regulations (claim may also be submitted as a class of financial creditors vide Form CA). The Depositor may also submit supplementary documents or clarifications in support of the claim before the constitution of the CoC;

(ii) the existence of a financial debt due to the Depositors may be proved by:

- the records available with an information utility, if any; or

- other relevant documents, including:
  - — financial contract supported by financial statements as evidence of the debt;
  - — a record evidencing that the amounts committed by the financial creditor to the corporate debtor under a facility has been drawn by the corporate debtor;
  - — financial statements showing that the debt has not been paid; or
  - — an order of a court or tribunal that has adjudicated upon the non-payment of a debt, if any.

(iii) Further, as per Regulation 10 of the CIRP Regulations, the IRP or RP may call for other evidences or clarification as he deems fit from a creditor for substantiating the whole or part of its claim.

J. In the event there are a large number of Depositors, an authorised representative may be appointed in terms of Section 21(6A) of the Code. Such authorised representative shall represent the Depositors in the CoC of the FSP and vote on behalf of them to the extent of their voting share in terms of the provisions of the Code.

Solidification of The Status of Depositors under The Code

K. The status of deposit holders and their position in their waterfall mechanism of Section 53 of the Code was recently settled by the National Company Law Appellate Tribunal ('NCLAT') in the matters of:

(i) ***Air Force Group Insurance Society vs. Mr. R. Subramaniakumar, Administrator of Dewan Housing Finance Corporation Limited & Ors. and Mr Anup Kumar Shrivastava & Ors. vs. Mr. R. Subramaniakumar, Administrator of Dewan Housing Finance Corporation Limited & Ors. (Company Appeal (AT) (Insolvency) No. 546 & 552 of 2021) vide order passed on 27 January 2022 ("DHFL Case 1");***

(ii) ***Vinay Kumar Mittal & Ors. vs. Dewan Housing Finance Corporation Limited & Ors. (Company Appeal (AT) (Insolvency) No. 506 & 507 and 516 of 2021) vide order passed on 27 January 2022 ("DHFL Case 2")***; and

(iii) ***Mr. Raghu K S & Ors. vs. Mr. R. Subramaniakumar, Administrator of Dewan Housing Finance Corporation Limited (Company Appeal (AT) (Insolvency) No. 538 of 2021) dated 7 February 2022 ("DHFL Case 3").***

L. DHFL Case 1

Factual Background

(i) The appellants were Depositors and had deposited their money in the fixed deposit scheme offered by a FSP which had promised higher returns and money security. The said FSP was then admitted into insolvency on 29 November 2019 and its insolvency resolution process was initiated by the RBI under rule 5 of the FSP Rules vide CP No. 4258 of 2019.

Subsequently, the resolution plan submitted by a resolution applicant was approved by the Committee of Creditors ('CoC') of the FSP. In terms of the approved resolution plan, small investors including the appellants were proposed to be paid less than 40% of the admitted claims agreed to be paid to secured financial creditors.

Vide the impugned order, the NCLT had disposed the appellant's application with the direction to the CoC to reconsider payment to small investors under the resolution plan to match the secured financial creditors. The NCLT further requested the CoC to repay the entire admitted claim of Army Group Insurance Fund ('Army Fund') without any haircut and consider them as a separate class/ sub-class of creditors in consideration of nature of duties being performed by them. However, the suggested revision was rejected by the CoC by a majority of 89.49% vote share.

(ii) The appellant in its appeal to the NCLAT contended that it would fall within the same class of creditors as Army Fund. It also contended that the approved resolution plan ought to have rejected since the same did not make full payment of the admitted claims of the appellants and was therefore violative of various provisions of the National Housing Bank Act, 1987 ('NHB Act'). The appellant resorted to the RBI Act, 1934 stating that it mandated full payment to the depositors and that any resolution plan having the effect of extinguishing the claims of the Depositors upon payment as per the plan is illegal, violative and cannot be sustained in law. The appellants additionally stated that the deposits were held in trust by the FSP until maturity and did not come under the ambit of loans.

Observations

(iii) The NCLAT after due consideration of the submissions of all parties stated the following observations:

a) In light of the Supreme Court's decision in ***N. Raghvender vs. State of Andhra Pradesh (2021 SCC OnLine SC 1232),*** it was held that the bank is not a trustee of the money deposited by the customers and that their relationship is that of a creditor and debtor. Since, the FSP took fixed deposits from the appellants on agreed interest on the amount invested, their relationship

was that of a creditor and debtor.

b) In view of the Apex's court stance in ***Essar Steel vs. Satish Kumar Gupta and Ors (2020) 8 SCC 531,*** the NCLAT reiterated that the CoC in its commercial wisdom may negotiate and accept the resolution plan involving differential payment to different class of creditors along with differences in the distribution amounts between different classes of creditors.

c) In light of the above, the NCLAT stated that having participated in the insolvency resolution process, the appellants cannot challenge the actions of the CoC which is otherwise in compliance with the provisions of the Code. The NCLAT unequivocally stated that the task of the CoC members is to work towards the maximisation of value for all stakeholders of the corporate debtor and not the depositors alone. The appellants' who were financial creditors and hence a part of the CoC, by seeking payment outside the resolution plan are acting in silo. Such action is not only detrimental to the interest of other stakeholders but also against a holistic resolution for maximisation of value and distribution of funds among other creditors.

d) The Depositors of the FSC stand on an equal footing with other financial creditors. There exists no rationale for treating them as a separate class with preferential treatment being accorded in the matter of distribution of fund and that the commercial wisdom of the CoC reigns supreme.

e) That the powers of the adjudicating authorities under Section 60(5)(c) of the Code or Rule 11 of the NCLT Rules are limited in view of ***Jaypee Kensington Boulevard Apartments Welfare Association vs. NBCC (India) Ltd 2021 SCC OnLine 253 and Ebix Singapore (P) Ltd. vs. Committee of Creditors of Educomp, 2021 SCC OnLine Sc 707***. The powers of the adjudicating authorities are relating to the broader compliance with the insolvency framework and its underlying objective, one of which is timely resolution of the corporate debtor.

f) Neither the NHB Act nor the RBI Act provides for full payment of the holders of fixed deposits. The stated acts merely envisage the cancellation of license in the event of non-payment. Additionally, the above acts operate in the ordinary circumstances wherein the company is not undergoing insolvency. It is of utmost

importance that once a company is admitted into insolvency, it is the Code which governs the entire process with respect to its resolution.

g) Lastly, considering the decision of the Supreme Court in ***Pratap Technocrats Private Limited vs. Monitoring Committee of Reliance Infratel Limited & Anr. 2021 SCC OnLine SC 569***, the NCLAT stated that the adjudicating authorities are endowed with limited jurisdiction under the Code and cannot act as courts of equity or exercise plenary powers to prevail over the commercial wisdom of the CoC.

In light of the above observations, the appeals were dismissed with no interference with the approved resolution plan.

M. DHFL Case 2

Factual Background

(i) The appellant had filed the stated appeals on behalf of himself and 444 other individual Depositors and other charitable trust holding fixed deposits in the FSP. They were filed against a common order dated 7 June 2021 of the NCLT, Mumbai Bench which had declared the appellant's objections raised post the approval of the resolution plan as infructuous and had disposed their interim applications. It was the contention of the Depositors that they could not be legally subjected to the resolution process by considering the same assets of the FSP and that the NCLT erred in approving the resolution plan without considering the objections of the appellants.

Observations

(ii) The NCLAT after due consideration of the submissions of all parties stated the following observations:

a) Similar to DHFL 1, the NCLAT herein observed that there was no provision either under the RBI Act or the NHB Act or any other law in force which mandated full payment to the Depositors and that the stated acts only provided for the revocation of license in the event of non-payment by an FSP to the Depositors;

b) While reiterating the view laid down in several judgement e.g. ***Innoventive Industries Limited, ICICI Bank and anr. (2018) 1 SCC 407*** and ***The Directorate of Enforcement vs. Sh. Manoj Kumar Agarwal and ors., Company Appeal (AT) (Ins) No 2019,*** the tribunal held that it is a settled position of law that a special statute enacted on a later date will prevail over the earlier statute, in the event both contain a non-obstante clause. Hence, the Section 238 of the Code shall prevail over the NHB Act, NHB Directions and the RBI Act.

c) The NCLAT while relying on the Report cemented the position of Depositors as financial creditors in the insolvency of a FSP. Additionally, in light of the law laid down in ***Chitra Sharma vs. Union of India (2018) 18 SCC 575,*** the tribunal held that during the pendency of the CIRP, the Depositors cannot claim a disbursement since the same shall amount to preferential treatment to a particular class of creditors which is impermissible under the Code.

d) That on the combined reading of the FSP Rules, related provisions of the Code along with the various precedents under it, it becomes clear that it is the Code that provides for a detailed mechanism whereunder the claims of the creditors, including the Depositors have been sufficiently dealt with. Accordingly, the interest of the Depositors as a class of creditors has been adequately represented and protected in the CIRP and is valid in law. Considering the above, the tribunal held that claims of the appellant's must be viewed only in terms of the statutory mechanism under IBC and the FSP Rules.

e) The order emphasised that when a statute has conferred the power to do an act and has laid down the method in which the power is to be exercised, the doing of the said act in any other manner is prohibited. Hence, the Depositors (herein the dissenting financial creditors) cannot seek an amount which is beyond the liquidation value of their debt as the same is provided in terms of the Code.

f) The objections of the Depositors on being dissatisfied with the distribution under the approved resolution plan was found to be not maintainable on the ground that the NCLT/NCLAT has been endowed with limited jurisdiction as and cannot act as a court of equity or exercise plenary powers. It was thereby held that CoC's commercial or business decisions are not open to judicial review by the NCLT or NCLAT under the Code.

In light of the above observations, the appeals were dismissed with no interference with the approved resolution plan.

N. DHFL Case 3

Factual Background

The facts of the present matter were similar to DHFL Case 1 and DHFL Case 2. The appellants had invested in the fixed deposit scheme of a FSP post which the latter was admitted

into insolvency. The appellants were given the biggest haircut in terms of the distribution envisaged with only a sum equivalent to ₹ 1243,00,00,000/- (Rupees One Thousand Two Hundred Forty Three Crores Only) (23.08%) being allotted out of the admitted claim of ₹ 5375,00,00,000/- (Rupees Five Thousand Three Hundred and Seventy Five Crores Only). The allotted value fell short by a huge margin and was against the 40% (minimum) of the admitted claims agreed to be paid to secured financial creditors with huge risk appetite.

Such action was opposed by the appellants via I.A. No 625/2021 preferred in C.P. (I.B)/4258/(M.B.)/C-11/2019 which was disposed by the NCLT with the direction of reconsideration to the CoC so as to enhance the payment to a minimum of 40% of the amount being paid to secured financial creditors in the resolution plan. The above order was appealed against by the appellants under Section 60(5) of the Code who sought declaration from the NCLAT to the effect that the resolution plan passed by the CoC was illegal and violative of the Code. Additionally, directions were also sought to the effect that resolution plan be modified such that the fixed deposits of the appellants are refunded along with their interest in terms of the NHB Act.

Observations

The NCLAT in light of the decision in DHFL Case 2 disposed of the appeals with the previous judgement being made part of the decision in DHFL Case 2.

Conclusion

We are increasingly witnessing multiple FSPs being admitted into insolvency under the Code. It is imperative to note that the insolvency of a FSP is far more complex with myriad issues since they hold the deposits and assets of the general public. Considering its importance, the adjudicating authorities have been vigilant in clarifying the position of law wherein the Depositors of FSPs are considered to be financial creditors and constitute part of the CoC. The legislators and regulators have also been prompt in framing comprehensive rules and regulations to address the procedure to be followed for realization of claim by the Depositor of a FSP. Such steps have ensured that the Depositors have a say in the treatment meted out to them by the resolution applicant and realize their claim value in a timely manner.

It is to be noted that vide the judgements in the three DHFL cases referenced above, the NCLAT has amply clarified that the Code under Section 238 supersedes the provisions of the RBI Act and NHB Act. This shall reduce multiplicity of forums in resolving the stress in FSPs and bring respite to the stakeholders who in light of the nascent jurisprudence face extreme delays in resolution, subsequently leading to erosion of value of the FSP. Hence, a successful resolution may set the precedents for resolution of stress on FSPs going forward.

Ankoosh Mehta
Advocate

Analysis of The Maharashtra Protection of Interests of Depositors (in Financial Establishments) Act, 1999

Maharashtra enacted the Maharashtra Protection of Interests of Depositors (in Financial Establishments) Act, 1999 (**"MPID Act"**) in the year 2000 with the dual objective of safeguarding the rights of depositors and holding financial establishments liable for their wrongdoings. The intention was to increase the vigil over such financial institutions that can potentially cheat innocent depositors of their deposits or default on the repayments on maturity of the deposits.

The MPID Act has had quite a tumultuous journey ever since it came into force. There were multiple ordinances promulgated by the Governor and a legislation passed by the State legislature before the MPID Act was finally enacted. Subsequently, it was held to be constitutionally untenable by the High Court of Bombay, only to be reversed 6 (six) years later by the Supreme Court of India. Of late, there have been attempts to widen the scope of the MPID Act and the Apex Court has been instrumental in ensuring that the legislation not only reaches its full potential, but also expands its ambit to fulfill the welfare intent of the statute.

The article charts the progress of the MPID Act through the years by covering the salient features of its functioning in brief, decoding important judgements on the constitutionality and scope of the legislation, and highlighting some key developments in the recent years.

I. Salient Features of the MPID Act

The MPID Act, further to the intention behind the introduction of the same, seeks to penalise financial establishments[1] for

1. Section 2(d), Maharashtra Protection of Interests of Depositors (in Financial Establishments) Act, 1999
   (d) "Financial Establishment" means any person accepting deposit under any scheme or arrangement or in any other manner but does not include a corporation or a co-operative society owned or controlled by any State Government or the Central Government or a banking company as defined under Clause (c) of Section 5 of the Banking Regulation Act, 1949 (10 of 1949).

fraudulently defaulting on the payments to the depositors, on their deposits. The legislation makes such acts of default punishable with imprisonment extendable up to 6 (six) years and fine extendable up to INR 1 lakh. It defines the term 'deposit' to include receipts of money or acceptance of any valuable commodity by any financial establishment, which/who has to return it after a specified period of time or otherwise, either in cash or kind or some other form of specified service and with or without interest, bonus or profit[2]. Similarly, 'financial establishment' has been defined to mean any person accepting deposit under any scheme or arrangement or in any other manner but not including a corporation or cooperative society owned or controlled by the State or Central Government or a banking company.

In cases where depositors have filed complaints regarding default on the part of the financial establishment or where the state government *suo moto* takes cognisance that the financial establishment is running its operations in a calculated manner detrimental to the interests of the depositors and with an intention to defraud them, then in such cases, the state government can issue directions to attach the assets of the financial establishment and/or the promoter, director, partner, manager or other member of such establishment.

Such attachment of assets[3] is provisional in nature and can be made permanent by a Special Court[4], as provided for in the MPID Act. The Competent Authority[5] who is responsible for fulfilling the purposes of the MPID Act has to present the case before the Special Court, which after giving an opportunity of hearing to the concerned parties, can either vacate the provisional attachment of assets or make the same permanent.

2. Section 2(c), Maharashtra Protection of Interests of Depositors (in Financial Establishments) Act, 1999
   (c) "deposit" includes and shall be deemed always to have included any receipt of money or acceptance of any valuable commodity by any Financial Establishment to be returned after a specified period or otherwise, either in cash or in kind or in the form of a specified service with or without any benefit in the form of interest, bonus, profit or in any other form.
3. Section 4, Maharashtra Protection of Interests of Depositors (in Financial Establishments) Act, 1999.
4. Section 6, Maharashtra Protection of Interests of Depositors (in Financial Establishments) Act, 1999
   (1) For the purposes of this Act, the Government may, with the concurrence of the Chief Justice of the Bombay High Court by notification in the *Official Gazette*, constitute one or more Designated Court in the cadre of a District and Sessions Judge for such area or areas or for such case or class or group of cases, as may be specified in the notification.
5. Section 5, Maharashtra Protection of Interests of Depositors (in Financial Establishments) Act, 1999
   (1) The Government may while issuing the order under sub-section (1) of Section 4, appoint any of its officers not below the rank of the Deputy Collector, as the Competent Authority, to exercise control over the monies and the properties attached by the Government under Section 4, of a Financial Establishment.

II. Constitutional Validity of the MPID Act

A. *The High Court of Bombay declares the MPID Act to be ultra vires the Constitution of India*

The MPID Act has faced a bumpy ride ever since its inception and has largely been ineffective in what it set out to achieve. There was ambiguity on the scope of the MPID Act itself in terms of the types of depositors it extended to and the kind of institutions that came under its ambit. As a result, it came up for scrutiny before the judiciary, when a Full Bench of the High Court of Bombay was set up to decide the constitutional validity of the MPID Act in ***Vijay C. Puljal and Ors. vs. State of Maharashtra and Ors.***[6]

The primary argument challenging the constitutionality of the MPID Act was that the State Legislature did not have the legislative competence to come up with a law on this subject matter, which fell within the scope of powers of the Union. Additionally, it was argued that the legislation did not have anything to do with public order, and therefore, it could not be justified as a state legislation. The State of Maharashtra, in turn, elaborated upon the legislative history of the MPID Act, wherein the State was urged by none other than the Reserve Bank of India to come up with a legislation to address the gap in the existing legislative framework. The existing legal protection, it was argued, could barely safeguard innocent depositors from getting duped by financial establishments who made tall promises and failed to stand true to the same.

The bench on hearing the arguments from both sides and weighing the material before them, held that there was substantial overlap between the sanctions imposed by the state government through the MPID Act and those contained within the Central legislation, that is the Companies Act, 1956. They also elaborated upon the doctrine of pith and substance, a concept deeply embedded in constitutional jurisprudence, which holds that if the pith and substance of a legislation falls within the scope of items of one list, then any incidental trenching of the items in another list, would not in itself make the legislation constitutionally untenable. However, the court interestingly observed that the pith and substance of the MPID Act was not in relation to public order and that the encroachment was not incidental. On the above-mentioned grounds, it held the MPID Act to be *ultra vires* the Constitution of India.

B. *Supreme Court resurrects the MPID Act*

The MPID Act remained in limbo since the decision in ***Vijay C. Puljal and Ors. vs. State of Maharashtra and Ors.*** However, an interesting

6. 2005 SCC OnLine Bom 1069.

development took place parallelly with the decision of the Madras High Court in the case of *S. Bagavathy vs. State of Tamil Nadu*[7]. Tamil Nadu too had a similar statute as that of Maharashtra, namely the Tamil Nadu Protection of Interest of Depositors (in Financial Establishments) Act, 1997 (**"TNPID Act"**). Post the decision by the Bombay High Court holding the MPID Act to be constitutionally invalid, the Madras High Court was also constrained to consider and rule upon the constitutional validity of TNPID Act. *Au contraire* to the decision of the High Court of Bombay, the Madras Hight Court upheld the constitutional validity of the TNPID Act.

The case went in appeal before the Supreme Court in the case of ***K.K. Baskaran vs. State rep. by its Secretary, Tamil Nadu and Ors.***[8] The Apex Court observed that the Statement of Objects and Reasons of the TNPID Act stated that the legislation had been brought in to ameliorate the situation of thousands of depositors from the wrath of financial establishments. To provide an adequate remedy whilst also safeguarding the interest of the depositors, the TNPID Act provides for attachment of assets of the financial establishments and other *mala fide* transferees so that the depositors can get their deposits back through sale of these assets. Pertinently, the Apex Court held that the pith and substance of the TNPID Act related to public order and did not transgress into the items in the Union List. Further, it said that the doctrine implies that any incidental trenching would not in itself invalidate the legislation and hence, even if some aspects in the Union list were encroached, the same would not be decisive. On these grounds, the Apex Court upheld the constitutional validity of the TNPID Act while also expressly holding that it disagreed with the decision in *Vijay C. Puljal*. Additionally, it provided that though there were minor differences between the two statutes, the view taken in this case vis-à-vis the TNPID Act would also be applicable to the MPID Act.

Although a reading of the judgment would give an impression that the constitutional validity of the TNPID Act extended to the MPID Act as well, an appeal filed in the Apex Court by the respondents in Vijay C. Puljal led to a conclusive decision that the MPID Act was constitutionally tenable. As a result, the MPID Act was resurrected[9].

7. 2007 SCC OnLine Mad 218.
8. AIR 2011 SC 1485.
9. *State of Maharashtra vs. Vijay C. Puljal, (2012) 10 SCC 599; Sonal Hemant Joshi vs. State of Maharashtra, (2012) 10 SCC 601.*

III. Recent Developments

Since the verdict in the K.K. Baskaran case, the MPID Act has had a rebirth in terms of it being increasingly used by the state government in addressing the distress of depositors and providing them with adequate remedies. In 2016, through an amendment to the MPID Act, 1999, companies incorporated under the Companies Act, 1956 and Non-Banking Financial Companies were brought within the ambit of financial establishments. Similarly, money paid to builders or developers by real estate allottees as booking amounts or earnest money was also brought within the purview of deposits within the MPID Act. Consequently, these real estate allottees too were empowered to raise complaints against builders or developers who failed on their promises of handing over the flats or compromising on their obligations. This was a landmark move to curb malpractices in the real estate sector.

IV. Concluding Remarks

With the ever-increasing scope of the MPID Act, courtesy its treatment as a welfare statute by the judiciary, the path is clear for it to stand true to the vision of the policy makers in the state legislature. With effective implementation, it can be a handy tool for the state government to put a check on the unscrupulous activities of financial establishments and protect the genuine interests of the depositors.

"All love is expansion, all selfishness is contraction. Love is therefore the only law of life. He who loves lives, he who is selfish is dying. Therefore love for love's sake, because it is the only law of life, just as you breathe to live."

— *Swami Vivekananda*

"Let the first act of every morning be to make the following resolve for the day:

- I shall not fear anyone on Earth.
- I shall fear only God.
- I shall not bear ill will toward anyone.
- I shall not submit to injustice from anyone.
- I shall conquer untruth by truth. And in resisting untruth, I shall put up with all suffering."

— *Mahatma Gandhi*

CA Pranay Gandhi

CA Neeraj Bang

CA Lekh Mehta

Section 194R – The Saga Continues

1. Introduction

We had earlier contributed our article published in the Chamber's Journal (September 2022 issue) titled 'Section 194R – The New Litigation Source' wherein we covered the various facets of tax deduction at source under section 194R and the implication of Circular No.12/ 2022 dated 16 June 2022 issued by the Central Board of Direct Taxes ('the Board') (the first circular).

Subsequently, the Board has issued another Circular to remove difficulties faced by Taxpayer vide Circular No.18/ 2022 dated 13 September 2022. This article explains the contents of this (the second) circular and contains our reactions to the views expressed therein.

At the outset, the circular 'clarifies' that it is issued only for removing difficulties in implementation of provisions of section 194R and does not impact the taxability of income in the hands of the recipient which shall be governed by the other applicable provisions of the Act. In line with the first circular, this circular also leaves the taxpayers unclear, confused and apprehensive that practice suggected in this circular is at times at variance with principles understood hitherto.

Our views on some of the 'clarifications' 'for removal of difficulties' are given below:

1. **Question No 3 of the Circular No 12 of 2022: If loan settlement/waiver by a bank is to be treated as benefit/ perquisite, it would lead to hardship as the bank would need to incur the additional cost of tax deduction in addition to the haircut that he has taken. Will section 194R of the Act apply in such a situation?**

   In the second circular, the Board has acknowledged that subjecting loan settlement/ waiver to tax deduction actually puts extra cost on the lender as it would require payment of tax by the deductor in addition to him taking a haircut already. However,

it seems that, in their view this is a difficulty for banks and other financial institutions and not for other classes of taxpayers alike. This discrimination is further evident from the below list of institutions whose one-time loan settlement is exempt from tax deduction under section 194R:

- Public Financial Institutions;
- Scheduled Banks;
- Co-operative Banks;
- Primary co-operative Agricultural and Rural Development Bank;
- State Financial Corporations;
- State Industrial Investment Corporation;
- Deposit taking Non-Banking Financial Company;
- Systemically Important Non-deposit Taking Non-Banking Financial Company; and
- Public company engaged in providing long term finance for construction or purchase of houses in India for residential purpose and which is registered in accordance with the guidelines/direction issued by the National Housing Bank

It is not only the abovementioned category of persons that normally give loans to others for example, holding company advancing loan to its subsidiary, loans granted by individuals, etc. Accordingly, exempting loan settlement/ waiver by only certain categories of persons is discriminatory towards the rest especially considering that the reasoning expressed by the Board is equally applicable to any loans.

Another discrimination apparent from the face of the circular is towards foreign financial institutions having to settle/ waive their loans advanced to Indian concerns. Given that the Government has aggressively pushed India as an investment destination, such stand would deter prospective investors.

Also, the Board's decision to exempt only a one-time loan settlement/ waiver instead of a blanket exemption is something which cannot be comprehended. There may be situations where settlement/ waiver are tranched or may be more than once. In such scenarios, one could argue that being discriminated and their economic hardships not mitigated.

All this is without considering the fact that loan settlement/ waiver gives rise to taxable income in the hands of the recipient by virtue of section 41(1) and not section 28(iv) which has been dealt with in our previous article. Therefore, question of deduction under section 194R does not arise in the first place.

A relook at the Board's approach is therefore imperative especially considering the still very much binding decision of the Hon'ble Supreme Court in the case of

Mahindra and Mahindra Limited (404 ITR 1).

2. **Question No 7 of the Circular No 12 of 2022- If under the terms of the agreement, the expense incurred by the service provider is the cost of service recipient and such cost is reimbursed by the service recipient to service provider, how is it benefit/ perquisite if the bill is not in the name of service recipient?**
One of the most debated clarifications in the first circular has hands down has been the question of dealing with reimbursement. Not only is it against the common senses but also against settled position of law.

By the second circular, the Board has tried to further explain its approach by stating that where the bill is in the name of the service provider, the liability is of the service provider and not the service recipient since the service provider gets input tax credit under GST. If it were a liability of the service recipient, the input tax credit would have been provided to him.

Exemption however is given to 'pure agents' subject to certain additional conditions. In this regard, one may pay attention to the following

(a) Who is a 'Pure Agent' under GST laws?
A 'pure agent' is defined under GST Laws (Explanation to Rule 33 of the Central Goods and Services Tax Rules, 2017) as under:

"pure agent means a person who:

a) enters into a contractual agreement with the recipient of supply to act as his pure agent to incur expenditure or costs in the course of supply of goods or services or both;

b) neither intends to hold nor holds any title to the goods or services or both, so procured or provided as pure agent of the recipient of supply;

c) does not use for his own interest such goods or services so procured; and

d) receives only the actual amount incurred to procure such goods or services in addition to the amount received for supply he provides on his own account."

(b) What are the key conditions that a 'Pure Agent' needs to satisfy under GST laws?
The following conditions need to be satisfied by a pure agent to exclude the value of re-imbursements from taxable value of supply under the GST laws:

(i) the supplier acts as a **pure agent** of the recipient of the supply, when he makes the payment to the third party on **authorisation by such recipient**;

(ii) the payment made by the pure agent on behalf of the recipient of supply has been **separately indicated in the invoice** issued by the pure agent to the recipient of service; and

(iii) the supplies procured by the pure agent from the third party as a pure agent of the recipient of supply are in **addition to the services he supplies on his own account**.

One illustration of the above under the GST laws is given as under:

- Corporate services firm A is engaged to handle the legal work pertaining to the incorporation of Company B.
- Other than its service fees, A also recovers from B, registration fee and approval fee for the name of the company paid to the Registrar of Companies.
- The fees charged by the Registrar of Companies for the registration and approval of the name are compulsorily levied on B.
- A is merely acting as a pure agent in the payment of those fees. Therefore, A' s recovery of such expenses is a disbursement and not part of the value of supply made by A to B.

Most providers of goods or services do not meet the above definition of 'pure agent' and/ or the related conditions as mentioned above and therefore, generally the players in industry have taken a position to levy GST on the OPE component as well, passing the entire credit on to the service recipient [except in specific cases where all the said conditions as well as the definition of pure agent has been strictly complied with].

The additional conditions fastened by the Board to pure agents for exemption from tax deduction under section 194R are as under:

"i. the supplier acts as a pure agent of the recipient of the supply, when he makes payment to the third party on authorization by such recipient;

ii. the payment made by the pure agent on behalf of the recipient of supply has been separately indicated in the invoice issued by the pure agent to the recipient of service; and

iii. the supplies procured by the pure agent from the third party as a pure agent of the recipient of supply are in addition to the services he supplies on his own account."

Prima facie, these conditions appear to be in sync with those under the GST

laws [as explained in point (b) above] and hence, CBDT seems be aligned with CBIC on this aspect.

This unfortunately still brings a lot of Out of Pocket expenses into the TDS net and will remain an area of focus given the reluctance of the CBDT to reconsider the position.

3. **Question No 7 of the Circular No 12 of 2022- Question No 30 of CBDT Circular No 715 dated 8th August 1995 clarifies that tax deduction under section 194C and 194J is required to be made from the gross amount of bill including the reimbursement. A person has provided service to a Company and out of pocket expenses are charged by him to the Company along with service fee in the same bill. Company deducts tax under section 194J of the Act on both service fee component as well as on out of pocket expense ('OPE') in accordance with this circular. Is there a noncompliance with the provision of section 194R of the Act?**

In a way this question is an extension of question 2.

Here, the Board has clarified that where tax deduction on OPE component has been made under section 194C or section 194J, further deduction under section 194R is not required to be made. Deduction under section 194R would apply only where no tax has been deducted on the OPE component. This is logical

4. **Question No 8 of the Circular No 12 of 2022- If there is a dealer conference to educate the dealers about the products of the company - (i) is there a requirement that all dealers must be invited in the conference, (ii) what if dealers arrive one day before and leave one day after and (iii) how to identify benefit against individual dealers in a group activity?**

Another highly debated 'clarification' by the previous circular was surrounding dealer conferences.

In this (second) circular, the Board's approach on this issue is 'mixed' with the views expressed on either end of the spectrum.

On the positive clarification side, the Board has provided that it is not necessary that all dealers are required to be invited in a dealer/ business conference for the expenses to be not considered as benefit/ perquisite. This is a welcome clarification for organizations who employ thousands of dealers/ partners.

While the Board has considered over stay prior to the dates of conference or beyond the dates of such conference as benefit/ perquisite, it does provide that the day immediately prior to actual start date of conference and a day immediately following the actual end date of conference would not be considered as over stay.

On the opposite side, the Board has 'clarified' that if benefit/perquisite

is provided in a group activity in a manner that it is difficult to match such benefit/perquisite to each participant, the tax deductor may apply a reasonable allocation key and *suo-moto* disallow a portion of the expenses while computing its taxable income. Needless to say, with allocation of expenses, comes additional disallowance on the grounds of improper allocation and a good round of litigation. One silver lining is that the Board requires prior debit in the accounts.

It is difficult to comprehend this part of the so called ‘clarification’. This suggestion appears to go beyond the scope of the section itself and also the scheme of deduction of tax at source itself. Nowhere in the Act is it stated that disallowance of expenditure absolves a taxpayer for the consequences of not deducting tax at source. Followers of the income-tax laws are left perplexed with this ‘answer’.

One point to be considered apart from the legal point, is that deductors may not adopt this approach since tax deduction under section 194R (10%) is significantly lower than standard rates of tax. This approach may be useful to loss making assessees or those with significant brought forward losses since the approach reduces cash outlay and eases working capital pressure.

Though, the Board clarifies that the taxpayer adopting such approach will not be considered to be an assessee in default in terms of section 201, only time will tell whether the filed officers also adopt this approach where additional disallowance has been made and how our courts look at this, is another interesting point.

5. Question No 9 of the Circular No 12 of 2022- Company "A" gifts a car to its dealer "B" and deducted tax on this benefit under section 194R of the Act. Dealer "B" uses this car in his business. Will he get deduction for depreciation in calculating his income under the head "profits and gains of business or profession"?

Vide question 5, the Board clarifies that where tax has been deducted on benefit/perquisite in form of an asset and duly offered to tax by the recipient, the recipient shall be eligible for depreciation on fulfilment of other conditions laid down in section 32.

The Board is however silent on whether the recipient needs to offer the sum on which tax was deducted or the FMV of the Asset as its income. Further, depreciation would be allowed on the sum on which tax was deducted or the FMV. Logically, depreciation is to be allowed on the sum offered to tax by the recipient.

A question also remains in a situation where the asset is given to the dealer/ retailer with a condition to use for business purposes which actually benefits the manufacturer – eg. retailer is provided refrigerator to

store and display manufacturer's goods? We believe that in such cases, deductibility needs to be evaluated on facts and circumstances of each case.

Another question which comes to one's mind is regarding claim for revenue deduction on benefits/ perquisites which are received in the form of revenue items e.g. free samples. We believe that such scenario is not covered by the latest circular. The issue has been dealt with in our previous article where our view on the matter is that it too depends on facts and circumstances of each case. Where free samples inherently carry a corresponding obligation to pass these on to the final customer, it is arguable that no benefit or perquisite arises.

6. **Question 6: Whether Embassies/ High Commissions are required to deduct tax under section 194R of the Act?**

Vide question 6, the Board has clarified that the provisions of section 194R shall not apply to benefits/ perquisite provided by the following:

- an organization in scope of The United Nations (Privileges and Immunity Act) 1947;
- an international organization whose income is exempt under specific Act of Parliament;
- an embassy;
- a High Commission;
- legation;
- commission;
- consulate; and
- the trade representation of a foreign state

7. **Question 7: Whether issuance of bonus share/right share is a benefit or perquisite if issued by a company in which the public are substantially interested as defined in clause (18) of section 2 of the Act and whether tax is required to be deducted under section 194R of the Act?**

It seems that the Board has kept the most illogical 'clarification' for last.

Vide Question 7, the Board 'clarifies' that provisions of section 194R will not apply to issuance of bonus or right shares by a company in which the public are substantially interested provided that the bonus shares are issued to all shareholders by such a company or right shares are offered to all shareholders by such a company.

One simply cannot fathom as to how does a benefit or perquisite arise on issue of bonus or right shares by a company in which the public are not substantially interested. However, the Board in its infinite wisdom believes the case to be for such companies.

Provisions governing bonus and right issue are the same for both classes of companies and therefore, it is highly discriminatory to exempt one class and leaving the other high and dry. Interestingly, the Board also does not provide any logic behind the approach as it has for the preceding questions.

Even if one were to try deducting tax, it would be practically impossible to know whether the shareholder holds the shares as part of its business or as investment (bear in mind that deduction under section 194R is linked to section 28(iv) which operates in case of income from business or profession). Would Rule 11UA can also be applied?

Even if somehow tax is deducted, question arises on the value to be adopted while offering the same to tax and if somehow that is also dealt with and a sum offered to tax, a question would on the allowability of the sum on which tax is paid as cost of acquisition/ business income. It is for the Board now to actually clarify on the position or else shareholders would be subject to tax twice in relation to the same shares.

The clarification sadly opens a Pandora's Box especially in case of preferential allotments. The tax officers are surely to now create significant difficulties for deductors and recipients alike on this issue.

Conclusion

After the previous circular, the Board had an opportunity to actually 'clarify' on various issues surrounding deduction under section 194R and logically deal with the issues in the earlier circular for providing some much required relief to the deductors. However, not only has the latest circular failed to do this but also it has created confusion by itself.

This should count as a missed opportunity.

Taxpayers will find it difficult to follow the two circulars to the 'T'. Litigation on the interpretations of the Board also cannot be ruled out.

"By doing well the duty which is nearest to us, the duty which is in our hands, we make ourselves stronger"

— *Swami Vivekananda*

"A thousand candles can be lighted from the flame of one candle, and the life of the candle will not be shortened. Happiness can be spread without diminishing that of yourself."

— *Mahatma Gandhi*

Keshav B. Bhujle,
Advocate

DIRECT TAXES

Supreme Court

1 ***Principal CIT vs. ABC Papers Ltd.; [2022] 447 ITR 1 (SC): Dated 18/08/2022:***

Appeal to High Court — Territorial jurisdiction — Transfer of case — Effect — Jurisdiction of Court not subject to transfer of "case" from one AO to another — "case" would not include proceedings pending before Tribunal or High Court — Transfer of case relatable only to jurisdiction of Income-tax Authorities — Jurisdiction of High Court not dependent on location of Appellate Tribunal — Appeals against orders of Appellate Tribunal lie before High Court within whose jurisdiction AO who passed assessment order situated even if case of assessee transferred: Ss. 116, 120, 124, 127, 252, 255, 260A and 269 of ITA 1961 and Rules 3 and 4 of ITAT Rules, 1963: A. Y. 2008-09

The Respondent was assessed under the Income-tax Act, 1961 at New Delhi. For the A. Y. 2008-09, the assessee filed its return of income in New Delhi. The Deputy Commissioner, at New Delhi, passed assessment order. The Commissioner (Appeals) at New Delhi allowed the appeal filed by the assessee. The Appellate Tribunal, New Delhi dismissed the appeal filed by the Department by an order dated 11th May 2017.

While the matter was pending appeal before the Commissioner (Appeals) at New Delhi, pursuant to a search operation u/s. 132(1) of the Income-tax Act, 1961 carried out at the office and factory of the assessee in Chandigarh and certain places in the State of Punjab, by the Directorate at Ludhiana, the cases of the assessee for the A. Ys. 2006-07 to 2013-14 were centralised and transferred to Central Circle, Ghaziabad by an order dated June 26, 2013, passed u/s. 127 of the Act, by the Commissioner, Ludhiana. In view of the transfer, the Deputy Commissioner at Ghaziabad, proceeded and passed an assessment order. Against that order, the assessee filed an appeal which was allowed by the Commissioner (Appeals) at Kanpur. Against this appellate order, the Department preferred an appeal to the Appellate Tribunal at New Delhi. The Appellate Tribunal at New Delhi followed its earlier order dated May 11, 2017 in the assessee's own case and dismissed the appeal filed by the Department by its order dated September 1, 2017.

In view of the transfer of the cases of the assessee to Central Circle, Ghaziabad by an

order dated June 26, 2013, passed u/s. 127 of the Act, by the Commissioner, Ludhiana, the Department filed the appeals against both the orders of the Tribunal i.e. dated May 11, 2017 and September 1, 2017 before the Punjab and Haryana High Court. The Punjab and Haryana High Court dismissed the appeals holding that, notwithstanding the order u/s. 127 of the Act which transferred the cases of the assessee to Chandigarh, the Punjab and Haryana High Court would not have jurisdiction as the Assessing Officer who passed the initial assessment order was situated outside the jurisdiction of the High Court. Against the very same order of the Appellate Tribunal, New Delhi, dated May 11, 2017, the Department also filed an appeal before the Delhi High Court. The Delhi High Court dismissed the appeal on the ground of lack of territorial jurisdiction of the Delhi High Court taking the view that when an order of transfer u/s. 127 of the Act was passed, the jurisdiction got transferred to the High Court within whose jurisdiction the situs of the transferee officer was located.

On appeals against the orders of the Punjab and Haryana and Delhi High Courts the Supreme Court held as under:

"i) It is well-settled that the appellate jurisdiction of a High Court u/s. 260A of the Income-tax Act, 1961 is exercisable by a High Court within whose territorial jurisdiction the Assessing Officer is located.

ii) An order of transfer made u/s. 127 would not have the effect of transferring the case "lock, stock and barrel" from the jurisdiction of the Appellate Tribunal, and also from that of the High Court in which the Assessing Officer was located, and vest it in the High Court having jurisdiction over the transferee-Assessing Officer.

iii) The power of transfer exercisable u/s. 127 is relatable only to the jurisdiction of the Income-tax authorities. It has no bearing on the Appellate Tribunal, much less on a High Court. If we accept the submission that the jurisdiction of a High Court u/s. 260A of the Act would be on the basis of the location of the Assessing Officer who assessed the case, it will have the effect of the executive having the power to determine the jurisdiction of a High Court. This can never be the intention of Parliament. The jurisdiction of a High Court stands on its own footing by virtue of section 260A read with section 269 of the Act and cannot be subject to the exercise of executive power to transfer a "case" from one Assessing Officer to another Assessing Officer. While interpreting a judicial remedy, a Constitutional court should not adopt an approach where the identity of the appellate forum would be contingent upon or vacillate subject to the exercise of some other power. Such an interpretation will clearly be against the interest of justice. U/s. 127, the authorities have the power to transfer a case either upon the request of an assessee or for their own reasons. Though the decision u/s. 127 is subject to judicial review or even an appellate scrutiny, the court for larger reasons would avoid an interpretation that would render the appellate jurisdiction of a High Court dependent upon the executive power. As a matter of principle, transfer of a case from one judicial forum to another judicial forum, without the intervention of a court

of law is against the independence of judiciary. This is true, particularly, when such a transfer can occur in exercise of pure executive power.

iv) The jurisdiction of a High Court is not dependent on the location of the Appellate Tribunal, as sometimes a Bench of the Appellate Tribunal exercises jurisdiction over plurality of States.

v) Appeals against every decision of the Appellate Tribunal shall lie only before the High Court within whose jurisdiction the Assessing Officer who passed the assessment order is situated. Even if the case or cases of an assessee are transferred in exercise of power u/s. 127 of the Act, the High Court within whose jurisdiction the Assessing Officer has passed the order, shall continue to exercise the jurisdiction of appeal. This principle is applicable even if the transfer is u/s. 127 for the same assessment year or years.

vi) Against the decision of the Appellate Tribunal, New Delhi dated May 11, 2017, the Delhi High Court was the correct Court to entertain and dispose of the appeal as per law.

vii) The Punjab and Haryana High Court did not also have jurisdiction to entertain the appeal against the order of the Appellate Tribunal arising out of the order passed by the Assessing Officer at Ghaziabad, and the correct High Court to dispose of the appeal would be the Lucknow Bench of the Allahabad High Court."

2 ***Principal CIT vs. Khyati Realtors Pvt. Ltd.; [2022] 447 ITR 167 (SC): Dated 25/08/2022:***

Bad debt — Principles governing deduction of — Law after 1989 — Provision for bad and doubtful debts no longer included — Merely stating debt irrecoverable and written off without appropriate treatment in accounts and compliance with conditions not sufficient — Assessee engaged in real estate business — Depositing sum of money with developers for acquisition of commercial premises — Project not materialising and sum written off in assessee's books — Accounts of assessee nowhere showing advance was in ordinary course of business — No details to substantiate that payment was for construction of unit to be given to assessee or that amount was given as loan — Nothing to suggest bad debt written off as irrecoverable in accounts for year — Sum advanced for acquiring immovable property could not be treated as business expenditure — Deduction of sum as bad and doubtful debt not allowable: Ss. 36(1)(vii), (2) and 37 of ITA 1961: A. Y. 2009-10

The assessee carried on real estate development business. The assessee deposited an amount of Rs. 10 crores with developers towards acquisition of commercial premises in 2007. The project did not make any progress, and consequently, the assessee sought return of the amounts from the builder. However, the developers did not respond. As a result, the assessee's board of directors resolved to write off the amount as a bad debt in 2009. For the A. Y. 2009-10, the assessee claimed deduction of this sum on the ground that its case fell within the provisions of section 36(2) of the Income-tax Act, 1961 and the write off of advances was allowable u/s. 36(1)(vii). The

Assessing Officer disallowed the sum of Rs. 10 crores claimed as a bad debt in determining its income under "Profits and gains of business or profession".

The Commissioner (Appeals) confirmed the disallowance. The Appellate Tribunal allowed the assessee's plea. The Bombay High Court dismissed the Department's appeal and ruled that no question of law requiring a decision arose.

The Supreme Court allowed the appeal filed by the Department and held as under:

"i) For the purposes of computing income chargeable to tax, besides specific deductions, "other deductions" enumerated in different clauses of section 36 of the Income-tax Act, 1961 can be allowed by the Assessing Officer. Each of the deductions must relate to the business carried out by the assessee. If the assessee carries on a business and writes off a debt relating to the business as irrecoverable, it would without doubt be entitled to a corresponding deduction under clause (vii) of sub-section (1) of section 36 subject to the fulfilment of the conditions set forth in sub-section (2) of section 36 of the Act.

ii) Before the amendment in 1989, the law was that even in cases where the assessee had made only a provision in its accounts for bad debts and interest thereon, without the amount actually being debited from the assessee's profit and loss account, the assessee could still claim deduction u/s. 36(1)(vii) of the Act. With effect from April 1, 1989, with the insertion of the new Explanation u/s. 36(1)(vii), any bad debt written off as irrecoverable in the account of the assessee would not include any "provision" for bad and doubtful debt made in the accounts of the assessee. In other words, before this date, even a provision could be treated as a write off. However, after this date, the Explanation to section 36(1)(vii) brought about a change. As a result, a mere provision for a bad debt per se is not entitled to deduction u/s. 36(1)(vii). Merely stating a bad and doubtful debt as an irrecoverable write off without the appropriate treatment in the accounts, as well as non-compliance with the conditions in section 36(1)(vii), (2), and Explanation to section 36(1)(vii) would not entitle the assessee to claim a deduction.

iii) The rulings of the Court lay down that : (i) The amount of any bad debt or part thereof has to be written off as irrecoverable in the accounts of the assessee for the previous year. (ii) Such bad debt or part of it written off as irrecoverable in the accounts of the assessee cannot include any provision for bad and doubtful debts made in the accounts of the assessee. (iii) No deduction is allowable unless the debt or part of it "has been taken into account in computing the income of the assessee of the previous year in which the amount of such debt or part thereof is written off or of an earlier previous year", or represents money lent in the ordinary course of the business of banking or money-lending which is carried on by the assessee. (iv) The assessee is obliged to prove to the Assessing Officer that the case satisfies the ingredients of section 36(1)(vii) as well as section 36(2) of the Act.

iv) The accounts of the assessee nowhere showed that the advance made by it to the developers was in the ordinary course of business. Its primary argument was that the amount of Rs. 10 crores was given for the purpose of purchasing constructed premises. However, the amount was written off on March 28, 2009. As noted by the Commissioner (Appeals), there was no material to substantiate this submission, in respect of payment of the amount, the time by which the constructed unit was to be given to it, the area agreed to be purchased, etc. Equally, in support of its alternate argument that the amount was given as a loan, the assessee nowhere established the duration of the advance, the terms and conditions applicable to it, interest payable, etc. The assessee conceded that it had received interest income for the relevant assessment year. However, it could not establish that any interest was paid (or shown to be payable in its accounts) for the sum of Rs. 10 crores. Furthermore, there was nothing on record to suggest that the requirement of the law that the bad debt was written off as irrecoverable in the assessee's accounts for the previous year had been satisfied.

v) Another reason why the amount could not have been written off, was that the assessee's claim was that it was given to the developers for acquiring immovable property – it therefore, was in the nature of a capital expenditure. It could not have been treated as a business expenditure. The assessee's claim to deduction of Rs. 10 crores as a bad and doubtful debt could not have been allowed.

vi) The proposition of law that even if a claim for deduction u/s. 36(1) is not allowed, the possibility of its exclusion u/s. 37 cannot be ruled out is unexceptional, since the heads of expenditure that can be claimed as deduction are not exhaustive – which is the precise reason for the existence of section 37. Therefore, in a given case, if the expenditure relates to business, and the claim for its treatment under other provisions are unsuccessful, application of section 37 is per se not excluded."

"So long as the millions live in hunger and ignorance, I hold every person a traitor who, having been educated at their expense, pays not the least heed to them!"

— *Swami Vivekananda*

"Seek not greater wealth, but simpler pleasure; not higher fortune, but deeper felicity."

— *Mahatma Gandhi*

Paras S. Savla
Advocate

Jitendra Singh
Advocate

Nishit Gandhi
Advocate

DIRECT TAXES
High Court

1

1) Pradeep Alexander 2) Academic Charitable Environmental and Research Foundation

vs

1) Tax Recovery Officer, 2) Sub-registrar 3) Club India Resorts & Metro Hotels Ltd.

[W.P. 11136 & 12683 of 2019, W.M.P. Nos. 11544, 11543 & 12913 of 2019, order dated 30.06.2022, Madras High Court]

Recovery of tax – attachment of immovable property – Transfer treated as void u/s section 281B – Held that in light of the statutory embargo under Rule 68B, the attachment of the properties itself, 25 years from the elapse of the assessment years in question, is wholly impermissible in law – Further attachments made after purchase of the properties by the petitioners for valuable consideration cannot be sustained by the Department

Facts

In this case writ petitions were filed challenging the order passed by the Tax Recovery officer, for attachment of immovable property. In WP.No.11136 of 2019, the Petitioner was an individual who had purchased land comprised in Survey No.316/1, Kankarkadu area, Poombarai Village, Kodaikanal Taluk, Dindigul District (property A) from an entity by the name and style of M/s Club India Resort and Metro Hotels Ltd. under a registered sale deed dated 08.12.2008. Petitioner claimed to be in absolute possession and enjoyment of the property thereafter and held valid documents issued by the revenue authorities in his favour. The petitioner in WP.No.12683 of 2019 claimed to be a research foundation that had purchased the land in Re-Survey No.316/3, Poombarai Village, Kodaikanal Taluk, Dindigul District (Property B) from one Mr.Mani under a registered sale deed dated 15.06.2009 and stated to be in absolute possession and enjoyment of the same thereafter. This petitioner also held valid documents issued by the revenue authorities in his favour.

The petitioners received order dated 13.07.2009 attaching several tranches of properties, including the properties in question that had earlier stood in the name of the M/s Club India Resort and Metro Hotels Ltd. assessee including the properties purchased by the petitioners.

The petitioners corresponded with the Department after having come to know of the impugned attachment, pointing out that they have purchased the properties in question and that the attachment is contrary to law. There had been no response to the representations. It is as against the aforesaid attachment notice that the writ petitions were filed.

Arguments before the Court

The Petitioner submitted as under;

(i) there was no justification whatsoever in law or on facts, for the Income Tax Department to have taken the impugned action.

(ii) the recovery was of arrears of an assessee unconnected to the petitioners

(iii) the lands in question constituted private lands of the petitioners

(iv) the petitioners had remitted valuable consideration for the purchase of the properties in question

(v) that apart, the arrears relate to assessment years (AY) 1995-96 to 1998-99, more than 15 years prior to when the impugned attachment was made.

The Department relied rely upon the provisions of Section 281B of the Income Tax Act, 1961 (in short 'Act') and several Rules in the Second Schedule that deal with, and set out the procedure for recovery of tax. It was submitted that the Income Tax Department was vested with the requisite power to attach the property of a defaulting assessee, who had transferred/dealt with property despite being in arrears of statutory demands that have attained finality. Department argued that Income-tax being a Crown debt, Income Tax Department would have first charge upon the property of a defaulting assessee. The alienation of its properties by a defaulting assessee in the face of pending arrears, are to be treated as void and thus, coercive recovery by way of the attachment of property was well founded.

Decision of the Court

The Court observed that the attachments have been made after the date of purchase of the properties in question, and the petitioners are unrelated to the defaulting assessee and there was no allegation whatsoever in regard to collusion between the parties. The purchase was bonafide and made for valuable consideration. The Court observed that the scheme of the Act and Rules provide for framing of assessment and raising of disputes both pre-assessment, that is, pending proceedings for assessment, as well as post-assessment, that is, after an order of assessment has been passed and demand raised in terms of Section 156 of the Act. Section 281B of the Act, protects the interests of the Department to the extent to which it invalidates any charge created upon, or alienation by an assessee of assets in his name, in favour of any other person. With effect from 01.10.1975, Section 281 was substituted and in the substituted form includes a proviso. The Court held that the proviso protects the interests of *bonafide* purchasers and states that the alienation

of the property by an assessee shall not be void, if it has been made by such assessee for adequate consideration and without having received any notice from the Assessing Officer of the pendency of the assessment proceedings or without notice of any tax or other sums payable by such assessee. Such charge/transfer shall also not be void had it been made with the previous permission of the assessing officer. Referring to the said section the Court held that it deals with the creation of charge/alienation of property, pending proceedings for assessment and prior to the service of notice under Rule 2 of the Second Schedule. Thus, where proceedings for assessment have been completed and an order of assessment, accompanied by a valid demand, has been served upon an assessee, that normally provides for a period of 30 days for settlement of the demand or a lesser period where the assessing officer in his discretion believes that such lesser period would be more appropriate in the circumstances of that case, but such demand still remains outstanding, then resort may be taken to the procedure set out in the Second Schedule to the Act. The trigger for the proceedings under the Second Seclude is the drawing up of a certificate under Section 222 of the Act by a Tax Recovery Officer (TRO). The Court took note of the fact that assessment proceedings are initiated and finalized under the powers granted to an assessing officer defined in terms of Section 2(25) whereas recovery in terms of the Second Schedule is by a TRO, as defined in Section 2(44) of the Act. There is thus a clear and categoric distinction between assessment and recovery under the Act. The definitions of, nomenclature used, titles, roles and powers of the two officers are separate and distinct. An Income Tax Officer (ITO) is defined under Section 2(25) and the appointment is in terms of Section 117. Once a certificate is drawn up under Section 222, an assessee is stated to be ‘in default’ or is deemed to be in default in making a payment of tax. Such a statement is to be drawn in terms of Rule 2 of the Second Schedule to the Act. The Court observed that such certificate was been drawn up on 13.08.2002 in the required form, being ITCP-1, certifying that a sum due from the assessee. With the issuance of Rule 2 notice, the procedure for recovery under the Second Schedule stands kick-started. Rule 3 of the Second Schedule provides for the execution of the certificate and provides for a period of fifteen days to be given to the defaulting assessee to settle the outstanding. Rule 4 talks about modes of recovery that are available to a TRO to proceed to realise the amount in question by (a) attachment and sale of the movable property (b) attachment and sale of defaulter’s immovable property (c) by arrest and detention (d) by appointing a receiver for the management of his properties. The Court observed that an attachment notice was sent on 10.07.2006. The properties in question, that had been attached, were specified and described in the notice of attachment.

The Court was of the view that, combined reading of the Rule 2 notice and the attachment notice issued in terms of Rule 4, made it clear that the attachment was only been of the rooms and resorts of the defaulting assessee. There was no mention of any other property that being attached. The Court then observed that power of detention was set out under Rule 48 which provides for an order prohibiting the defaulter from transferring or charging the property in any way and prohibiting all persons from taking any benefit under such transfer or charge.

On a combined reading of the certificate and attachment in terms of Forms ITCP-1 and ITCP-16 respectively, Court held that the attachment was only of the rooms of the properties and there has been no attachment of any other property of the defaulting assessee. The question then arose on the impact of a Rule 2 notice, which is an omnibus notice of demand.

The Court held that a literal reading of Rule 2 would result in a situation where any property of a defaulting assessee would fall and continue to be under a cloud, for all time, till such time the defaulter settles the arrears. The question then arises is as to the status of the property if the defaulter does not take any step for settlement of the arrears and neither does the Department, for enforcing recovery of the same. The Court also considered another argument raised by the Revenue upon an interpretation of Rule 16 of the Second Schedule, that deals with instances of private alienation and stipulates situations when such private alienation would be void. Taking a cue from Rule 16, Revenue argued that as notice under Rule 2 has been served as early as in 2002, the right of the assessee to alienate its properties stood frozen from the date of issuance of such notice and even for this reason, the transfers to the petitioners are void. The Court held that this argument fails in light of the time frame set in terms of Rule 68B of the Second Schedule, which, envisages similar situation and stipulates a time limit for sale of the attached property. In the present case, the demands had become final and that there have no appeals that have been filed by the defaulting assessee. The Court held that in such a situation, and in light of the statutory embargo under Rule 68B, the attachment of the properties in question, 25 years from the elapse of the assessment years in question, is wholly impermissible in law. The question of competence or otherwise of the assessee to have made the transfers in 2008 and 2009 becomes irrelevant as on date today, seeing as the time frame set out under Rule 68B has long expired and the Department has, admittedly not taken any action within the time provided. It must be noted that the scheme of recovery under the Second Schedule is time bound, sacrosanct and must be enforced strictly, both qua the assessee as well as the Department. The Court thus was of the view that the attachments made after purchase of the properties by the petitioners for valuable consideration cannot be sustained by the Department. Bearing in mind the elapse of time and the sequence of events that Court noticed, the reference to incompetence under Rule 16 is entirely misconceived. The impugned attachments were quashed and Department was directed to lift the attachments within a period of one week. The writ petitions were allowed.

2 ***Viraj Exports Pvt. Ltd. and Anothers vs The CCIT(TDS) and Anothers, W.P.(C) no. 6080/2022, C.M. No.18277/2022, order dated 05.09.2022, Delhi High Court]***

Prosecution u/s 276B for default of TDS – High Court confirmed rejection of compounding of offences on the ground that Assessee's application failed to disclose same offences in earlier years

Facts

Assessee Company, who was under an obligation to deduct income tax on payments made by it during the course of business, deducted the income tax but there was a

delay in depositing it with the Income Tax Department. However, the deposit of TDS did not cross the due date of filing of return of income in the concerned relevant FYs i.e. 2013-14, 2014-15 and 2016-17, and was made prior to any notice of default received from the department. Further the TDS was deposited along with the interest payable on the delayed payment for the relevant financial years.

The department issued a show cause notice for initiating proceedings u/s 276B r.w.s. 278B due to the admitted default in deposit of TDS. Upon receipt of the said notice, Assessee filed an application for compounding of the offences for FYs 2013-14, 2014-15 and 2016-17. The said application was withdrawn and a fresh application for compounding of offences under Sections 276B and 278B was filed on 22nd March, 2021, in compliance with the Guidelines dated 14th June, 2019, issued by the Government of India, Ministry of Finance, Department of Revenue, Central Board of Direct Taxes ('CBDT') for compounding of the offences under Direct Tax Laws, 2019 (Compounding Guidelines, 2019).

The said application for compounding of offences filed on 22nd March, 2021 was processed by the CCIT (TDS) and he issued a notice dated 10th November, 2021, recording that the application is not maintainable in light of the para 8.1. (iii) of the Compounding Guidelines, 2019 and also due to the suppression of the fact that Assessee has been convicted for the same offences for FYs 2009-10, 2010-11 and 2011-12, which information was not disclosed in the application. Opportunity to the rebut the observations were granted in the said notice. Assessee furnished a reply dated 22nd November, 2021 to the aforesaid notice, explaining the reasons for non-mentioning of the conviction for the FYs 2009-10, 2010-11 and 2011-12. In this reply, it was stated that the order of conviction was under challenge before the Supreme Court in Special Leave Petition ('SLP'), wherein had stayed the operation of the order of conviction. It was further stated that the compounding application filed before the CCIT pertained to compounding of the FYs 2013-14, 2014-15 and 2016-17, which are entirely different from the Financial Years, which are the subject matters of the conviction orders pending before the Supreme Court, being FYs 2009-10, 2010-11 and 2011-12. The CCIT after considering the aforesaid reply concluded that Assessee has misrepresented facts by not disclosing the existence of the order convicting for defaults committed in the FYs 2009-10, 2010-11 and 2011-12. The CCIT also rejected the contention that the stay order granted by the Supreme Court with respect to the previous conviction would amount to overturning the conviction and concluded that the Assessee was not fit for compounding of the offences in the light of the para 8.1 (iii) contained in CBDT Guidelines, 2019 due to its prior conviction. The Assessee challenged the said order by filing a writ petition before Delhi High Court.

Arguments before the Court

It was contended on behalf of the Assessee that the information required to be furnished in response of Column No. 18 of the Form of Compounding Guidelines, 2019, pertains only with respect to conviction, if any, for the FYs 2013-14, 2014-15 and 2016-17, in respect whereof, compounding was sought and admittedly, there was no conviction in the said Financial Years and therefore

there was no wrong information furnished in the application. In the alternative, it was submitted that in light of the stay order granted by the Supreme Court it does not fall in the category of 'convict' and therefore, the information provided in Column No. 18 of the application was not false. Reliance was placed on various judgements.

The department submitted that compounding of offences is not a matter of right. The compounding application can only be allowed, subject to the satisfaction of the competent authority of the eligibility conditions as prescribed in the CBDT Guidelines, 2019 and keeping in view the factors such as conduct of the applicant and other relevant facts and circumstances. It was also contended that in light of the repeated defaults of the Assessee since FY 2009-10 till FY 2016-17 the CCIT was justified in rejecting the application.

Decision of the Court

The Court observed that the facts pertaining to default by the Assessee in depositing the TDS for six (6) years during the period between FYs 2009-10 to 2016-17 (except FY 2012-13 & 2015-16) was not in dispute. The conviction of the Assessee by the criminal Court for the defaults for FY 2009-10, FY 2010-11 and FY 2011-12 was also not in dispute. The Court observed that Assessee has inexplicably not applied for compounding of its conviction for the said FYs 2009-10, 2010-11 and 2011-12 and has only applied for compounding the prosecution for subsequent defaults committed in FYs 2013-14, 2014-15 and 2016-17. The conviction for FYs 2009-10, 2010-11 and 2011-12 and non-disclosure of the said fact weighed with CCIT while rejecting the 279(2) of the Act. The Court observed that a complaint with respect to the default for financial year 2010-11 pertaining to assessment year 2011-12 was instituted on 11th March, 2016. The trial Court convicted the Assessee on 10th January, 2018. The appeal filed by the Assessee against the said order was dismissed by the appellate Court on 12 March 2018. The Criminal revision petition filed by Assessee before the Delhi High Court was also dismissed on 15 October 2018. In the SLP filed before the Supreme Court, notice was issued on 18 February 2019, whererin Supreme Court had stayed operation of the order. The Court observed that Assessee was also been convicted for default in deposit for FY 2009-10 and 2010-11, however the order of the Trial Court and Appellate Court was not placed on record. The Court observed that order passed by the High Court dismissed three (3) revision petitions presumably against the orders of conviction for the aforesaid three financial years.

Upon inquiry with respect to the steps taken by Assessee for compounding the said conviction for FY 2009-10, 2010-11 and 2011-12, Assessee stated that he has not filed any application for compounding of the said offences. The Court noted that though, the complaint under Sections 276B and 278B of the Act was instituted on 11th March, 2016, for defaults committed in FY 2011-12 and a show cause notice for the said default was issued by department on 28th July, 2014, the Assessee again committed default in depositing of TDS for the subsequent FYs 2013-14, 2014-15 and 2016-17. The Court observed that Assessee continued to default in deposit of TDS, despite having received a show cause notice dated 28th July,2014 and undeterred by the fact that a complaint also stood instituted in 2016. The Court observed that the question in

Column No. 18 of the Form was “whether the applicant was convicted by a court of law for the offence sought to be compounded?”. The Court held that the contention of the Assessee that non-disclosure of the conviction in the application for the FYs 2009-10, 2010-11 and 2011-12 was on the bona fide understanding that Column No. 18 requires disclosure of conviction pertaining to the assessment years for which compounding is sought was incorrect. This was evident from contradistinction of the information sought at Column No. 5 of the same Form, which read as “Status of case (i.e. whether Contemplated/ Pending in Court/Convicted/Acquitted)”.

The Court held that Column No. 5 requires the status of the complaint of the relevant assessment year pertaining to the offences which is sought to be compounded. Column No. 18 clearly requires disclosure of a prior conviction for the similar offence, which was necessary with respect to other assessment years. The Court thus, did not accept the submission made by the Assessee that it was not required to disclose the conviction order for FYs 2009-10, 2010-11 and 2011-12.

Reliance was placed on the Supreme Court judgement in case of ***Rama Narang vs. Ramesh Narang & Ors. (1995) 2 SCC 513,*** wherein it has observed that, there can be a suspension of ‘sentence’ as well as ‘conviction’ under Section 389(1) of Cr.P.C., however, the suspension of conviction can be done only in exceptional cases, for instance, where the conviction may incur disqualification. The Supreme Court further iterated that the Appellate Court must be apprised of the consequence that is likely to fall if conviction is not stayed to enable the Court to apply its mind to the issue and record its reasons in writing, since under Section 389(1) of Cr.P.C., the Court is under an obligation to support its order with reasons in writing. The aggrieved cannot suppress the precise purpose for which he seeks suspension of the conviction and obtain a general order of stay and then contend that the disqualification has ceased to operate.

The Court thus observed that the SLP is pending and may either be allowed or dismissed. There is no presumption that the SLPs will be allowed in favour of Assessee. Further from a perusal of the stay order passed in the SLP, it was not evident that the Supreme Court was made aware of the subsequent defaults or the disqualification which attaches to the Assessee while seeking compounding for subsequent years under the applicable CBDT guidelines for compounding. THE Court thus held that the stay by the Supreme Court, cannot be urged by the Assessee for contending that it is not a convict for the purpose of eligibility under the CBDT guidelines, 2019. The Court held that the Assessee cannot contend that the competent authority must not concern itself with the orders of conviction for FYs 2009-10, 2010-11 and 2011-12 within the parameter of para 8.1 (iii) of the CBDT Guidelines, 2019 while considering the compounding application for the subsequent assessment years. This is also for the reasons that peculiarly the Assessee was not seeking compounding of the offences for which he has been convicted. The Court held that prior order of conviction is a relevant fact and not inconsequential. The competent authority cannot be faulted for taking exception to such a non-disclosure.

It is well settled that Court in exercise of its power of judicial review, reviews the process adopted by the adjudicating authority and

whether the decision suffers from error of jurisdiction. In the present case, the Court noted that the competent authority has duly applied its mind to the Assessee's application. It also issued a show- cause notice to the Assessee to explain the circumstances in which the material information pertaining to prior conviction was not disclosed in the petition. After considering the reply filed by the Assessee, the CCIT has passed a reasoned order rejecting the compounding application. The Court thus did not find any infirmity in the impugned order passed by the CCIT in exercise of his jurisdiction. The Court however, observed that in the event, Assessee succeeds in the Special Leave Petition being SLP (Crl.) No. 1576/2019 filed before the Supreme Court, the Assessee will be entitled to apply for compounding of the offences for the Financial Years 2013-14, 2014- 15 and 2016-17 and the said application, as and when filed, shall be considered by the Commissioner in accordance with law.

3 ***Gopalakrishnan Rajkumar vs. PCIT, W.P. Nos. 6367 & 6374 of 2021, WMP Nos. 6979, 6980, 6985, 6987, 18493 & 18494 of 2021, order dated 22 April 2022, Hon'ble Madras High Court***

Revision of orders prejudicial to revenue - section 263 of the Income Tax Act, 1961 - dispute settled through DTVSV Scheme - notice issued under section 263 of the Act to revise the assessment order, indicating that assessee had incorrectly claimed deduction under section 54F of the Act - unjustified. [A.Y. 2011-12]

Facts

The assessee has received certain consideration from sale proceeds of a land belonging to a firm in which his deceased father was a partner. The assessee while filing his return of income for the year under consideration claimed exemption under section 54F of the Act.

The Assessing Officer reopened the assessment under section 147 of the Act. After considering the contentions of the assessee, the Assessing Officer finalized the assessment order by making an addition under the head capital gains.

The assessee being aggrieved filed an appeal before the Ld. CIT(A) which was pending for adjudication. The assessee opted for settlement under Direct Tax Vivad Se Vishwas Act, 2020 (DTVSV Act) and filed form No. 1 and 2 to settle the dispute. The designated authority also issued form No. 3 determining the taxes payable by the assessee. Ultimately the assessee paid the taxes as per the form No. 3 issued and also communicated to the designated authority.

The Principal Commissioner of Income Tax (PCIT) thereafter issued the notice under section 263 of the Act on the ground that the assessment order passed by the Assessing Officer is erroneous as well as prejudicial to the interest of the revenue as the assessee had incorrectly claimed deduction under section 54F, therefore, deduction under section 54F was to be withdrawn and the gross receipt was to be treated as an income from other source.

Being aggrieved by the above said notice issued under section 263 of the Act, the assessee challenged the same before the Hon'ble Madras High Court.

Assessee's argument before the Hon'ble court

The assessee before the Hon'ble High Court

contended that the notice issued under section 263 of the Act is without jurisdiction in the light of the fact that the assessee has settled his dispute under the DTVSV Act 2020. Hence, in the light of the subsequent developments, the assessee's rights under the appeal as also the case for being settled under the DTVSV Act, 2020, cannot be compromised

Department's argument before the Hon'ble court

On the other hand, the department contended that the assessee was not a partner in the firm which had sold the immovable property. Hence, income from the sale of immovable property by the firm cannot be treated as a long-term capital gain in the hands of the assessee and ought to have been assessed as income from other sources. Hence, the return filed under section 139 of the Act was incorrect. Thus, there is no question of the assessee claiming legitimately the benefit of Section 54F of the Act. Therefore, the PCIT is well within his right to invoke the jurisdiction under section 263 of the Act as the Assessment order passed by the Assessing Officer is erroneous as well as prejudicial to the interest of the revenue.

Decision of Hon'ble Madras High Court

The Court was mindful of Section 5 of the Direct Tax Vivad Se Vishwas Act, 2020, that makes it clear that save as otherwise expressly provided in sub-section (3) of section 5 or section 6, noting contained in this Act shall be construed as conferring any benefit, concession or immunity on the declarant in any proceedings other than those in relation to which the declaration has been made. The Court observed that Section 6 of the Direct Tax Vivad Se Vishwas Act, 2020, makes it very clear that once there is a compliance with the timeliness specified under section (5), the designated authority shall not institute any proceedings in respect of an offence or aims or levy any penalty or charge any interest under the Income-tax in respect of the tax arrears.

The Court held that the intention of the parliament enacting the of the Direct Tax Vivad Se Vishwas Act, 2020, was to bring a closure of disputes in respect of tax arrears. Whether the Assessee had correctly or wrongly availed the benefit of section 54(F) of the Income-tax Act or not cannot be re-opened once again under section 263 of the Income-tax Act, 1961. The Court held that once an Assessee had opted to settle the dispute under the Direct Tax Vivad Se Vishwas Act, 2020, the proceedings initiated under section 263 have to go. The writ petition was allowed, and the notices were quashed.

4 ***Rajendra R. Singh vs. ACIT [WP No. 3590 of 2019, order dated 26.07.2022, Bombay High Court]***

Liability of Directors - section 179 of the Income Tax Act, 1961 - proceedings initiated against the assessee without recording any satisfaction that the tax cannot be recovered from the company - unjustified. [A.Y. 2010-11]

Facts

The assessee before the Hon'ble Bombay High Court was the Chairman and Managing Director in a company namely "Crest Paper Mills Limited" (CPML). The assessee was served with a notice informing him that tax dues for an amount of ₹ 3,88,19,430/- were

outstanding against M/s. Crest Paper Mills Ltd. and therefore the assessee was show caused as to why proceedings under section 179 of the Act be not initiated against him for recovery of the said tax amount.

In reply to the said notice, the assessee submitted that jurisdiction under section 179 of the Act could be assumed as against a director of a private company and not against a public company. The assessee further contended that the proceedings against a director cannot be initiated without exhausting all the remedy available for recovery of tax from the company and there is no finding in the notice that amount due from the company cannot be recovered from the company.

The Department rejected the objections and contentions raised by the Director observing that the allegation that the proceedings under section 179 were directly initiated was baseless. It was further observed that after the determination of tax demand, several phone calls were made to the ARs of the assessee which did not elicit any response whereafter the bank account of the assessee was attached for recovery of dues and further that proceedings under section 179 were initiated because the assessee was unwilling and non-co-operative to pay its tax dues. On the issue whether section 179 could be resorted to against the directors of the public company, it was held that no evidence had been furnished by the Director to prove that it was a public company. It was further held that the assessee company having been delisted from the stock exchange as a penal measure for failure to comply with the requirements of the Listing Agreement did not warrant that the benefits attached to the public company should be accorded to the Assessee Company. Further, it is held that assuming the company is a public company, yet by lifting the corporate veil, even the directors of such companies could be brought within the purview of section 179 especially where the affairs of the company were not conducted as a public limited company in its true sense.

Based upon the above reasoning and by holding that the Director during the relevant period, was a part of the decision making process which led to the crystallization of the demand for the assessment year 2010-11, the Director was held jointly and severally liable for the entire demand of ₹ 3,98,19,430/- along with interest under section 220(2) of the Act, outstanding in the name of CPML. This order was challenged in revision under section 264 which was also dismissed. The Director being aggrieved by the impugned order challenged the same before the Hon'ble Bombay High Court.

Decision of the Court

Referring to section 179, the Court observed that before the jurisdiction is assumed and exercised under section 179 against the Director the Assessing Officer must feel satisfied that:

a) tax was due from the Private Limited Company, and that

b) the tax dues cannot be recovered from such a company

The Court observed that, in the present case, the notice under section 179 of the Act issued by Department did not at all inform the Director of its intention to treat the company, i.e., CPML as a public company by invoking the principle of 'lifting the corporate veil' much less did it refer to any material or

conclusion based upon which it could assume jurisdiction under section 179 of the Act against the directors of a Private Company.

On the other hand, the Department invoked the principle of lifting the corporate veil to hold that CPML was in fact a privately held enterprise under the garb of a public company only after the Director had taken an objection to the Officer assuming jurisdiction against a public company. The Court refrained to go into the question as to whether, the facts and circumstances of the case justified invoking the principle of lifting the corporate veil, but held that the procedure adopted by Officer was clearly violative of the principles of natural justice and without affording to the Director, an opportunity of being heard on the question, as to why the principle of 'lifting the corporate veil' be not applied in the case of CMPL to justify the recovery of the tax dues from the directors.

The Court observed that the impugned orders were also unsustainable on another ground. Power under section 179 of the Act can be exercised against the Directors upon satisfaction of certain conditions only if the tax dues cannot be recovered from the private company. To justify that the tax dues cannot be recovered, the Assessing Officer has to enumerate the steps taken towards recovery of tax dues from the company. Referring to the show cause notice the Court held that the notice clearly suggest that there was no satisfaction recorded that the tax cannot be recovered. It needs to be understood that recovery procedure under section 179 of the Act against the directors is not to be resorted to casually and only because it is convenient to do so for affecting recovery of the tax dues. To demonstrate that the Officer had mechanically resorted to the provisions of section 179 of the Act, the Director relied upon an order of attachment, dated 6th March 2019, whereby the Tax Recovery Officer-2, Thane had ordered the attachment of land at Village Kalivali, Taluka Panvel, Dist. Raigad to show that if Officer had made an effort, the tax dues could be recovered from the company. In response, the Department had filed an affidavit in reply in which a stand was taken that steps for sale of the property attached would be initiated after getting the fair market value determined. The Court held that this statement itself has the effect of nullifying the action initiated u/s 179 of the Act against the Director rendering the order impugned unsustainable in law.

In the light above, the Writ Petition was allowed. The order passed u/s 179 as well as order passed u/s 264 of the Act were quashed. The Court however, directed that in case, the tax dues are not fully satisfied upon sale of the property that has been attached, then the Assistant Commissioner can proceed in the matter afresh in accordance with law, after giving an opportunity of being heard to the Director.

Neelam Jadhav,
Advocate

Tanmay Phadke
Advocate

DIRECT TAXES
Tribunal

1 ***Amasebail Vyvasaya Seva Sahakari Sangha Ltd. vs. Dy,CIT [537/Bang/2022](AY 2018 – 2019)***

Section 80P : Exemption is allowable for income of co-operative societies is allowable, If delay in Filing Income Tax Return is condoned by Competent Authority

Facts

The assessee, Amasebail Vyvasaya Seva Sahakari Sangha Ltd. filed an application for condonation of delay in filing the income tax return for the assessment year 2018-19 and on the basis, exemption u/s 80P of the Act to be granted. The assessee pleaded to grant an exemption under section 80P on the income return that would be filed after condoning the delay in filing the income tax return for the assessment year 2018-19.

Held

The Tribunal held that, if the delay is condoned by the competent authority, assessee is entitled for exemption u/s 80P of the Act in accordance with law. It was not justified in denying exemption under section 80P of the Income-tax Act on the mere ground of belated filing of return. A return filed by the assessee beyond the period stipulated under section 139(1) or 139(4) or section 142(1) or section 148 can also be accepted and acted upon provided further proceedings about such assessments are pending in the statutory hierarchy of adjudication in terms of the provisions of the Income-tax Act.

2 ***Girdhar Gopal Rastogi vs. CIT [ITA 162 /Alld/2019] (AY: 2012-13)***

Sections 131 and 133A: Proceedings u/s 131 and 133A are different. Impounding of books of accounts u/s 131 cannot be considered as "impoundment during a survey proceeding." and a case would not fall in the category of compulsory scrutiny as per Instruction No. 13/2013

Facts

A survey u/s 133A was conducted at the premises of the assessee. Thereafter, the AO issued summons u/s 131. Accordingly, the Assessee visited the office of the AO along with books of account. The statement of the

assessee was recorded and the books were impounded. Thereafter, notice u/s 143(2) was issued and the assessment was framed. Being dissatisfied, the Assessee challenged the order before the CIT(A) without any success. Thereafter, the assessee approached the ITAT. It was submitted that the notice u/s 143(2) and the consequent assessment order were bad in law in the light of Instruction No. 13/2013. After hearing both the sides, the ITAT held as under:

Held

The ITAT observed that the books of accounts were impounded during the course of summon proceeding and there was no impounding during the survey. The ITAT referred to the Instruction No. 13/2013 and observed that the clause (d) of para 3 of the instructions is without any ambiguity and enunciates that where no impounding of books of account or documents during survey under section 133A then the case would not fall in the category of compulsory scrutiny. The ITAT further observed that the revenue has not disputed the fact that the returned income for the year under consideration is not less than the returned income of the preceding year and there is no doubt about the satisfaction of the criteria prescribed in the instructions that where the books of account are not impounded during the survey and returned income for the year is not less than the returned income of the preceding year the case would not fall in the category of compulsory scrutiny. Sections 133A and 131 are district and impounding of documents during summon cannot be considered as that of the survey proceeding. As there was no impounding of the books of account during the survey u/s 133A and the returned income of the assessee for the year under consideration was not less than the returned income of the immediate preceding year, the Revenue was incorrect in picking up the case for the compulsory scrutiny. The ITAT held the assessment without jurisdiction and quashed the same.

3 *M/s. Hamilton Industries Pvt. Ltd vs. ITO [ITA 218/Mum/2022](A.Y. 2018-19)*

Section 234C(1) : Interest on deferment of advance tax - Failed to make Payment of Advance Tax towards Unexpected Income does not attract Interest u/s. 243C(1)

Facts

The appellant declared total income under the normal provisions as well as under the provisions of MAT. Accordingly, the appellant company had paid taxes with interest under MAT. The Book profit includes capital gain which arose in 4th quarter only i.e., on 28-02-2018 and 28-03-2018. Accordingly, appellant paid advance tax on 15-03-2018 and 31-03-2018 for the capital gains arose on 28-02-2018 and 28-03-2018 respectively. Subsequently in intimation u/s. 143(1) wherein all the calculations of tax payable, interest, figures of income returned and other figures embodied in the return were accepted by the CPC Bangalore, except the interest u/s.234C was enhanced. The appellant had filed an application for rectification u/s 154, the said application was rejected by CPC Bangalore. The appellant filed an appeal before the National Faceless Appeal Centre (NFAC), Delhi, the appeal of the appellant was rejected by the (NFAC). Then after Appellant filed an appeal before the ITAT.

Held

The Honourable ITAT observed that, it was established law that provisions of sec 234C are applicable in the case of Income chargeable to tax u/s 115JA/115JB. The

provisions of S. 234C (1) regarding payment of interest shall not apply to any shortfall in the payment of the advance tax due on the returned income. Further observed that, when the appellant was not possible to estimate accrual or receipt of income at any time when the payment of the first, second, third or fourth instalment of advance tax then the appellant is not liable to pay advance tax on the respective due dates in respect of such windfall gain. The Tribunal held that, if the returned income is higher due to unexpected income received after earlier due dates, the shortfall in payment of advance tax instalment on an earlier date may not attract interest. Further, observed that S. 234C (1) shall not apply to any shortfall in the payment of the advance tax due on income like windfall gain/unexpected income under other heads of income.

4 ***Air India air transport services Ltd vs. DCIT [ITA 2856 /Mum/2019] (AY: 2013-14)***

Section 271B: Penalty is not leviable as the Tax audit report u/s 44AB could not be furnished by the Assessee, a government owned company, before the specified date due to non-completion of the audit under the Companies Act and delay in getting a report from the CAG

Facts

The assessee is a public sector company wholly owned by the Government of India. The assessee did not furnish a tax audit report u/s 44AB within the prescribed time limit and thus, the AO levied the penalty u/s 271B of the Act. Being aggrieved, the assessee filed an appeal before the CIT(A) but did not succeed. Subsequently the appeal was filed before the ITAT. It was submitted by the assessee that it is a public sector company and had to get the accounts audited under the Companies Act and subsequently, also had to obtain a report from the CAG which took substantial time due to which the tax audit report could not be filed on time. The Revenue submitted that as there was no sufficient cause, the levy of penalty was justified in law. After hearing both the sides, the ITAT held as under:

Held

The ITAT relied on the decision of the special bench in the case of "ACIT vs. Gayatri traders (1996) 58 ITD 121" and noticed that the penalty was leviable even if the audit report was not filed within the prescribed time as mentioned under section u/s 44AB of the Act. In other words, the ITAT observed that the penalty was not only for the complete failure to obtain a tax audit report but also the delay in obtaining the same. However, the ITAT noticed that the assessee was a public sector company owned by the government of India and was subject to different compliances. It was observed by the ITAT that the accounts of the assessee were not finalised before 30.09.2014. The statutory audit was completed on 23.01.2014 and the report from the CAG was obtained in March 2014. The tax audit could not be conducted prior to the statutory audit and the CAG report which took place only after 30.09.2014. The ITAT observed that despite of best efforts, the tax audit could not be conducted due to the circumstances beyond the control of the assessee and thus, the levy of penalty u/s 271B was unjustified. The ITAT deleted the penalty and allowed the appeal filed by the Assessee.

Aditya Surte
Advocate

INDIRECT TAXES

GST Gyaan — Important Changes Relating to Goods after the Recommendations of The 47th GST Council Meeting

The 47th meeting of the Goods and Services Tax Council was held on 28th and 29th June 2022 at Chandigarh under the chairmanship of Union Minister for Finance & Corporate Affairs Smt. Nirmala Sitharaman. The GST Council made several recommendations relating to changes in GST rates on supply of goods and services as well as changes related to GST law and procedure. Following the said meeting, a plethora of notifications and circulars were issued by the Central Board of Indirect Taxes (CBIC). So much so, that the recommendations and changes have been compared to a mini budget in GST. It is, therefore, necessary to understand and comprehend the changes thoroughly.

The following article focuses on the important changes relating to goods as recommended by the GST Council in its 47th meeting and implemented by the CBIC by issuance of notifications and circulars.

1. Rate rationalisation on food products

1.1. Probably the most radical change in the taxation of goods is the change in the approach of taxing the packaged food items. Prior to the amendment, GST was applicable on specified goods when they were put up in a unit container and were bearing a registered brand name in respect of which an actionable claim or enforceable right in a court of law was available. Where such goods did not bear a registered brand name or where the actionable claim or enforceable right in respect of such brand name was forgone by way of a specific declaration, exemption was available.

1.2. The GST Council, at its 47th meeting, recommended to revise the scope of exemption to exclude from it pre-packaged and pre-labelled retail pack in terms of the Legal Metrology Act, 2009 (including pre-packed, pre-labelled curd, lassi and buttermilk), irrespective of whether they are unbranded goods or that the right on the brand has been foregone.

1.3. Accordingly, Notification No. 6/2022-CTR dated 13.07.2022 was issued to

amend the relevant entries in Schedule I – 2.5% of Notification No. 1/2017-CTR dated 28.06.2017. The amended entries read as follows:

Sl. No.	***Chapter/ Heading/Sub-heading/Tariff item***	***Description of goods***
1	0202, 0203, 0204, 0205, 0206, 0207, 0208, 0209, 0210	All goods [other than fresh or chilled], pre-packaged and labelled
2	0303, 0304, 0305, 0306, 0307, 0308, 0309	All goods [other than fresh or chilled], pre-packaged and labelled
9A (New)	0403	Curd, Lassi, Butter milk, pre-packaged and labelled
11	0406	Chena or paneer, pre-packaged and labelled
13	0409	Honey natural, pre-packaged and labelled
16	0504	All goods [other than fresh or chilled], pre-packaged and labelled
25	0713	Dried leguminous vegetables, shelled, whether or not skinned or split, pre-packaged and labelled
26	0714	Manioc, arrowroot, salep, Jerusalem artichokes, sweet potatoes and similar roots and tubers with high starch or inulin content, frozen, whether or not sliced or in the form of pellets, pre-packaged and labelled
30	08	Makhana, dried whether or not shelled or peeled, pre-packaged and labelled
45	10	All goods i.e. cereals, pre-packaged and labelled
46	1001	Wheat and meslin, pre-packaged and labelled
47	1002	Rye, pre-packaged and labelled
48	1003	Barley, pre-packaged and labelled
49	1004	Oats, pre-packaged and labelled
50	1005	Maize (corn), pre-packaged and labelled
51	1006	Rice, pre-packaged and labelled
52	1007	Grain sorghum, pre-packaged and labelled

Sl. No.	***Chapter/ Heading/Sub-heading/Tariff item***	***Description of goods***
53	1008	Buckwheat, millet and canary seed; other cereals such as Jawar, Bajra, Ragi, pre-packaged and labelled
54	1101	Wheat or meslin flour, pre-packaged and labelled
55	1102	Cereal flours other than of wheat or meslin i.e. maize (corn) flour, Rye flour, etc., pre-packaged and labelled
56	1103	Cereal groats, meal and pellets, including suji and dalia, pre-packaged and labelled
58	1105	Meal, powder, flour, flakes, granules and pellets of potatoes, pre-packaged and labelled
59	1006	Meal and powder of the dried leguminous vegetables of heading 0713 (pulses) [other than guar meal 1106 10 10 and guar gum refined split 0713], of sago or of roots or tubers of heading 0714 or of the products of Chapter 8, pre-packaged and labelled
91A (New)	1701 or 1702	Jaggery of all types including Cane Jaggery (gur), Palmyra Jaggery, pre-packaged and labelled; Khandsari Sugar, pre-packaged and labelled
98A (New)	1904	Puffed rice, commonly known as Muri, flattened or beaten rice, commonly known as Chira, parched rice, commonly known as khoi, parched paddy or rice coated with sugar or gur, commonly known as Murki, pre-packaged and labelled
101A	2106 90	Namkeens, bhujia, mixture, chabena and similar edible preparations in ready for consumption form, other than those pre-packaged or labelled

1.4. Entries in Schedule II – 6% of Notification No. 1/2017-CTR have also been amended vide Notification No. 6/2022-CTR. The amended entries read as follows:

Sl. No.	Chapter/Heading/ Sub-heading/ Tariff item	Description of goods
41A	2009 89 90	Tender coconut water, pre-packaged and labelled
46	2106 90	Namkeens, bhujia, mixture, chabena and similar edible preparations in ready for consumption form [other than roasted gram], pre-packaged and labelled

1.5. Exemption from tax relating to the aforesaid goods under Notification No. 02/2017-CTR shall now be available only when such goods are supplied in other than pre-packaged and labelled form.

1.6. Clause (ii) of the Explanation given under Notification No. 1/2017-CTR has been substituted to define the expression 'pre-packaged and labelled' to mean a **'pre-packaged commodity'** as defined in clause (l) of section 2 of the Legal Metrology Act, 2009 (1 of 2010) where, the package in which the commodity is pre-packed or a label securely affixed thereto is required to bear the declarations under the provisions of the Legal Metrology Act and the rules made thereunder.

1.7. On perusal of the above definition, it is noticed there is two-fold criteria for the goods to be called **pre-packaged and labelled** for the purposes of GST:

a) It is a pre-packaged commodity; and

b) It is required to bear the declarations under the provisions of the Legal Metrology Act, 2009 and the rules made thereunder.

1.8. As for the first criteria, clause (l) of section 2 of the Legal Metrology Act, 2009 defines "pre-packaged commodity" to mean a commodity which without the purchaser being present is placed in a package of whatever nature, whether sealed or not, so that the product contained therein has a pre-determined quantity.

1.9. However, if such pre-packaged commodity is supplied in a package that does not require declaration(s) / compliance(s) under the Legal Metrology Act and the rules made thereunder, the same would not be treated as pre-packaged and labelled for the purposes of levy of GST.

1.10. In this context, a useful reference may be made to The Legal Metrology (Packaged Commodities) Rules, 2011 (hereinafter referred to as "LMPCR" for the sake of brevity). Provisions applicable to packages intended for retail sale are covered by Chapter II of LMPCR. Rule 3 relating to applicability of Chapter II states that the provisions of the said Chapter shall not apply to –

a) packages of commodities containing quantity of more than 25 kg or 25 litre excluding cement or fertilizer sold in bags up to 50 kg; and

b) packaged commodities meant for industrial consumers or institutional consumers.

1.11. Therefore, specified food articles which are pre-packaged and sold in retail packs of up to 25 kg or 25 litre will be liable to GST and those sold in retails packs of more than 25 kg or 25 litre will be exempt from levy of GST, since they are not required to bear the declarations under the Legal Metrology Act r/w LMPCR. The FAQs on GST applicability on pre-packaged and labelled goods issued by the Tax Research Unit[1] also clarify that **"a**

1. Vide F. No. 190354/172/2022-TRU, dated 17th July 2022

single package of these items [cereals, pulses, flour etc.] containing a quantity of more than 25 Kg/25 litre would not fall in the category of pre-packaged and labelled commodity for the purposes of GST and would therefore not attract GST."

1.12. For the purposes of rule 3 of LMPCR, 'institutional consumer' means the institutional consumers like transportation, Airways, Railways, Hotels, Hospitals or any other service institutions who buy packaged commodities directly from the manufacturer for use by that institution and 'industrial consumer' means the industrial consumers who buy packaged commodities directly from the manufacturer for use by that industry[2]. As such, packaged food articles which are meant for consumption by industrial consumers or institutional consumers are exempt from levy of GST irrespective of whether they are packed in units of up to 25 kg or 25 litre, since they are not required to bear the declarations under the Legal Metrology Act and the LMPCR. S. No. 7 of FAQs referred to above affirms the said view.

1.13. As to the question of a wholesale package containing multiple retail packs of less than 25 kg but exceeding 25 kg in total, S. No. 4 of the FAQs referred to above clarifies that in case several packages intended for retail sale to ultimate consumer are sold in a larger pack, then GST would be applicable to such supply, since the individual packs of less than 25 kg each are meant for eventual sale to retail consumer. The same FAQ further clarifies that a package of say rice containing 50 kg (in one individual package) would not be considered a pre-packaged and labelled commodity for the purposes of levy of GST even if rule 24 of LMPCR mandates certain declarations to be made on such wholesale package.

1.14. As to the applicability of GST on supply of loose quantities of food articles by a retailer, since the goods do not get covered by the term 'pre-packaged commodity' as defined u/s 2(l) of the Legal Metrology Act, they would not be considered as 'pre-packaged and labelled' for the purposes of levy of GST.

1.15. Another issue for consideration is whether the fact that the supplier of specified goods, though required, is not complying with the provisions of the Legal Metrology Act for making the necessary declarations under the LMPCR, is relevant for determining the applicability of GST on such goods? The answer is in the negative. Once the goods in question are pre-packaged commodity and are **required to bear the declaration**, they would be treated as 'pre-packaged and labelled' and GST would be leviable irrespective of whether the supplier is complying with the provisions of the Legal Metrology Act or not.

2. *Explanation* to rule 3 of LMPCR

1.16. Lastly, rule 26 of LMPCR exempts certain commodities from applicability of the said rules. Accordingly, where the specified goods conform to the criteria given under rule 26 and are therefore, exempt from the provisions of LMPCR, such goods shall not be considered as 'pre-packaged and labelled' for the purposes of levy of GST.

1.17. Following the change of rates in case of pre-packaged and labelled food articles, the Ministry of Consumer Affairs, Food and Public Distribution vide a letter dated 01.08.2022 addressed to the Controller of Legal Metrology of all States / UTs, has issued guidelines on revision of MRP on unsold stock of pre-packaged commodities. The guidelines, in a nutshell, state that –

a) the unsold stock with the revised MRP must be disposed on or before 31st January 2023;

b) the difference between original and revised MRP cannot be higher than the tax amount;

c) the original MRP shall continue to be displayed and the revised MRP shall not overwrite it.

d) manufacturers/ packers/ importers must advertise the change in MRP.

2. Changes relating to expeditious disposal of withheld refund claims of risky exporters

2.1. The Council in its 47th meeting had recommended to amend rule 96 of CGST Rules to provide for transmission of suspended/ withheld IGST refund claims of risky exporters or cases of violation of provisions of the Customs Act in a system generated form to the GST authorities for processing with a view to expeditiously dispose such refund claims after due verification by GST officers.

2.2. Accordingly, in situations where the refund of IGST paid on export of goods or services may be withheld as provided in rule 96(4) of CGST Rules, an additional situation has been added by way of clause (c) as under:

"(c) the Commissioner in the Board or an officer authorised by the Board, on the basis of data analysis and risk parameters, is of the opinion that verification of credentials of the exporter, including the availment of ITC by the exporter, is considered essential before grant of refund, in order to safeguard the interest of revenue."

2.3. Rule 96(5) dealt with intimation by the proper officer of integrated tax at the Customs station to the applicant and the jurisdictional Commissioner of GST of the fact of withholding of refund of IGST paid on exports upon jurisdictional Commissioner's request in accordance with section 54(10) or 54(11). Further, rules 96(6) & 96(7) dealt with passing of orders subsequent to such intimation. The said sub-rules (5), (6) & (7) of rule 96 have been omitted with retrospective effect from 1st July 2017 vide CGST (Amendment) Rules, 2022.

2.4. Sub-rule (5A) has been inserted to rule 96 with retrospective effect from 1st July 2017 to provide that in case of withholding of refund of IGST paid on exports upon a request by the

jurisdictional Commissioner in terms of provisions of section 54(10) & 54(11) or where the refund is withheld because of exporter is considered risky in terms of clause (c) of rule 96(4), such refund claim shall be transmitted to the proper officer under GST through the GST portal in a system generated **FORM GST RFD-01** along with intimation of such transmission to the exporter and the said system generated RFD-01 shall be deemed to be the application for refund filed on the date of transmission. Such application shall, thereafter, be dealt with in accordance with rule 89 of CGST Rules.

2.5. Sub-rule (5B) has been inserted to rule 96 with retrospective effect from 1st July 2017 to provide that in case the refund of IGST paid on exports is withheld because the Customs officer determines that the goods were exported in violation of the provisions of the Customs Act, 1962 and the said officer passes an order to that effect, then, such claim shall also be transmitted to the proper officer under GST in the same manner provided in rule 96(5A) above.

3. Changes relating to refund claim by Duty Free Shops

3.1. The GST Council had recommended that the special procedure for claiming refund by **Duty Free Shops (DFS)** under rule 95A of CGST Rules should be withdrawn by rescinding the said rule, Circular No. 106/25/2019-GST and related notifications. Further, the supplies made by DFS at international terminals to outgoing international passengers shall be treated as exports and DFS shall be eligible to claim refund as exporters.

3.2. Accordingly, rule 95A, which was inserted by the CGST (Fourth Amendment) Rules, 2019 w.e.f. 1st July 2019 to enable the DFS to claim refund of the GST paid on inward supply of indigenous goods which were sold to outgoing international tourists leaving India, has been omitted with retrospective effect from 1st July 2019 vide CGST (Amendment) Rules, 2022[3]

3.3. Circular No. 176/08/2022-GST, dated 6th July 2022 has been issued to withdraw, ab-initio, the previously issued Circular No. 106/25/2019-GST, dated 29th June 2019.

3.4. FORM GST RFD-10B, which was the prescribed form of application for refund by DFS has been omitted retrospectively with effect from 1st July 2019.

4. Refund of unutilised ITC on account of export of electricity

4.1. The GST Council had recommended an amendment in the CGST Rules to provide for refund of unutilised ITC on account of export of electricity.

4.2. Accordingly, clause (ba) has been inserted in sub-rule (2) of rule 89 to prescribe the following document to be furnished along with the refund application:

3. Refer to Sr. No. 9 of Notification No. 14/2022-Central Tax, dated 05.07.2022

"(ba) a statement containing the number and date of the export invoices, details of energy exported, tariff per unit for export of electricity as per agreement, along with the copy of statement of scheduled energy for exported electricity by Generation Plants issued by the Regional Power Committee Secretariat as a part of the Regional Energy Account (REA) under clause (nnn) of sub-regulation 1 of Regulation 2 of the Central Electricity Regulatory Commission (Indian Electricity Grid Code) Regulations, 2010 and the copy of agreement detailing the tariff per unit, in case where refund is on account of export of electricity;"

4.3. Statement-3B has been inserted in FORM GST RFD-01 to report the aforesaid particulars prescribed by rule 89(2)(ba) of CGST Rules.

4.4. Circular No. 175/07/2022-GST, dated 6th July 2022 has been issued to clarify various issues and procedure for filing refund claim pertaining to export of electricity.

5. Miscellaneous changes relating to refund on account of export of goods carried out by CGST (Amendment) Rules, 2022:

5.1. Rule 89(4) of CGST Rules deals with refund of unutilised ITC in the case of zero-rated supply of goods and/or services without payment of tax under bond or LUT. An explanation has been inserted in rule 89(4) to state that for the purposes of rule 89(4), the value of goods exported out of India shall be taken as the lesser of the FOB value declared in the Shipping Bill or Bill of Export, or the value declared in the tax invoice or bill of supply.

5.2. Clause (b) of rule 96(1) has been substituted retrospectively with effect from 1st July 2017 to provide that the application for refund of IGST paid in case of export of goods shall be deemed to have been filed only when any mismatch between GSTR-1 and Shipping Bill is rectified by the exporter.

5.3. FORM GST RFD-01 has been amended. In Statement-3 of the said Form, an additional column for reporting FOB value has been added.

6. Recommendations and actions towards avoiding disputes / litigation and providing clarity

6.1. Pursuant to the recommendations of the GST Council at its 45th meeting, Circular No. 164/20/2021-GST was issued on 06.10.2021 to clarify that the supply of ice-cream by ice-cream parlours shall be treated as supply of goods liable to tax @ 18%. The GST Council at its 47th meeting recommended that GST charged by the ice-cream parlours @ 5% without ITC (considering the same to be a supply of restaurant service) during the period from 01.07.2017 to 05.10.2021 shall be regularised to avoid unnecessary litigation.

6.2. Pursuant to the GST Council's recommendation for issuance of clarifications on various aspects of taxability of goods, Circular No. 179/11/2022-GST has been issued on 3rd August 2022 to cover the following aspects:

a) Electric vehicles whether or not fitted with a battery pack are eligible for concessional GST rate of 5%.

b) Stones otherwise covered in S. No. 123 of Schedule-I (such as Napa stones), which are not mirror polished, are eligible for concessional rate under said entry.

c) GST rate on all forms of mango under CTH 0804, including mango pulp (other than fresh mangoes and sliced, dried mangoes) attract GST at the rate 12%. Raw or fresh mangoes are exempt. Mangoes, sliced and dried, are chargeable to a concessional rate of 5%. Relevant entry at S. No. 16 of Schedule-II of Notification No. 1/2017-CTR has also been amended to make this amply clear.

d) Supply of treated sewage water, falling under heading 2201, is exempt under GST and is not the same as purified water provided in Entry No. 99 of Notification No. 2/2017-CTR. The word 'purified' has been omitted from the aforesaid entry vide Notification No. 7/2022-CTR dated 13.07.2022 to make this amply clear.

e) Nicotine Polacrilex Gum, which is commonly applied orally and is intended to assist tobacco use cessation is classifiable under tariff item 2404 91 00 and attracts a GST rate of 18%.

f) All fly ash bricks attract the same concessional rate irrespective of fly ash content.

g) By-products of milling of Dal/ Pulses such as Chilka, Khanda and Churi which inter-alia are used as cattle feed ingredient are classifiable under heading 2302 and attract GST at the rate of 5% vide S. No. 103A of Schedule-I of Notification No. 1/2017-CTR. Further, considering the prevailing multiple interpretations and genuine doubts regarding the applicability of GST, the matter would be regularised on as is basis for past periods.

6.3. Circular No. 173/05/2022-GST dated 6th July 2022 was issued to clarify that refund of accumulated ITC on account of inverted rate structure as per section 54(3)(ii) of CGST Act would be allowed in cases where accumulation of ITC is on account of rate of tax on outward supply

7. No requirement for reversal of ITC for exempted supply of Duty Credit Scrips

7.1. The GST Council had recommended an amendment to Explanation 1 of rule 43 of the CGST Rules to provide that there is no requirement of reversal of ITC for exempted supply of Duty Credit Scrips by the exporters.

7.2. Accordingly, clause (d) has been inserted in Explanation 1 to rule 43 of the CGST Rules by way of CGST (Amendment) Rules, 2022.

"Explanation 1. – For the purposes of rule 42 and this rule, it is hereby clarified that the aggregate value of exempt supplies shall exclude: -

(a) ..

(b) ..

(c) ..

(d) the value of supply of Duty Credit Scrips specified in the notification of the Government of India, Ministry of Finance, Department of Revenue No. 35/2017-Central Tax (Rate), dated the 13th October, 2017, published in the Gazette of India, Extraordinary, Part II, Section 3, Sub-section (i), vide number GSR 1284(E), dated the 13th October, 2017."

8. Recommendations and actions relating to rate changes in respect of goods (all rate changes made effective from 18.07.2022)

A. Rate Rationalisation to remove inverted duty structure [Approval of recommendations made by GoM on rate rationalization]

S. N.	*Description*	*From*	*To*	*Notification issued for rate change*	*Brief description of the change carried out by notification issued for rate change*
1.	Printing, writing or drawing ink	12%	18%	06/2022-CTR dt. 13/07/22	Entry at Sl. No. 70 of Sch. II – 6% omitted and inserted in Sch. III – 95 at S. No. 54C.
2.	Knives with cutting blades, Paper knives, Pencil sharpeners and blades therefor, Spoons, forks, ladles, skimmers, cake-servers, etc.	12%	18%	06/2022-CTR dt. 13/07/22	Entries at S. No. 187, 188, 189 of Sch. II – 6% omitted and inserted in Sch. III – 9% at S. No. 301A, 302A and 302B. Present entry at S. No. 301A of Sch. III – 9% shall be renumbered as 301AA.
3.	Power driven pumps primarily designed for handling water such as centrifugal pumps, deep tube-well turbine pumps, submersible pumps; Bicycle pumps	12%	18%	06/2022-CTR dt. 13/07/22	Entries at S. No. 192, 193 and 195 of Sch. II – 6% omitted and inserted in Sch. III – 9% at S. No. 317A, 317C and 317D.
4.	Machines for cleaning, sorting or grading, seed, grain pulses; Machinery used in milling industry or for	5%	18%	06/2022-CTR dt. 13/07/22	Entries at S. No. 230, 233, 234C of Sch. I – 2.5% omitted and inserted in Sch. III – 9% at S. No. 329A, 376AC.

S. N.	***Description***	***From***	***To***	***Notification issued for rate change***	***Brief description of the change carried out by notification issued for rate change***
	the working of cereals etc; Pawan Chakki that is Air Based Atta Chakki; Wet grinder;				
5.	Machines for cleaning, sorting or grading eggs, fruit or other agricultural produce and its parts, Milking machines and dairy machinery	12%	18%	06/2022-CTR dt. 13/07/22	Removed from description of entry at S. No. 197 and 198 of Sch. II – 6% and inserted in Sch. III – 9% at S. No. 328A and 328B.
6.	LED Lamps, lights and fixture, their metal printed circuits board;	12%	18%	06/2022-CTR dt. 13/07/22	Entries at S. No. 205, 226 and 227 of Sch. II – 6% omitted and covered in Sch. III – 9% at S. No. 390 and 438A.
7.	Drawing and marking out instruments	12%	18%	06/2022-CTR dt. 13/07/22	Entry at S. No. 217 of Sch. II – 6% omitted and inserted in Sch. III – 9% at S. No. 413.
8.	Solar Water Heater and system	5%	12%	06/2022-CTR dt. 13/07/22	Entry at S. No. 232 of Sch. I – 2.5% omitted and inserted in Sch. II – 6% at S. No. 194A.
9.	Prepared/finished leather/chamois leather / composition leathers	5%	12%	06/2022-CTR dt. 13/07/22	Entries at S. No. 197A to 197E of Sch. I – 2.5% of N. No. 1/2017-CTR omitted and inserted in Sch. II – 6% at S. No. 85B to 85F.
10.	Refund of accumulated ITC not to be allowed on flowing goods: i. Edible oils ii. Coal			09/2022-CTR dt. 13/07/22	Entries at S. No. 1A to 1O inserted in N. No. 5/2017-CTR.

B. Other GST rate changes relating to goods recommended by the Council

S. N.	*Description*	*From*	*To*	*Notification issued*	*Remark*
1.	Ostomy Appliances	12%	5%	06/2022-CTR dt. 13/07/22	Following entry inserted at S. No. 181B in Sch. I – 2.5% of N. No. 1/2017-CTR: "Ostomy appliances including pouch or flange, stoma adhesive paste, barrier cream, irrigator kit, sleeves, belt, micro-pore tapes"
2.	Orthopaedic appliance-Splints and other fracture appliances; artificial parts of the body; other appliances which are worn or carried, or implanted in the body, to compensate for a defect or disability; intraocular lens	12%	5%	06/2022-CTR dt. 13/07/22	Following entry inserted at S. No. 255A in Sch. I – 2.5% of N. No. 1/2017-CTR: "Orthopaedic appliances, such as crutches, surgical belts, and trusses; Splints and other fracture appliances; artificial parts of the body; other appliances which are worn or carried, or implanted in the body, to compensate for a defect or disability; intraocular lens [other than hearing aids]"
3.	Tetra Pak (Aseptic Packaging Paper)	12%	18%	06/2022-CTR dt. 13/07/22	Entry at S. No. 120 of Sch. II – 6% omitted and covered in Sch. III – 9% at S. No. 148.
4.	Tar (whether from coal, coal gasification plants, producer Gas plants and Coke Oven Plants).	5% / 18%	18%	06/2022-CTR dt. 13/07/22	S. No. 163 of Sch. I - 2.5% of N. No. 1/2017-CTR omitted and inserted in Sch. III – 9% at S. No. 30A.
5.	IGST on import of Diethylcarbamazine (DEC) tablets supplied free of cost for National Filariasis Elimination Programme	5%	Nil	40/2022-Customs dt. 13/07/22	Entry at S. No. 213A inserted in the Table and Entry No. 113 inserted in the Annexure of N. No. 50/2017-Customs dt. 30/06/2017.

S. N.	***Description***	***From***	***To***	***Notification issued***	***Remark***
6.	Cut and Polished diamonds	0.25%	1.5%	06/2022-CTR dt. 13/07/22	Entries at S. No. 1 & 3 of Sch. VI – 0.25% substituted and new Schedule VII – 0.75% inserted in N. No. 1/2017-CTR w.e.f. 18/07/22.
7.	IGST on specified defence items imported by private entities/ vendors, when end-user is the Defence forces.	Appli-cable rate	Nil	41/2022-Customs dt. 13/07/22	Words in the opening paragraph substituted.
8.	Cheques, loose or in book form	Nil	18%	07/2022-CTR & 06/2022-CTR dt. 13/07/22	Entry at S. No. 118 of N. No. 2/2017-CTR omitted and added to entry at S. No. 157B in Sch. III – 9% of N. No. 1/2017-CTR
9.	Maps and hydrographic or similar charts of all kinds, including atlases, wall maps, topographical plans and globes, printed	Nil	12%	07/2022-CTR & 06/2022-CTR dt. 13/07/22	Entry at S. No. 122 of N. No. 2/2017-CTR omitted and entry at S. No. 125A inserted in Sch. II – 6% of N. No. 1/2017-CTR
10.	Scientific and technical instruments supplied to public funded research institutes	5%	Appli-cable rate	11/2022-CTR dt. 13/07/22	N. No. 45/2017-CTR dt. 14/11/2017 rescinded w.e.f. 18/07/2022
11.	E-waste	5%	18%	06/2022-CTR dt. 13/07/22	Entry at S. No. 234A of Sch. I – 2.5% omitted and inserted in Sch. III – 9% at S. No. 371A.

"The more we come out and do good to others, the more our hearts will be purified, and God will be in them."

— *Swami Vivekananda*

CA Naresh Sheth   CA Jinesh Shah

INDIRECT TAXES
GST – Recent Judgments and Advance Rulings

A. DECISIONS BY HIGH COURT

1. *AMARA RAJA BATTERIES LIMITED – MADHYA PRADESH HIGH COURT [(2022) 142 TAXMANN.COM 192]*

Facts and issue involved

Petitioner was carrying GST paid goods to his Jabalpur office whereas e-way bill generated showed destination at Indore. State Tax Officer, by invoking powers u/s 68 and 129 of CGST Act levied tax and penalty on the petitioner. The said order was upheld by Appellate Authority vide its order dated 18.12.2019.

Petitioner assails the order of State Tax Officer as well as Appellate Authority by present writ petition filed under Article 226 of the Constitution of India.

Petitioner's submissions

Due to inadvertence during generation of e-way bill, a clerical error took place due to which the registered address of the petitioner at Indore was mentioned instead of its Jabalpur address. Petitioner relied upon judgement in case of **Robbins Tunnelling and Trenchless Technology (India) Private Limited [WP No. 12913/2020].**

Revenue's submissions

Clause 5 of executive instruction dated 14-09-2018 provides that section 129 of CGST Act shall not apply where there is error in address of consignee. However, the said relief is subject to condition that locality and other details of consignee is mentioned correctly. Since, locality and other details on petitioner's e-way bill is also mentioned incorrectly the above benefit shall not be available to it.

Observations and Discussion by Court

It is evident that strictly going by the terminology used in clause 5 of circular dated 14.09.2018, immunity from provisions of section 129 of CGST Act may not be available to the petitioner. However, in penal provisions such as section 129 of CGST Act, the element of intention to evade tax must be present to sustain an order of penalty.

Decision of High Court

Order dated 18.12.2019 passed by Appellate Authority stands quashed. Appellate Authority is redirected to consider the appeal solely on the question of presence or absence of any *malafide* intention to evade tax on the part of petitioner and pass appropriate order.

2. *INDIA YAMAHA MOTOR PRIVATE LIMITED VS ASSISTANT COMMISSIONER – MADRAS HIGH COURT [2022-TIOL-1186-HC-MAD-GST]*

Facts and issue involved

Petitioner had challenged the order dated 10th April 2019 wherein the respondent called upon to remit interest of a sum of INR 5,00,00,000 (approx.) for belated remittance of GST for the period from July 2017 to October 2017.

While filing GSTR-3B for the month of July 2017, there was an inadvertent error whereby the data pertaining to its plant at Faridabad was included instead of data pertaining to the Chennai plant. This swap resulted in a short disclosure of liability for the period July to October 2017 leading to the levy of interest.

The petitioner had filed a grievance seeking modification of the return for the month of July 2017 that has not been addressed by the authorities.

Petitioner had not filed returns for subsequent months August 2017 to October 2017 on the ground to contain the cascading effect of the error that had transpired in the return for July 2017.

Petitioner had sufficient balance in electronic cash ledger and electronic credit ledger before due date of filing return.

Respondent taking into consideration the amendment in Section 50 of CGST Act recomputed the interest liability to INR 1,19,00,000 vide order dated 18th October 2021 after reducing the amount of cash already deposited by the petitioner in its electronic cash ledger before the due date of filing return.

Petitioner filed the present writ petition against order dated 18th October 2021 asking why the same logic that has merited acceptance by GST authorities in relation to the cash balance is not applied in the context of ITC balance.

Petitioner's submissions

Petitioner had sufficient balance in both the electronic cash ledger as well as the electronic credit register. Thus, there had been no loss caused to the revenue as balance electronic cash ledger as well as the electronic credit register was available to the Government for use. Hence, no justification to levy interest since the interest is only compensatory in nature.

Petitioner relied on the decision in the case of ***Refex Industries Limited vs. Assistant Commissioner of CGST and Central Excise [2020-TIOL-382-HC-MAD-GST]*** wherein Court held that proviso to Section 50 should operate retrospectively and thus, in a case where an assessee had sufficient cash credit, there is no question of the Department requiring to be compensated, since funds were available with it, to the credit of that assessee.

Petitioner is of the view that above analogy should be similarly applied in respect of balance available in electronic credit ledger also.

Petitioner also relied on the decision in the case of ***Union of India vs. Bharti Airtel Limited & Ors. [2021-TIOL-251-SC-GST]*** wherein Honorable Supreme Court permitted rectification of GSTR-3B.

Observations and Discussion by Court

Honorable Telangana High Court in case of M/s. Megha Engineering & Infrastructures Ltd [W.P. No. 44517 of 2018] observed that sufficient balance of ITC in the Electronic Credit Ledger is immaterial unless the return is filed and the same is debited towards payment of GST. The tax payment happens only when the statutory returns are filed and the two ledgers are debited towards the tax liability. Hence, any kind of tax payment is final only when the returns are electronically filed on the common portal and the actual tax liability is debited in the Electronic Credit/ Cash Ledger.

After the amendment in Section 50 of CGST Act, interest on delayed payment of GST is chargeable only on net tax liability (cash portion). The petitioner is liable to pay amount of INR 67,84,030 under the Reverse Charge Mechanism (RCM), payable in cash, for the month of July 2017 which has been deposited on 19th August 2017 and adjusted the said amount at the time of filing GSTR 3B for the month of June 2019, on 19th July 2019. Here, interest liability arises on the delayed payment of tax (under RCM, tax payable only in cash). Since the payment was not made on or before the due date, the petitioner shall be liable for payment of interest on delayed payment of tax starting from 26th day of August 2017 till the date of debit in the electronic cash ledger on filing of Return.

There is some force to the submissions of the respondents that credit cannot, prior to availment be taken to construe the payment. There are many number of situations where credit may be found to have been availed erroneously or on a mistaken interpretation of law. Thus, it would be risky, from the view point of the revenue to assume that available credits will be set-off against tax liability.

Language used in Section 50 of CGST Act is categoric to the effect that it is only when a remittance is affected by way of debit, that an assessee would be protected from the levy of interest.

If stand of petitioner is considered that would result in rewriting the proviso, to the effect that, even mere availability of credit would insulate the petitioner from interest which is impermissible.

Decision of High Court

Writ Petition is dismissed and petitioner is asked to discharge interest demand of INR 1,19,00,000 vide order dated 18th October 2021.

B. RULINGS BY APPELLATE AUTHORITY OF ADVANCE RULING

1. *UNITY TRADERS – MADHYA PRADESH AAAR [MP/AAAR/03/2020]*

Facts and Issues involved

Appellant is engaged in providing clearing & Forwarding Agent services. As a C&F agent, the firm stores goods of other companies and charge rent for the same. The firm has 2 Separate GST Registrations, one for the unit located in Jabalpur (MP) and the other for unit located in Raipur (CG) . The revenue from operations consists of:

- C&F Commission
- Warehouse Rent

- Other Reimbursement Freight etc.

Appellant had sought an advance ruling in respect of the following questions:

1. Whether ITC of GST Paid on goods purchased for the purpose of construction & Maintenance of warehouses such as verified Tiles, Marble, Granite, ACP Sheet, Steel Plates, TMT Tor (Saria), Bricks, Cement, Paint, and other construction material can be claimed in full?
2. Whether ITC of GST Paid on Work Contract service received from registered & unregistered contractor for construction & maintenance contract of a building can be claimed in full?
3. Whether ITC of GST Paid on goods purchased & Work Contract service received during the FY 2017-18 for the purpose of construction & maintenance of warehouse can be claimed in full?

MP AAR pronounced its ruling on above questions as under:

1. ITC of GST paid on goods purchased for the purpose of construction & maintenance of warehouses such as verified Tiles, Marble, Granite, ACP Sheet, Steel Plates, TMT Tor (Saria), Bricks, Cement, Paint, and other construction material is not admissible u/s 17(5) of CGST Act.
2. ITC of GST Paid on Work Contract service received from registered & unregistered contractor for construction & maintenance contract of a building is not admissible u/s 17(5) of CGST Act.
3. ITC of GST Paid on goods purchased & Work Contract service received during the FY 2017-18 for the purpose of construction & maintenance of warehouse is not admissible u/s 17(5) of CGST Act.

Appeal to AAAR and appellant's contentions

Appellant challenged the above order of AAR before AAAR on following grounds:

- There is no break in tax chain of appellant as they are discharging GST on rentals received by them and thus, they are entitled to claim above referred ITC.
- Disallowance of ITC of GST paid on inputs would result in cascading effect of multi-stage taxation which is opposed to the basic rationale of GST itself.
- AAR has erred by not allowing ITC on goods and services used for maintenance of the warehouse, cost of which is booked as revenue expenditure in Profit and Loss account and same is not capitalized.

Discussions by and observations of AAAR

All of three questions deal with inward supply of goods or work contracts services for construction and maintenance of warehouse/ building on appellant's account and hence, the relevant provision in given case would be section 17(5)(d) of CGST Act.

As per section 17(5) of CGST Act, ITC shall not be available on the goods or services or both received by a taxable person for construction of an immovable property (other than plant or machinery) on his own account including when such goods or services or both are used in the course or furtherance of business.

Appellant intends to construct warehouse/ building which is an immovable property. There is no specific principle/provision in the law where it states that non-entitlement of ITC would lead to breaking of chain of tax. Further, disallowance of ITC resulting into cascading effect has not been substantiated by appellant.

The explanation to Section 17(5)(d) of CGST Act allows ITC to the extent expenses are not capitalized. Capitalization or non-capitalization of these expenses is certainly not a permanent indelible mark in the books of account. These accounting entries may be modified, altered or deleted as per prevailing/changing contingencies. These entries are not static but dynamic in nature. However, since such a question is not raised, the same shall not be discussed further.

Ruling of AAAR

ITC of GST paid on goods purchased for the purpose of construction and maintenance of the Warehouse such as Vitrified Tiles, Marble, Granite, ACP Sheet, Steel plates, TMT Tor (Saria), Bricks, Cement, Paint, and other construction material cannot be claimed to the extent of capitalization u/s 17(5)(d) of CGST Act.

ITC of GST paid on work contract service received from registered & unregistered contractors for construction & maintenance contracts of buildings cannot be claimed to the extent of capitalization u/s 17(5)(d) of CGST Act.

ITC of GST paid on goods purchased and work contract service received during the FY 2017-18 for the purpose of construction & maintenance of warehouse cannot be claimed to the extent of capitalization u/s 17(5)(d) of CGST Act.

C. RULINGS BY AUTHORITY OF ADVANCE RULING

1. *TROIKAA PHARMACEUTICALS LTD – GUJARAT AAR [2022-TIOL-106-AAR-GST]*

Facts and issue involved

Applicant is engaged in the business of pharmaceutical products and provides canteen facilities to its employees and workers as mandated under The Factories Act, 1948. Applicant has made arrangement of food (lunch and dinner) through an outside party, who prepares the food and supplies it to the company's employees and the contractual workers. The food supplier vendor raises an invoice of the food bill as per the agreed billing frequency (i.e. on the basis of the actual number of the food plates consumed) by charging 5% GST thereon.

Applicant provides the canteen facility at a subsidized rate to its employees and contractual workers and bears 50% of food amount and recovers the balance 50% of the food amount from the company employee's salary pay out.

Applicant has sought an advance ruling on the following questions:

1. Whether GST shall be applicable on the amount recovered by them from employees or contractual workers, when provision of third-party canteen service is obligatory under section 46 of the Factories Act, 1948?

2. Whether input tax credit of GST paid on food bill of the Canteen Service Provider shall be available, since providing this canteen facility is mandatory as per the Section 46 of the Factories Act. 1948?

Applicant's submissions

Supreme Court in case of Bhayana Builders and Intercontinental Consultants and Larger Bench of the Tribunal in case of Bhayana Builders observed that "consideration" must flow from the service recipient to the service provider and should accrue to the benefit of the service provider and that the amount charged has necessarily to be a consideration for the taxable service provided under the Finance Act. Any amount charged which has no nexus with the taxable service and is not a consideration for the service provided does not become part of the value which is taxable. The same principle of law also applicable under the GST Laws which may be called "contractual reciprocity and there must be direct and immediate link/nexus between supply made and consideration received ".

Company bears 50% of the food amount and recovers the balance 50% of the food amount from the company employee's salary pay out and utilized same for payment of the bill of canteen service provider. Applicant is not the supplier of food to employees and contract workers and only providing canteen facility as a facilitator. Neither any intent to make profit nor any element is being retained as profit from the amount recovered from the employees pay out as their share. There is no reciprocity and direct and immediate link/nexus between supply of foods made by the third-party canteen service provider to employees and recovery of amount from the employees and contract workers to treat it as consideration received by applicant against any supply which is liable to GST.

As per clause I of schedule III of GST Act 2017, services by an employee to the employer in the course of or in relation to his employment shall not be treated as supply and hence such services are out of the purview of GST. Further, CBIC vide its press release dated 10th July 2017 clarified that supply by employer to employee in terms of contractual agreement entered into between the employer and the employee, will not be subjected to GST. Thus, canteen services, which is undertaken in the course of employment or in connection with employment has been specifically excluded from the ambit of supply.

Applicant also relied on various rulings wherein it was held that recovery/collection of employee portion of canteen charges/food provided by canteen service provider is not a supply and liable to GST.

Discussions by and observations of AAR

Applicability of GST on the amount recovered from employees

CBIC vide Circular No. 172/04/2022-GST dated 06.07.2022 has issued clarification that any perquisites provided by the employer to its employees in terms of contractual agreement entered between them are in lieu of the services provided by employee to the employer in relation to his employment and thus, will not be subjected to GST.

Hence, activities provided by applicant to its employees is not an activity made in the course or furtherance of its business to deem it a supply.

Applicability of GST on the amount recovered from contractual workers

The contractual workers do not form part of the 'employee' as they are not on the pay roll of the company. The term `contract labour' under Contract Labour (Regulation and Abolition) Act, 1970 ("CLRA") means a person who is hired in or in connection with the work of an establishment by or through a contractor. It is important to note

that the word, 'hire', as used in the Act, has a significant connotation and it is not equivalent to an employer-employee relationship. Where a person is 'hired' specifically for the work of an establishment, his scope of work does not extend beyond the work of that establishment and he is considered to be a contract labour.

CBIC in Circular No. 172/04/2022-GST dated 06.07.2022 has clarified, that perquisites provided by the employer to the employee in terms of contractual agreement entered into between the employer and the employee, will not be subjected to GST when the same are provided in terms of the contract between the employer and employee. The test for establishing an employer-employee relationship as laid down by the Apex Court in ***Balwant Rai Saluja vs. Air India Ltd.*** is, complete administrative control, which is decided by several factors, including, among others who appoints the workers; who pays the salary/remuneration; who can take disciplinary action; etc. In given case, applicant has pad gross amount to the labour contractor and labour contractor being employer paid the wages per month to the workers being employees and also deduct Provident Fund. Therefore, it evident that the instant case does not pass the test of employer-employee relationship and is therefore does not fall under the ambit of entry I of Schedule III of CGST Act.

From the plain reading of the definition of "business", it can be safely concluded that the supply of food by the applicant to its contractual worker would definitely come under clause (b) of Section 2(17) as a transaction incidental or ancillary to the main business. Even though, there is no profit as claimed by the applicant on the supply of food to its contractual worker, there is a "supply", as provided in Section 7(1)(a) of the CGST Act, 2017. The applicant would definitely come under the definition of "Supplier", as provided in sub-section (105) of Section 2 of the CGST Act, 2017. Since the applicant recovers the cost of food from its contractual worker, there is 'consideration', as defined in Section 2(31) of the CGST Act, 2017.

To sum up, the supply of food by the applicant is 'Supply of Service' by the applicant to their contractual worker/s. The cost, which is recovered from the salary of contractual worker, as deferred payment is 'consideration' for the supply and GST is liable to be paid.

ITC on canteen charges of food supplied to employees

Proviso of section 17(5)(b) of CGST Act stipulates that ITC shall be available on the GST paid where it is obligatory to provide a benefit for an employer to its employees in terms of any law for the time being in force. In view of the above clarification, ITC of the GST paid on canteen charges is available to the applicant on the food supplied to the employees of the applicant.

ITC on canteen charges of food supplied to contractual worker

Labour contractor shall provide the canteen facility to the labour employed by the contractor. Thus, there is no obligation to the applicant company to provide canteen facility to the contractual worker. ITC on foods, beverages, outdoor category is not block provided it is obligatory for an employer to provide the same to its employees under any law for the time being in force under Section 17(5) of CGST Act. In the instant case the applicant and contractual worker do not cover under the category of employer-employee relationship and it is not obligatory on the

applicant company to provide canteen facility to the Contractual worker as per the provisions of CLRA Act. Thus, applicant is not eligible to the ITC on food supplied to the contractual worker under Section 17 (5) (b) of CGST Act 2017.

Ruling of AAR

Applicant is not liable to pay GST on the amount representing the employees portion of canteen charges, which is collected by them and paid to the Canteen service provider.

However, applicant is liable to pay GST on the amount representing the contractual worker portion of canteen charges, which is collected and paid to the Canteen service provider.

ITC on GST paid on canteen facility is admissible to the applicant under Section 17 (5)(b) of CGST Act on the food supplied to employees of the company subject to the condition that burden of GST have not been passed on to the employees of the company.

However, ITC on GST paid on canteen facility is not admissible to the applicant under Section 17(5)(b) of CGST Act on the food supplied to contractual worker supplied by labour contractor.

2. *HYDERABAD SECURITY OFFSET PRINTERS PRIVATE LIMITED – TELENGANA AAR [2022-TIOL-113-AAR-GST]*

Facts and issue involved:

Applicant is printing leaflets and packing materials of his clients pertaining to pharmaceutical sector. The leaflet contains the literature pertaining to said medicine. They are presently charging GST at the rate of 18% on such leaflets.

Applicant has sought an advance ruling as to what is the applicable rate of tax including HSN code for printing of leaflets?

Discussions by and observations of AAR

The applicant is providing services of printing but this activity of printing does not fall under item (i) of heading 9989 i.e., printing of newspapers, books (including Braille books), journals and periodicals. Hence, it is covered under Heading 9989 (ii) of Notification No. 11/2017 – Central Tax (Rate) dated 28.06.2017 as amended and is taxable at the rate of 18%.

Further, by amended Notification No. 31/2017 – Central Tax (Rate) dated 13.10.2017 the following entry was introduced at serial no. 26 with chapter heading 9988 at sub item (iia):

"Services by way of any treatment or process on goods belonging to another person, in relation to printing of all goods falling under Chapter 48 or 49, which attract GST at the rate of 12%".

In light of the above amended entry where the applicant uses physical input, i.e., paper supplied by their client for the purpose of goods falling under chapter 48 or 49 of customs, then the same will be taxable at 6% under CGST and 6% SGST.

Ruling of AAR

Where the physical inputs are used by the applicant, the activity falls under S.No. 27(ii) of the Notification No. 11/2017 and hence is liable to be taxed at the rate of 18%.

Where the physical inputs are supplied by the recipient of services, the activity falls under S.No. 26(iia) of Notification No. 11/2017 as amended on 13.10.2017 and same is taxable at the rate of 12%.

3. *M/s. MADDI SEETHA DEVI – TELANGANA AAR [A.R.Com/15/2019]*

Facts and issues involved
Applicant, being a landowner, has entered into a Joint Development Agreement with PHL in the year 2016 wherein applicant has supplied development rights of its owned land to PHL in lieu of 27% of the developed property to be provided by PHL to the applicant.

Applicant has sought advance ruling with respect to following questions:

1. Whether transfer of land or development rights to the developer by the landowner is to be considered as receipt of consideration by the developer towards construction of flats in residential complex for the landowner?
2. Whether the liability to pay GST or service tax as applicable arises on the developer immediately on receipt of development rights or immediately on conveyance of the flats to be constructed by way of an allotment letter?

Discussions by and observations of AAR
Applicant, being landowner-promoter, has entered into a joint development agreement (JDA) with the "developer-promoter" on area sharing basis for Residential Real Estate Project (RREP) in Jan' 2016. GST structure on real estate services has been greatly altered with effect from 01.04.2019 through various notifications dated 29.03.2019.

As per the provisions contained in clause 2 of the 4th provision in the column 5 of Sr. No.3 of Notification No. 03/2019 dated 29.03.2019 read with Sr. No. 41(a) and 41(b) of Notification No. 04/2019, the liability of the developer-promoter and land owner-promoter will be as follows for projects which have commenced prior to 01.04.2019

1. Developer-promoter shall be liable to pay CGST and SGST on the supply of construction of apartment to the landowner promoter.
2. If the landowner promoter further supplies such apartment to the buyers before the issuance of completion certificate, he shall be liable to pay CGST and SGST on such supplies. However, the land owner promoter shall be eligible for input tax credit of the taxes charged from him by the developer-promoter.

Further, according to the conditions laid down in Notification No. 04/2018, the liability to pay tax on consideration received by the developer-promoter in form of development rights shall arise at a time when such developer-builder transfers possession or right in the constructed complex i.e. after the complete of construction of civil structure.

Ruling by AAR
Transfer of development rights by the landowner to the developer is construed as consideration received by such developer for supply of construction service.

The liability to pay GST by the developer shall arise at the time of transfer of possession or right in the constructed complex or constructed flats and not at the time of receipt of development rights.

4. *INCUT LIFESTYLE RETAIL PRIVATE LIMITED – TELANGANA AAR [TSAAR Order No. 46/2022]*

Facts and issue involved
Applicant is in the business of manufacturing hair oil, shampoos etc., some of which are cosmetics and others Ayurvedic medicaments. They have obtained AYUSH license for each

of their product. Applicant is engaged in manufacture and sale of following products:

- Hair Oil & Serum for Hair Loss treatment
- Shampoo for treatment of dandruff and other Hair disorders
- Face cream and mask for treatment of facial disorders
- Oral care oil for treatment of mouth and oral disorders

Applicant has sought an advance ruling on the question as to whether the products manufactured by them under the license issued by AYUSH department of Government of Telangana and sold as Ayurvedic products fall under HSN No. 3004 (taxable @12%) or under HSN 3304 (taxable @ 18%) of the GST Tariff?

Applicant's submissions

Applicant submits that they manufacture Ayurvedic products using Ayurvedic ingredients which are helpful in the treatment of specified disorders and that their products are primarily to prevent, control, cure or mitigate skin and hair related problems and that these medicaments have preventive properties also. The products are to be used for a specific period prescribed and that there is no requirement to continue the same once the physiological disorder is addressed. The applicant contends that all the goods manufactured by them are sold as medicaments and therefore are eligible to be taxed as Ayurvedic medicaments i.e., under HSN '30049011' and taxable @ 12%.

Applicant is relying on the decision in case of ***Hindustan Lever Ltd vs CCE, Chennai [2015-TIOL-194-SC-CX]*** wherein the Hon'ble Supreme Court of India has ruled that Vaseline is medicament.

Applicant also relied on decision in case of ***Aswini Home Pharmacy [2019-TIOL-181-SC-CT]*** wherein it was ruled that Arnica Hair Oil is a medicament.

Discussions by and observations of AAR

Relying on observations of various judgements by Honorable Supreme Court, authority for advance ruling, to classify the products either as a cosmetic whose primary function is care or medicament used to treat or cure a medical condition, has adopted following parameters:

The product has a drug license.

- The Composition of the product should have medical ingredients.
- Prescription of a medical practitioner is not necessary to classify a product as a medicament
- If a product's primary function is "care" and not "cure", it is not a medicament.
- The product label/character should indicate the function or the purpose for which it is used.

Ruling of AAR

The products which are used for care are treated as 'Cosmetics' and therefore taxed at the rate of 18%.

The products which are used for cure are treated as 'Medicaments' falling under Serial No. 63 of Schedule II taxable at the rate of 12%.

CS Makarand Joshi

CORPORATE LAWS
Case Law Update

SEBI

Order of Adjudicating Officer of Securities and Exchange Board of India

Name of the Case: In respect of Carnation Industries Limited (hereinafter referred to as 'Noticee 1/CIL/Company/by Name')

Facts of the case:

1. Securities and Exchange Board of India (hereinafter referred to as 'SEBI') conducted an investigation into the irregularities of CIL's financial statements and observed certain accounting-related issues pertaining to the accounting of interest therein during the financial years ending March 31, 2018, & March 31, 2019, and quarter ending on June 30, 2019, & quarter ending September 30, 2019 (hereinafter referred as "Investigation period/IP").

2. On investigation, SEBI found that accounts of CIL were declared as Non-Performing Assets (NPA) by State Bank of India (hereinafter referred to as 'SBI') and Punjab National Bank (hereinafter referred to as 'PNB'), (collectively referred as banks) from which, the Company had availed credit facilities. Further, SEBI found that on declaring the accounts of CIL as NPA by banks during FY 2017-18, CIL reversed the interest expense on loans provided in FY 2017-18 and stopped providing for interest expenses in the ensuing financial statements. Further SEBI noted that statutory auditors of the company M/s. Jain Saraogi & Co., Chartered Accountants, had qualified their audit reports for FY 2017-18 & FY 2018-19 and limited review reports for the quarters ended June 30, 2019, & September 30, 2019.

3. SEBI alleged that instant accounting treatment of reversal and non-provisioning of interest was not found to be in accordance with the applicable and notified Accounting Standards and consequently, the published financial statements of the company did not present a true and fair view of the

company's affairs. SEBI observed that Noticee's 2 to 5 (viz. Ravindra P Sehgal, MD and Member of Audit Committee - Noticee 2, Suvobrata Saha, Joint MD - Noticee 3, Arun Kumar Bose, Executive Director – Noticee 4, Sephali Roy, Chairman of Audit Committee – Noticee 5) were directors of the company during the financial investigation period. Further, Noticee 6 was the Chief Financial Officer ('CFO') of the Company in the FY 2017-18 and Noticee 7 was the current CFO of the Company from February 1, 2019. SEBI issued a show cause notice ('SCN') to CIL, its Executive Directors, erstwhile and current Chief Financial Officer (hereinafter referred to as 'CFO') of CIL (collectively referred to as 'Noticees').

4. SEBI stated that as per Regulation 17(8) of SEBI (Listing Obligations and Disclosure Requirements) Regulations ['LODR Regulations'], the CEO and CFO shall provide compliance certificates to the board of directors. In addition to that, in terms of regulation 33(2)(a) of LODR Regulations, it is the duty of the CEO and CFO of the listed entity to certify that the published financial results do not contain any false or misleading statements or figures and do not omit any material fact which may make the statements or figures contained therein misleading while publishing the financial results. SEBI observed that there was no person designated as CEO during the investigation period. In the absence of any designated CEO, the principal roles and responsibilities lie with the Managing Director and the Joint Managing Director. The Managing Director, the Joint Managing Director and the CFO of Carnation Industries Ltd have signed the compliance certificate. SEBI stated that the Managing Director and Joint Managing Director and CFO of Carnation Industries Ltd. have submitted an untrue compliance certificate in terms of regulations 17(8) and 33(2)(a) of LODR Regulations, to the board of directors in the FY 2017-18 and 2018-19. SEBI further stated that Noticee 6 was the CFO of the company till August 7, 2018, and had signed the compliance certificate for the financial year ended March 31, 2018, and Noticee 7 was appointed as the CFO on February 1, 2019, and has signed the compliance certificate for the financial year ended March 31, 2019, the quarter ended June 30, 2019, and quarter ended September 30, 2019. It appears that Noticees 6 & 7 have submitted a false compliance certificate in terms of regulations 17(8) and 33(2)(a) of LODR Regulations, to the board of directors in the FY 2017-18 and FY 2018-19, the quarter ended June 30, 2019, & quarter ended September 30, 2019, respectively.

Charge

SEBI alleged that Noticees and CIL have violated Sections 12A(a), (b), (c) of the Securities and Exchange Board of India Act, 1992 (hereinafter referred to as 'SEBI Act') r/w regulations 3(b), (c) & (d), 4(1), 4(2)(f) of the SEBI (Prohibition of Fraudulent and Unfair Trade Practices Relating to Securities Market) Regulations, 2003 (hereinafter referred as PFUTP Regulations) & Regulations 4(1)(a), 4(1)(b), 33(1), 34(3), 48 of SEBI (Listing Obligations & Disclosure Requirement), 2015

(hereinafter referred as 'LODR Regulations 2015').

Arguments by Noticees

A. **Underestimate losses by not provisioning expenses:** Noticees submitted that CIL had taken credit facilities from two banks viz. State Bank of Hyderabad (now State Bank of India) and Punjab National Bank. The State Bank of India classified the accounts of the Company as an NPA on March 21, 2018, and did not give the Company, the interest amount charged by them since the account was classified as NPA. In absence of relevant information from the Bank, CIL could not assess the interest and penal interest amount which would be levied by the State Bank of India ('SBI') on the credit facility to CIL. Hence the same could not be provided for in the books of account. Noticee further stated that CIL thought it would be fair not to assume any wrong notional figure as additional interest. Calculation of the notional interest charges that the Bank would have charged was very difficult to calculate because they had an interchangeable limit facility for export by the way of floating packing credit which got converted into bill limit after the shipment of the cargo against the purchase order, (which was the basis of the grant of the packing credit). 100% of the Company's turnover was based on Exports and they were an MSME Unit. The funding received from the Bank was not on a fixed interest rate for the whole year, it was of floating interest rate based on RBI guidelines and subject to refund of interest subvention by the Government of India. This whole process made the calculation of notional interest a complicated and frivolous exercise. Noticees further stated that Company did not reverse anything in its books of account. In fact, it considered the balance in the Bank account as of 31st March 2018 and debited whatever interest was debited by the bank to its account. The company took the net balance of the interest charged and provided the same in its books of account. While it did not reverse anything in its books of account. Noticees further highlighted that it has been an industry trend not to provide for interest once the account of the company has been declared NPA. The Annual Accounts of the Company have been regularly filed with the Ministry of Corporate Affairs but at no point of time the Ministry of Corporate Affairs had raised any issue with respect to non-provision of interest after the account of the company has become a non-performing asset.

B. **Complied with Accounting Standards & Companies Act, 2013 ('CA 2013'):** Noticees submitted that Regulation 48 of LODR Regulations provides that the listed entity shall comply with all the applicable and notified Accounting Standards from time to time. Further Section 129(1) of the Companies Act, 2013 states that the financial statements shall, inter alia, comply with the accounting standards notified under Section 133 of the said Act. Sub Section (5) of Section 129 provides that where the financial statements of a company

do not comply with the accounting standards, the company shall disclose in its financial statements the deviation from the accounting standards, the reasons for such deviation and the financial effect, if any, arising out of such deviation. Section 134(5)(a) of the Companies Act cast an obligation on the Directors to disclose in their Directors' Responsibility Statement the fact of preparation of annual accounts following the applicable accounting standards along with proper explanation relating to material departures. Thus, it is explicit from the above that the Companies Act, 2013 contains elaborate provisions relating to the applicability of accounting standards and consequences arising out of any material departure therefrom. Noticees further stated that CIL has duly complied with the provisions of the Companies Act, 2013 and disclosed in its financial statements and the Boards' Report the reasons for deviation from the accounting standards and the financial effect of such deviation. Thus, the financial statements read with the Notes presented a true and fair view of the accounts and were not misleading in any manner. Noticees further submitted that Company had clearly stated the position of the Bank interest matter in its notes of the Annual Report as highlighted to SEBI.

C. **Interest was not ascertainable:** Noticees submitted that in the case of Export Finance, the interest amount is not pre-determined at the time of availing the loan. SBI's sanction letter dated 31.03.2017 clearly states that the rate is floating. This shows that in case of the limits sanctioned, the rates of interest would vary from time to time based on the Bank's lending rates and the Rating of the Company. This information is confidential in nature and due to this, CIL was unable to calculate interest. Further, once an account becomes NPA there is no renewal of bank limits, no ascertainment of the Company's rating and no fixation of any interest rates on the outstanding against export financing.

Arguments by SEBI

A. **Underestimate losses by not provisioning expenses:** SEBI stated that as per Reserve Bank of India's Income Recognition & Asset Classification Norms ['IRAC'], all Banks are required to classify income on NPA differently from that of Standard Accounts. In FY 2017-18, the credit facilities extended by Banks to the Company were declared as NPA and SBI reversed ₹ 16.85 lacs and transferred it to unrealised interest. SEBI stated that in the case of NPA accounts, banks in general calculate the interest periodically and transfer it to accrued interest. As it can be seen that SBI had reversed interest in FY2017-18 as per the IRAC norms, however, this did not absolve the liability of the Noticees to pay the interest on the outstanding loan amount. SEBI further stated that Noticees had argued their inability to calculate interest liability due to the floating rate of interest. To this, SEBI stated that if the contention of Noticees is that they were unable to calculate interest liability then Noticees should have approached the concerned

bank where the information about the interest charged was readily available. To the argument of the Noticees that it is an industry practice SEBI stated that accounting standards clearly define the treatment of interest expense and liability in the financial statements. SEBI further stated that accounting standards cannot be ignored given the reason that company followed industry standards. In view of this, the contention of the Noticees in this regard cannot be accepted.

B. **Complied with Accounting Standards & Companies Act, 2013:** SEBI stated that Noticees have not provided clear reasoning to depart from the accounting standards. SEBI further stated that Noticees have mentioned in notes to accounts as follows, "*... In the absence of advice/information, finance cost for the month of March 2018 could not be ascertained and accounted for...*" SEBI stated that this reasoning is not acceptable. SEBI further stated that had the Noticees approached banks, they would have obtained the interest liability on their outstanding amount. Further, the Noticees did not provide for the financial effect of its deviation from accounting standards for the quarter ended June & September 2019. Further SEBI stated that information related to interest charged was readily available with banks as banks aggregated interest amounts and principal amounts at the time of approval of the resolution plan. Further, SEBI stated that as per the loan agreement signed between Noticee 1 & SBI (erstwhile State Bank of Hyderabad), dated March 31, 2017, the loan covenant for irregular drawings is stipulated where SBI has clearly mentioned that if the account is irregular for more than 60 days, the penal interest of 2% on the entire outstanding would be charged. Therefore, the contention of the Noticee 1 that the Bank did not charge interest is incorrect and unacceptable.

C. **Interest was not ascertainable:** Noticees contended that they did not have a reliable estimate of the amount of the obligation. In this regard, SEBI stated that the information was readily available with the banks as they periodically calculate the interest on the outstanding loan. Further, SEBI stated that as per IND AS 109, the financial liability can be removed from the balance sheet only when the same is extinguished i.e. when the obligation specified in the contract is discharged or cancelled or expires. In the instant case, the company had acknowledged in its letter dated January 7, 2019, that the financial resolution was being discussed and planned with the banks. Therefore, the financial liability of the company for the interest component was not extinguished at the time of publishing of financial statements during the IP. This is also corroborated by the fact that the settlement of loans was done on December 4, 2019, by SBI and November 13, 2019, by PNB. Further, SEBI stated that banks had not waived off the interest liability of the company at the time of publishing of financial statements. The financial liability of the company cannot be

considered to be extinguished and the same had to be accounted for in the books of accounts and disclosed in the financial statements by the company. Therefore, in this regard, the contention raised by Noticees doesn't hold any merit.

SEBI views on the Role of the audit committee: SEBI stated that it was the responsibility of the Audit Committee to comply with the underlying accounting standards in the matter of dealing with interest expenses. Despite the statutory auditor raising the issue of non-compliance with Accounting Standard by way of a qualified opinion in its audit report and limited review report, the Audit Committee has failed to ensure that the published financial statements were in accordance with the applicable accounting standards and presented a true and fair view of the company's affairs. In view of the above, it can be inferred that Noticees 2 & 5 (Chairman and Members of Audit Committee) have failed to discharge their duties and thereby violated the provisions of Regulation 18(3) read with clauses A (1), (4), (5) under Part C of Schedule II of the SEBI (LODR) Regulations, 2015.

SEBI views on the Role of audit CFO: SEBI further stated that as per provisions of Regulations 17(8) of SEBI (LODR) Regulations, 2015, the Chief Financial Officer ('CFO') shall provide the compliance certificate to the board of directors. Further, under regulation 33(2)(a) of SEBI (LODR) Regulations, 2015, it is the duty of the CFO of the listed entity to certify that the published financial results do not contain any false or misleading statements or figures and do not omit any material fact which may make the statements or figures contained therein misleading while placing the financial results. CFO is a person of knowledge, who understands the concept of conservatism and why it is considered as one of the basic principles while preparing accounts. It is a well-known concept in finance to recognise expenses and liabilities as soon as possible when there is uncertainty about the outcome but to only recognize revenues and assets when they are assured of being received. The Statutory auditor raised the concern of not considering interest expense and also provided the qualification for the same, however, the CFO chose not to follow the underlying accounting standards and signed the compliance certificate and certified that the financial statement of the company is as per accounting standards and true to his knowledge. It shows the lackadaisical attitude of the CFO and unprofessionalism on the part of the CFO. In view of the same, it was noted that Noticees 2, 4, 6 & 7 (Managing Director, Executive Director and both CFOs) have violated the provisions of regulations 17(8), 33(2)(a) of the LODR Regulations.

Penalty

Noticee no.	*Name of Noticee*	*Penalty*
1	Carnation Industries Limited	₹ 500,000
2	Ravindra Sehgal	₹ 100,000
3	Suvobrata Saha	₹ 100,000
4	Arun Kumar Bose	₹ 100,000
5	Sephali roy	₹ 100,000
6	Biplab Ganguly	₹ 100,000
7	Somnath Pradhan	₹ 100,000

Cases quoted by Noticee

1. Adjudicating officer, SEBI in the matter of Radha Madhav Corporation Limited & Ors dated April 13, 2019.

Cases quoted by SEBI

1. ***Hon'ble High Court of Allahabad in the matter of Girish Chandra Tiwari vs. UCO Bank vide writ C No. 67132 of 2013 decided on 09.09.2014.***

2. ***Hon'ble Supreme Court of India in the matter of Chairman, SEBI vs. Shriram Mutual Fund {[2006]5 SCC 361}***

3. ***Suzlon Energy Ltd. and Anr. vs. SEBI (Appeal No. 201 of 2018) dated May 03, 2021.***

4. ***M/s NDTV vs. SEBI (Appeal no. 358 of 2015) dated August 07, 2019.***

5. ***Oasis Securities Ltd. & Ors. vs. SEBI (Appeal no. 316 of 2018), dated March 17, 2020.***

IBC

In the matter of Somesh Choudhary-Suspended Director at M/s Global Fragrances Private Limited (Appellant) vs. Knight Riders Sports Private Limited (Respondent 1) & Ms Arti Baluja, Interim Resolution Professional (Respondent 2) order passed at National Company Law Appellate Tribunal (NCLAT), Principal Bench, New Delhi dated 18th August 2022.

Facts of the Case

- Global Fragrances Private Limited - Corporate Debtor ('CD') had entered into a licensing agreement dated 3rd March 2014 for the term starting from 3rd March 2014 to 31st December 2016 with Knight Riders Sports Private Limited (Respondent 1) whereby the respondent had granted exclusive rights and allowance to the CD to use the trademark 'KKR', to manufacture, distribute and advertise licensed products namely Deodorants, Hair gels, and Perfumes (the licensed products) In return, the CD was obligated to pay Minimum Guaranteed Royalties ('MGR') as identified in the licensing agreement as compensation for enjoying the exclusive rights

- The respondent had raised invoices for an aggregate sum of ₹ 40,60,147/- towards the outstanding MGR payable by the CD under the licensing agreement and only part payment was received. The invoices towards MGR had to be paid irrespective of the sales made by the CD. On failure of the CD to pay the balance MGR, the respondent filed an application at

the National Company Law Tribunal (NCLT) for initiation of the Corporate Insolvency Resolution Process (CIRP) u/s 9 of the Insolvency and Bankruptcy Code, 2016 (IBC/Code).

- The application was admitted by the NCLT on the grounds that incorporeal rights like trademarks, copyrights, patents, and rights in personam capable of transfer or transmission are included in the ambit of "goods". Further for a claim to fall within the definition of 'operational debt', the operational creditor must establish that it has a right to payment in respect of the provision of goods or services and that CD committed a default towards its liability or obligation in respect of such outstanding claim.
- Aggrieved by the order of NCLT, Mr Somesh Choudhary – Suspended Director and Shareholder of the CD filed the appeal before NCLAT.

Arguments by the Appellant

- It was argued that the invoices were raised towards payment of MGR which were to be paid irrespective of the sales made by the CD. It was submitted that the 'Claim' arises out of non-payment of MGR, which admittedly does not arise out of non-payment of any goods or services and therefore cannot be an 'Operational Debt'
- The amount claimed is not an 'Operational Debt' as there is no transaction having a correlation of direct input into the output levels or supplied by the CD. The reliance was also placed on the decision of NCLAT as held in ***'M. Ravindranath Reddy' vs. 'Mr. G. Krishan & Ors.' in Company Appeal (AT) (Ins.) No. 331/2019*** *in support that any 'debt' arising without nexus to the direct input to the output produced or supplied by the 'Corporate Debtor', cannot be considered as an 'Operational Debt'.*
- Further, also placed reliance on the Judgement of this Tribunal in ***'Promila Taneja' vs. 'Surendra Design Pvt. Ltd.', Company Appeal (AT) (Ins.) No.459/2020,*** wherein *the NCLAT has held that the definition of goods and services cannot be lifted from taxation statutes unless it is specifically provided for under the Code and once again reaffirmed the decision* of ***'M. Ravindranath Reddy' (Supra).***
- Also, it was submitted that the first Respondent had failed to show that the Appellant had used the trademark of the first Respondent for the purpose of sale, marketing etc. and that their claim was with respect to non-payment of MGR which is not an 'Operational Debt'

Arguments by the Respondent 1

- As per the agreement, the CD was obligated to pay certain considerations in form of 'compensation' to the respondent for the payment of Royalties. The MGR were payable quarterly as the schedule agreed in the agreement. The Royalties would consider the MGR paid for the corresponding period as stated in the agreement.
- Further, the CD was required to all Royalties for each calendar quarter

not later than 15 days following the last day of such calendar quarter, failing which the late charge interest at 1.5% per month or the maximum rate permitted by law, whichever is less, along with any costs/attorney fee, etc., payable on such dues. Pursuant to the terms of the Agreement, several invoices were upon the CD. However, the CD deliberately/intentionally did not make the payments of the invoices. Further several reminders were also sent in this regard, but CD failed to respond.

- On 11th June 2015, the CD gave a post-dated cheque for a sum of ₹ 5 Lakhs issued by Xtreme Perfumes and Personal Care Private Limited - a Company in which the Appellant is also a director, however, it was returned as the drawer of the cheque did not have privity of contract. Despite repeated admission of debt, the CD defaulted in making the payments.

- Further, attention was drawn to the e-mail dated 13th June 2015 wherein the CD stated that the delay in payment was on account of pending commitments and that ₹ 5 Lakhs was being transferred by RTGS and the balance amount would also be paid in that month. Thereafter, two cheques for an amount of ₹ 10 Lakhs were handed over by the CD, but subsequently, the cheques were dishonoured on the ground that 'payment was stopped.

- Also, contended that in the email dated 1st October 2015, the CD agreed to pay the royalties as per their commitments. Despite repeated reminders, when the amounts were not paid, a legal notice dated 30th March 2016 was issued and also a Criminal Complaint was lodged on 5th July 2017 against the CD and the Appellant herein.

- A demand notice dated 28th March 2018 with a complete annexure was served upon the CD u/s 8 of the Code. The payment reminder was also sent to the CD's email ID registered in the Company's Master Data, but there was no reply

- NCLT rightly observed that there was no 'Pre-Existing Dispute' between the parties and allowed the Section 9 Application

Held

- The NCLAT looked into the definition of goods under the Sale of Goods Act, 1930 to determine whether non–payment of the MGR would constitute an operational debt, t wherein the term goods included all moveable property other than actionable claims and money.

- The NCLAT also observed and relied on the decision of *the Hon'ble Supreme Court in Vikas Sales Corporation vs. Commissioner of Sales Tax* wherein it was held that trademarks and copyrights would constitute moveable property and accordingly would be considered as goods under the Sale of Goods Act, 1930.

- The NCLAT also examined the terms of MGR and observed that a guaranteed minimum royalty is a periodic payment made by a licensee towards a licensor

to utilise a licensed product for an agreed period.

- Further, the NCLAT observed that pursuant to *Section 7 of the Central Goods and Service Act 2017*, any utilisation or enjoyment of intellectual property rights would be considered a service provided by the intellectual property rights holder.
- The NCLAT also referred to the decision of *the Madras High Court in the matter of* ***AGS Entertainment Private Limited vs. Union of India*** wherein it was held, that by providing the CD rights to utilise the trademark of 'KKR' in its licensed products, the respondent had temporarily provided permission to use its trademark, which would constitute the provision of a service by the respondent. Consequently, the outstanding MGR payable in connection with the provision of such service would constitute an operational debt under section 5(21) of the Code.
- Further, the NCLAT set aside the contention of the CD on the premise that as per Ravindranath Reddy (Supra) there was no direct nexus established between the MGR payable and the business operations of the CD.
- The NCLAT also referred to the decision by its larger bench in *Jaipur Trades Expocentre Private Limited vs. M/s. Metro Jet Airways Training Private Limited* and stated the ***Ravindranath Reddy (Supra)*** had been overturned as it did not correctly deal with the meaning of "service" under section 5(21) of the Code.
- The NCLAT examined the licensing agreement between the CD and the respondent and held that the trademark 'KKR' was used in the development, packaging, and advertisement of the licensed products. This establishes a direct nexus between the payment of the MGR and the business operations of the CD. Accordingly, such MGR dues constituted an operational debt under the Code. Accordingly, the appeal was dismissed and stated that the claims arising out of the grant of an exclusive license to use intellectual property rights fall within the ambit of the definition of operational debt.

"Do not believe in a thing because you have read about it in a book. Do not believe in a thing because another man has said it was true. Do not believe in words because they are hallowed by tradition. Find out the truth for yourself. Reason it out. That is realization."

— *Swami Vivekananda*

CA Hardik Mehta CA Tanvi Vora

OTHER LAWS

FEMA – Update and Analysis

FEMA – A new era in Overseas Investment Regulations - Update and Analysis – Part 2

1. Analysis of Schedule VI and Schedule V

1.1. Schedule VI - OI by person resident in India other than Indian entity and resident Individual

1.1.1. ODI by Registered Trust or Society engaged in hospital sector or which has set up hospitals in India have been permitted to make ODI in a foreign entity with prior RBI approval subject to certain conditions such as the foreign entity being engaged in the same sector and been in existence for more than three years along with other procedural conditions. Erstwhile FEMA 120 also included manufacturing sector which is no longer permitted.

1.1.2. OI by Mutual Funds or Venture Capital Funds or Alternative Investment Funds is permitted to acquire or transfer foreign securities as stipulated by SEBI. It is provided here that the aggregate investment limits shall be prescribed by RBI whereas the individual investment limits shall be prescribed by SEBI.

1.1.3. Rules have been notified for opening demat accounts by clearing corporations and for acquisition and transfer of foreign securities by domestic depositories.

1.1.4. AD banks including its overseas branch are permitted to acquire or transfer foreign securities in accordance with the terms of the host country or host jurisdiction, in the normal course of its banking business.

1.2. Schedule V - OI in IFSC by person resident in India

1.2.1. As a new category of investments, a person resident in India has been permitted to invest in an International Financial Services Centre ('IFSC') in accordance with the other schedules I, II, III and IV subject to further conditions that:

- In case of ODI made in an IFSC, the approval by the financial services regulator concerned, wherever applicable, shall be decided within forty-five days from the date of application (complete in all respects) failing which it shall be deemed to be approved - *It begs the questions whether the financial service regulator referred herein is that in mainland India (i.e. applicable to Indian entity) or that in IFSC. An understanding of IFSC laws r.w. Para 2 of Schedule 1 on ODI by Indian entities in financial service activity would bring us to understand that approval referred is that of the Indian financial service regulator's application to the Indian entity undertaking ODI in IFSC. The deemed approval can in some ways be considered a fast-track processing of applications for development of the economy in IFSC since such deemed approval has not been provided under the normal ODI in financial service activities.*

- If the Indian entity is not engaged in FS activity in India and is undertaking ODI in foreign entity directly/ indirectly engaged in FS activity (except banking/ insurance), such an entity is permitted to make ODI in IFSC even when it does not meet the net profit condition - *RBI has provided a relaxation for net profit condition to boost investment in IFSC.*

- Person Resident in India is permitted to make OPI as a contribution to an investment fund or vehicle setup in an IFSC - *The FEM OI Directions also provides that such investment may also be by way of sponsor contribution. Accordingly, in addition to listed Indian companies and resident individuals, unlisted Indian entities may also make such investment in IFSC.*

- Resident Individual is permitted to make ODI in a foreign entity (even engaged in financial services activity) in IFSC if such entity does not have subsidiary or step-down subsidiary o/s IFSC in case where the resident individual has control in the foreign entity - The FEM OI Directions has also liberalized the condition of requiring foreign entity to be an operating entity, with the exception of investment in banking and insurance which still remains restricted. Further, as explained in Part I of our article, the control condition w.r.t. step down subsidiary condition is restrictive in case of resident individuals. Such restrictions have continued in case of investment in IFSC by such resident individuals with control in the entity. The directions clarify that a resident individual who has made ODI without control shall not acquire control in a foreign entity that subsequently acquires or sets-up a subsidiary/SDS outside India, however, the rule could be interpreted to mean that if the resident individual does not have control in the foreign entity in IFSC but that entity further has a subsidiary/ SDS outside India with

control, such a structure would be in compliance with the rules. Clarification from RBI by way of FAQ or amendment would be beneficial to avoid confusion.

1.2.2 The FEM OI Rules provides that a recognised stock exchange in the IFSC shall be treated as a recognised stock exchange outside India for the purpose of these rules.

2. Acquisition and Transfer of Immovable Property outside India:

2.1. Originally issued as FEMA 7/2000-RB on 3rd May 2000 was superseded by Notification FEMA 7(R)/2015-RB on 21st January 2016. It has now once again been superseded and merged into the FEMA (OI) Rules, 2022.

2.2. The FEMA OI Rules have largely remained the same in comparison to FEMA 7(R) with a few amendments/ clarifications that are now available and listed below:

1. The rule now clarifies through a specific exemption that the FEMA OI rules shall not apply to a property acquired by a person resident in India on a lease not exceeding five years.

2. General permission is now granted to a person resident in India to acquire immovable property outside India from a person resident outside India

   - by way of inheritance - *while this provision was also present at the time of FEMA 7(R) the restriction with respect to 'from a person referred to in Sec 6(4) and pre partition is removed. This could be considered a liberalization.*

   - by way of purchase out of foreign exchange held in RFC account - No change

   - by way of purchase out of the remittances sent under LRS instituted by RBI. Provided that such remittances under the Liberalised Remittance Scheme may be consolidated in respect of relatives if such relatives, being persons resident in India, comply with the terms and conditions of the Scheme - *While consolidation of LRS was permitted, the same was not permitted for capital transactions. Specific insertion of this provision along with proviso allowing consolidation of LRS limits of the resident individuals would permit joint owning of property aboard. However, in our view, it should be interpreted that each person should remit and own a portion of the property due to LRS remittance. A person should not merely be able to 'own'/'acquire' immovable property without LRS remittance (as sometimes followed in India as a matter of convenience)*

   - jointly with a relative who is a person resident outside India - *Under FEMA 7(R), while it was permitted to jointly acquire property outside India with a*

relative resident outside India, it was only permitted if there were no outflow of funds from India. In the new FEMA OI rules, the restriction of no outflow of funds has been done away with.

- out of the income or sale proceeds of the assets, other than ODI, acquired overseas under the provisions of the Act - *newly inserted as a liberalization measure permitting persons resident in India to reinvest income or sale proceeds in order to buy immovable property outside India. This brings out the question if a person resident in India can hold money outside India in an account opened under LRS and accumulate money in the account in order to buy an immovable property the future.*

2.3. To summarize, the permissibility with respect to acquisition and transfer of immovable property outside India can be tabulated as below:

Mode	***Transferor***	***Transferee***
Inheritance	PRI	PRI
Gift	PRI	PRI
Purchase	PRI	PRI
Inheritance	PROI	PROI
Purchase	PROI	PROI

2.4. Interestingly, the new OI regime provides a separate sub-rule for transfer of immovable property outside India by a person resident in India which was not present in the earlier. Hereunder, a person resident in India who has acquired any immovable property outside India in accordance with the foreign exchange provisions in force at the time of such acquisition may transfer such property by way of **gift** to *a person resident in India* who is eligible to acquire such property under these rules or by way of **sale** or **create a charg**e on such property in accordance with the Act or the rules or regulations made.

2.5. Further, the term 'relative' was restricted to means husband, wife, brother or sister or any lineal ascendant or descendant of that individual. In the new OI regime this has been changed to the 'relative' definition assigned to it in clause (77) of section 2 of the Companies Act, 2013. A comparison of old and new definition is necessary to understand whether a relaxation has been provided or the rule has been made stringent with the alignment with Companies Act since a comparison would probably be show that some relations (especially lineal ascendants) may not be covered under the new definition thereby restricting in nature.

2.6. An Indian entity having an overseas office may acquire immovable property outside India for the business and residential purposes of its staff, as per the directions issued by RBI from time to time. These directions have been provided in the FEM (Overseas Investment) Directions, 2022 wherein total remittances should not exceed the following limits as laid down for initial and recurring expenses, respectively:

a) 15 per cent of the average annual sales/income or turnover of the Indian entity during the last two financial years or up to 25 per cent of the net worth, whichever is higher;

b) 10 per cent of the average annual sales/income or turnover during the last two financial years.

3. Analysis of key changes to the substantive provisions of the ODI framework – FEM (Overseas Investment) Regulations, 2022

3.1. In line with the demarcation of powers between RBI and CG, the FEM OI Regulations shall be governed by the RBI (in consultation with CG). The OI Regulations deal with those instruments categorized under debt instruments as defined and listed in part 1 of our article.

3.2. An Indian entity has been permitted to lend or invest in any debt instrument issued by a foreign entity or extend non-fund based commitment to or on behalf of a foreign entity including overseas step down subsidiaries only if the following pre-requisites are satisfied:

- The Indian entity is eligible to make ODI - *While this condition was not explicitly mentioned as a prerequisite in erstwhile FEMA 120, application of Regulation 6 thereat made the requirement of eligibility apparent. Eligibility to make ODI would mean that the entity is within its financial commitment limit of 400% to provide fund/non-fund based commitments.*
- The Indian entity has made ODI in the foreign entity - *Condition for holding investment in the foreign entity before undertaking any other kind of financial commitment has continued from erstwhile FEMA 120*
- The Indian entity has acquired control in such foreign entity at the time of making such financial commitment - *As an additional condition, the pre-requisite has been broadened to also require 'control' in the foreign entity. This new requirement ensure that the rules are not misused by highly leveraging the foreign entities by way of debt or non-fund based commitments after holding a miniscule or minority shareholding. The requirement would ensure that entity which is controlled from India is regulated through the ODI provisions and reported regularly through the various annual and other reporting requirements.*

3.3. An Indian entity cannot lend directly to its overseas SDS since it does not hold ODI in the SDS directly. Further, a resident individual cannot not make financial commitment by way of debt since this option has only been made available to *Indian entities*. Under erstwhile FEMA 120, a resident individual could only invest in equity or CCPS. Although, debt and debt instruments are still not permitted to resident individuals, the definition of 'equity capital' now broadens the permissibility to include other fully and compulsorily convertible instruments.

3.4. Financial commitment by Indian entity by way of debt –

1. An Indian entity has been permitted to i) lend or ii) invest in a debt instrument subject to:

   - loans are duly backed by a loan agreement - *Documentation of loan through a loan agreement has been given more importance now. This was to be submitted along with reporting of the loan as financial commitment in Form ODI and shall continue to be a requirement under new Form FC.*

   - the rate of interest shall be charged on an arm's length basis - *Arm's length has been explained to mean a transaction between two related parties that is conducted as if they were unrelated, so that there is no conflict of interest. This requirement has been newly inserted under FEMA similar to transfer pricing requirements under Income Tax Act, 1961. It has now become a compulsion to charge interest on loans extended to foreign entity. However, upon simultaneous analysis of both the income tax and FEMA provisions, control under FEMA would be with a threshold of 10% (among other possible controls) while that under Income Tax begins at 26% direct or indirect holding. Based on the way the OI regulations are worded, the arm's length requirement would need to satisfied even if control via shareholding was above 10% but below 26%.*

3.5. Financial commitment by way of guarantee –

1. The following guarantees have been permitted to be issued issued to or on behalf of the foreign entity or any of its step down subsidiary in which the Indian entity has acquired control through the foreign entity and has been summarized below:

   - corporate or performance guarantee by Indian entity – *In the case of performance guarantee, time specified for the completion of the contract shall be treated as its validity period. In case of performance guarantee, 50 per cent. of the amount of guarantee shall be reckoned towards the financial commitment limit.*

   - corporate or performance guarantee by a group company of such Indian entity in India, being a holding company (which holds at least 51% stake in the Indian entity) or a subsidiary company (in which the Indian entity holds at least 51% stake) or a promoter group company, which is a body corporate - *promoter group shall have the meaning provided to it under SEBI regulations. It is also further provided that where a guarantee is extended by*

a group company, it shall be counted towards the utilisation of its financial commitment limit independently not that of the Indian entity. In case of performance guarantee, 50 per cent. of the amount of guarantee shall be reckoned towards the financial commitment limit.

- personal guarantee by the resident individual promoter of such an Indian entity – *However, in case of resident individual promoter, it is provided that the utilisation of its financial commitment limit shall be counted towards the financial commitment limit of the Indian entity*
- bank guarantee, which is backed by a counter-guarantee or collateral by the Indian entity or its group company as above, and issued, by a bank in India – *SBLCs usually fall under this category of guarantees.*

3.6. It can be understood that approval for issuance of corporate guarantees to or on behalf of 2nd or subsequent level SDS has been dispensed with which was required under the erstwhile FEMA 120. This liberalization shall open up various avenues for a group to structure and leverage their financial commitments in the group.

3.7. The concept of utilising the net worth of the subsidiary/holding company by the Indian entity has been discontinued henceforth.

3.8. Approvals for remitting funds at the time of invocation of a performance guarantee extended in accordance with OI Rules/Regulations is no longer needed.

3.9. The condition of no guarantee being open-ended has continued from erstwhile FEMA 120 and it strictly required to be adhered with.

3.10. For the purpose of reporting, it has been clarified in the OI Directions that any guarantee, to the extent of the amount invoked, shall cease to be a part of the non-fund based financial commitment but will be considered as financial commitment by way of debt. Such invocation shall be reported in Form FC which would earlier have been reported in Form FC as a guarantee. However, roll-over of guarantee shall not be treated as fresh financial commitment but should be reported in Form FC. Furter, remittance towards invocation of guarantee is not considered as a financial commitment therefore NOC would not be required.

3.11. Financial commitment by way of pledge or charge –

1. Only an Indian entity has been permitted to undertake a pledge or create a charge on assets with the pre-requisite of having ODI by way of equity capital in that foreign entity.

3.12. The provisions applicable to the Indian entity have been summarized below:

Security by Indian entity	***In whose favour***	***Facility availed***	***Amount reckoned towards financial commitment***
A) Pledge the equity capital of the foreign entity /its SOS outside India.	AD bank or a public financial institution in India or an overseas lender.	Fund/non-fund based facilities for Indian entity.	Nil
		Fund/non-fund based facilities for any foreign entity/its SDSs outside India.	The value of the pledge or the amount of the facility, whichever is less.
	A debenture trustee registered with SEBI in India.	Fund based facilities for Indian entity.	Nil.
B) Create charge on its assets (other than A above) in India [including the assets of its group company or associate company, promoter and I or director].	AD bank or a public financial institution in India or an overseas lender.	Fund/non-fund based facility for any foreign entity/its SOS outside India	The value of charge or the amount of the facility, whichever is less
	Overseas or Indian lender.	fund/non-fund based facilities for Indian entity.	Nil.
C) Create charge on the assets outside India of the foreign entity/ its SOS outside India.	An AD bank in India or a public financial institution in India.	Fund/non-fund based facility for any foreign entity/its SOS outside India.	The value of the charge or the amount of the facility, whichever is less.
		Fund/non-fund based facility for Indian entity.	Nil.
	a debenture trustee registered with SEBI in India.	fund based facilities for Indian entity.	Nil

3.13. Further, the creation of charge or pledge is subject to the following:

- The value of pledge/or the amount of the facility whichever is less, shall be reckoned towards the financial commitment limit
- Overseas lender in whose favour such pledge/charge is created shall not be from any country or jurisdiction in which financial commitment is not permissible under the OI Rules

- the creation/enforcement of pledge/charge shall be in accordance with the relevant provisions of the Act or rules or regulations made, or directions issued thereunder
- The OI directions further provides conditions that the assets on which charge is being created are not securitized
- The period of charge, if not specified upfront, shall be co-terminus with the period of facility (like loan or other facility) for which charge has been created

3.14. It is provided that in the event of enforcement of charge created on domestic assets, such domestic assets shall be transferred by way of sale to a person resident in India only. In our view, this is to ensure that Indian assets are not moved outside India through this mode.

3.15. The OI Regulations also provides for a new concept under FEMA i.e. negative pledge" or "negative charge". It explains that a "negative pledge" or "negative charge" created by an Indian entity or a bid bond guarantee obtained in accordance with these regulations for participation in a bidding or tender procedure for the acquisition of a foreign entity shall not be reckoned towards the financial commitment limit referred to in sub-regulation (1) of regulation 3.

3.16. The new regime now permits acquisition or transfer of foreign equity capital on **deferred payment arrangement** terms. Payment of amount for consideration for i) equity capital by way of subscription to an issue or ii) by way of purchase from a person resident outside India or iii) where a person resident outside India acquires equity capital by way of purchase from a person resident in India, may be deferred for such *definite* period from the date of the agreement as provided in such agreement. However, definite period has not been defined under the rules. The period could be a few months or a few days and without a specific rule that defines the definite period, it would be subject to interpretation and will therefore be upon AD banks to consider each proposal. It would be helpful if RBI specifies a upper limit on the period of deferment similar to that provided under the FDI regime. In comparison to FDI regime, the deferred payment terms has not been limited by a maximum percentage that can be deferred. Also, contingent consideration as per the terms and conditions of the agreement is allowed or not is not clear. On literal reading it seems plain vanilla deferment of payment is only allowed, however the way these days transactions and deals are agreed/structured it would be good if there is a clarification by way of a FAQ as to whether contingent consideration which is backed by upfront formula/valuation is allowed or not.

3.17. Further conditions applicable to deferred payment include:

- the foreign securities equivalent to the amount of total consideration shall be transferred or issued, as the case may be, upfront by the seller to the buyer. *This could be considered similar to concept of partly paid shares in Companies Act*

2013 wherein the shares are issued to the shareholder.

- the full consideration finally paid shall be compliant with the applicable pricing guidelines therefore the *valuation report needs to be done and submitted upfront at the time of reporting the deferment in Form FC.*
- the deferred part of the consideration in case of acquisition of equity capital of a foreign entity by a person resident in India shall be treated as non-fund based commitment. *Subsequent payments towards deferred consideration shall be reported in Form FC as conversion of non-fund based financial commitment to equity.*

3.18. **Mode of payment** for Overseas Investments i.e. ODI, debt and OPI can be made through one of the following modes

- by remittance made through banking channels – *this should include normal fund transfer from regular Indian accounts.*
- from funds held in an account maintained in accordance with the provisions of the Act – *the regulations or directions do not specify which account they refer to. In our understanding it would include i) EEFC A/c. In erstwhile FEMA 120, investment from EEFC A/c was excluded from the limit of financial commitment but this exception has no longer continued under the new regime. ii) Foreign Currency Account opened for the purpose of ODI as permitted by Notification No. FEMA 10(R)/2015-RB, namely, Foreign Exchange Management (Foreign Currency Accounts by a resident in India) Regulations, 2015. The directions have reiterated Notification No. FEMA 10(R)/2015-RB, that remittances cannot be made by any Indian entity to its branch/office outside India for making any overseas investment and such remittances are allowed only for normal business operations.*
- by swap of securities – *same as erstwhile FEMA 120, though clarity is awaited as to what type of swap arrangements are covered here.*
- by using the proceeds of American Depository Receipts or Global Depositary Receipts or stock swap of such receipts or external commercial borrowings raised in accordance with the provisions of the Act and the rules and regulations made thereunder for making ODI or financial commitment by way of debt by an Indian entity - *same as erstwhile FEMA 120*

3.19. While there was no confusion on this, the OI Directions now specifically clarifies that overseas investments by way of Cash is not permitted.

3.20. Any investment/financial commitment in Nepal and Bhutan shall be done in a manner as provided in Notification No. FEMA 14(R)/2016-RB, namely, Foreign Exchange Management (Manner of Receipt and Payment) Regulations, 2016.

All dues receivable on investments (or financial commitment) made in freely convertible currencies, as well as their sale/winding up proceeds are required to be repatriated to India in freely convertible currencies only.

3.21. Similar to the Regulation 15 of erstwhile FEMA 120, the FEM (OI) Regulations, 2022 has formulated Regulation 9 listing the **obligations applicable to a person resident in India.** These include:

1. *Evidence of Investment* – PRI is required to submit to AD bank share certificates or any other relevant documents, as an evidence of ODI investment in the foreign entity within six months from the date of effecting remittance or the date on which the dues to such person are capitalised or the date on which the amount due was allowed to be capitalized. While there is no change on the time limit of 6 months in comparison to erstwhile FEMA 120, the words used earlier were, the PRI was required to 'receive' whereas the new regulation specifies the limit on 'submission' to AD bank. Hence many entities that would receive the certificates but were not aware on the requirement of submission or inadvertently forgot to do so would be considered in contravention. If the PRI is unable to submit evidence of investment, it is required to repatriate the funds remitted overseas within the said 6 months.

2. *Unique Identification Number* – PRI through AD Bank should obtain UIN from RBI for the foreign entity in which the ODI is intended to be made before sending outward remittance. This was not included under obligation regulation under erstwhile FEMA 120 but was instead under Regulation 10 wherein it specified allotment of a UIN by RBI. Having now included this regulation under the obligation provisions, in our view, the RBI is passing the burden onto the PRI to follow up and ensure that the AD bank files the necessary documents with RBI on the OID application portal which is not available to the public but only AD banks. Form FC shall be submitted along with requisite documents to AD bank for obtaining UIN on or before making initial ODI. The PRI should follow-up religiously for swift and timely processing of Form FC as only then they would be able to undertake remittances.

3. *Designated AD bank*: A PRI making ODI shall designate an AD bank and route all transactions relating to a particular UIN through such AD. In erstwhile FEMA 120 under Regulation 6(2)(v), the requirement was to route everything through the same 'branch' of the AD bank as well. This relaxation from same branch of AD bank to same AD bank could be due the fact that sometimes various banks have only one or limited branches that deal with forex transactions.

4. *Repatriation of due* – Under the erstwhile FEMA 120, all dues receivable from the foreign entity, like dividend, royalty, technical fees etc. were required to be repatriated within 60 days of its falling due. Also, the

sale proceeds were required to be repatriated within 90 days from the date of sale. However, under the new regime, the PRI shall realise & repatriate i) all dues receivable with respect to investment in a such foreign entity; ii) consideration received on transfer/ disinvestment; iii) net realizable value of assets on account of liquidation, within 90 days of them falling due or date of transfer/disinvestment or date of distribution upon liquidation. The RBI has therefore provided a relaxation on the number of days from 60 days to now 90 days.

5. An underlier to the whole outbound regime has been the tightening of the noose of non compliance under FEMA. It has been provided that a PRI who has made a financial commitment in a foreign entity shall not be permitted to make any further financial commitment, whether fund-based or non-fund-based, directly or indirectly till any delay in reporting is regularized.

Part 3 of our article will deal analysis of the reporting requirements under the new overseas investment regime and shall include a detailed step by step guide on the compliance and reporting under the new Form FC in Part 3 of the article.

We have discussed below recent amendments made in FEMA through Notifications, Circulars and Press Notes.

A. Update through A. P. (DIR Series) Circular

1. Late Submission Fee for reporting delays under Foreign Exchange Management Act, 1999 (FEMA)

The Late Submission Fee (LSF) was introduced for reporting delays in Foreign Investment (FI), External Commercial Borrowings (ECBs) and Overseas Investment related transactions with effect from November 07, 2017, January 16, 2019 and August 22, 2022 respectively. It has now been decided to bring uniformity in imposition of LSF across functions. LSF are mainly for reporting contraventions/delays and are not applicable for substantive contraventions. The following matrix shall be used by AD Banks/ RBI henceforth for calculation of LSF, wherever applicable:

Sr. No.	*Type of Reporting delays*	*LSF Amount (INR)*
1	Form ODI Part-II/ APR, FCGPR (B), FLA Returns, Form OPI, evidence of investment or any other return which does not capture flows or any other periodical reporting	7500
2	FC-GPR, FCTRS, Form ESOP, Form LLP(I), Form LLP(II), Form CN, Form DI, Form InVi, Form ODI-Part I, Form ODI-Part III, Form FC, Form ECB, Form ECB-2, Revised Form ECB or any other return which captures flows or returns which capture reporting of non-fund transactions or any other transactional reporting	$[7500 + (0.025\% \times A \times n)]$

Where:

a) "n" is the number of years of delay in submission rounded-upwards to the nearest month and expressed up to 2 decimal points.

b) "A" is the amount involved in the delayed reporting.

- The LSF amount is per return. However, for any number of Form ECB-2 returns, delayed submission for each LRN will be treated as one instance for the fixed component. Further, 'A' for any ECB-2 return will be the gross inflow or outflow (including interest and other charges), whichever is more.
- Maximum LSF amount will be limited to 100 per cent of 'A' and will be rounded upwards to the nearest hundred.
- Where an advice has been issued for payment of LSF and such LSF is not paid within 30 days, such advice shall be considered as null and void and any LSF received beyond this period shall not be accepted. If the applicant subsequently approaches for payment of LSF for the same delayed reporting, the date of receipt of such application shall be treated as the reference date for the purpose of calculation of "n".
- The facility for opting for LSF shall be available up to three years from the due date of reporting/submission. The option of LSF shall also be available for delayed reporting/submissions under the Notification No. FEMA 120/2004-RB and earlier corresponding regulations, up to three years from the date of notification of Foreign Exchange Management (Overseas Investment) Regulations, 2022.
- In case a person responsible for any submission or filing under the provisions of FEMA, neither makes such submission/filing within the specified time nor makes such submission/filing along with LSF, such person shall be liable for penal action under the provisions of FEMA, 1999.
- The above provisions shall come into effect immediately for the delayed filings made on or after the date of this circular.

(Source: A. P. (DIR Series) Circular No. 16 dated 30th September, 2022)

(Comments: The rational move to bring uniformity between all regulations as far as levy of Late Submission Fees is beneficial for all the stakeholders. Capital Account Transactions of FDI, ECB and ODI are all routed through AD Banks and approved by RBI in certain cases. Bringing uniformity in LSF for reporting delays/contraventions will ease the compliance burden. In another welcome move, in case of ODI reporting delays, the LSF option is made available which is missing for FDI and ECB reporting delays when LSF was introduced for those transactions. In our view, the formula for calculation of LSF has also been liberalized which should be beneficial for most of the applicants.)

Rahul Hakani
Advocate

Niyati Mankad
Advocate

Best of The Rest

ASSISTANT COMMISSIONER OF STATE TAXES AND EXCISE, BADDI, H.P. VS. LD. LIQUIDATOR – ORDER DT 19/09/2022 PASSED IN IA/1949/2022, IA/1951/2022 AND IA/2099/2022 TAKEN OUT IN CP/IB/1667/2018 [NCLT, MUMBAI]

Section 53 of IBC – In view of Taxing Statute providing for a First Charge over assets of Assessee/Corporate Debtor – such State Government/department to be classified as "Secured Financial Creditor" instead of as operational unsecured creditor

Facts

In the present case, the Liquidator had sold one of the properties of the Corporate Debtor (**"CD"**) in an auction which was purchased by M/s. Eva Grow Medicaps Private Limited (**"Auction Purchaser"**). Since, the department viz, Assistant Commissioner of State and Excise, Himachal Pradesh (""**ACSTE**") refused to give NOC to register the above property in the name of the purchaser by the Liquidator, the Auction Purchaser as well as Liquidator filed two applications bearing nos. I.A. 2766/2021 and I.A. 918/2022 praying for a direction to the ACSTE to issue NOC. The Hon'ble Bench on 05.05.2022 passed an ex-parte common order in both the I.A.'s bearing nos. I.A. 918/2022 and I.A. 2766/2021 directing the ACSTE to furnish NOC since the ACSTE remained absent despite service of notice them. The ACSTE took out IA/1949/2022 and I.A. 1951/2022 to recall the ex-parte direction passed against them and to give an opportunity of hearing and pass appropriate orders on merits in both the above applications i.e. I.A. 918/2022 and I.A. 2766/2021. Thereafter, purchaser also took out IA/2099/2022 for initiating contempt proceedings against ACSTE.

It is pertinent to note that the Himachal Pradesh Value Added Tax, 2005 provided for a first charge on the property of the dealer in case of default. Accordingly, it was ACSTE's contention that it was to be classified as "Secured Creditor". However, the Liquidator had classified the ACSTE as unsecured operational creditor because of which ACSTE had refused to issue NOC, as directed.

Issue involved

Whether the impugned Order dated 05/05/2022 deserved to be quashed/set aside?

Held

The Liquidator had submitted before the Bench that in view of the recent judgement dated 06/09/2022 of the ***Hon'ble Apex Court in the matter of State Tax Officer (1) Versus Rainbow Paper Limited in Civil Appeal No. 1661 of 2020*** **[2022 SCC OnLine SC 1162]** the claim of the ACSTE has priority and have to be included under the category of "Secured Financial Creditors" and shall be paid to them at the time of distribution for which the ACSTE had no objection. Under these facts and circumstances, as nothing had remained to be decided in any of the three applications i.e. I.A. 1951/2022, I.A. 1949/2022 & I.A. 2099/2022, the Hon'ble Authority disposed off all the three applications with direction to the ACSTE to issue NOC to Liquidator within two weeks and to receive their claim at the time of distribution.

THE STATE OF MAHARASHTRA AND OTHERS VERSUS MR. ASPI CHINOY AND ANOTHER - ORDER DT. 30/09/2022 PASSED IN CIVIL APPEAL NO. 5809 OF 2011 [SUPREME COURT]

No NOC of collector required to transfer flats (in a co-operative housing society) built on land leased to developer

Facts

In the year 1971, the State Government had invited offers for the lease of Plot Nos. 93, 94, 99, 100 and 121 from Block V Back Bay Reclamation Estate. In response to the said notice, one M/s. Aesthetic Builders Pvt. Ltd. (**"said builder"**) had made a bid for Plot No. 121 (Old) or 119 (New). The bid was on the basis that the said builder would construct and sell residential flats on ownership basis. The purchasers of the flats would thereafter form a Co-operative Society, in which Society the rights of the Company would be transferred. The bid of the said builder was accepted and the State Government granted a licence to the said builder to enter upon the plot and construct a building in accordance with the plans and specifications sanctioned by the Municipal Corporation of Greater Bombay.

On the said plot, a twenty-two storey building namely Jolly Maker Apartments No. 3 was constructed by the Company and the flats were sold to various parties on ownership basis. Occupation certificate in respect of the said building was issued on 12/12/1975. After completion of the building in the year 1977, the purchasers of the flats formed a Co-operative Society called Varuna Premises Co-operative Society Ltd., which was duly registered under the Maharashtra Cooperative Societies Act, 1960.

The dispute arose when Mr. Aspi Chenoy, Senior Advocate purchased a flat in the building. When he approached the sub-registrar for registration, he was directed to secure an NOC from the collector in view of a letter dated 27/06/2000 addressed by the Collector to the Sub-Registrar, Bombay City, Old Custom House whereby the Collector had directed the Sub-Registrar not to register any transaction in respect of transfer of flats in the buildings situated in B.B.R. Block Nos. 3 and 5, Nariman Point and Cuffe Parade, Bombay without obtaining a No Objection Certificate from the Collector.

Mr. Chinoy challenged the said letter dated 27/06/2000 by way of Writ Petition No. 713 of 2001.

It was the contention of the State that in view of Government Resolution dated 12/05/1983 and Government Resolution dated 09/07/1999,

the State was entitled to claim premium as a condition for grant of permission for transfer of the flats. The said Resolutions were applicable to co-operative societies to whom land was sanctioned at concessional rates. The State had also pressed into service Clauses 15 and 16 of the Memo of Terms and Conditions for the Lease of Plot from Block V Back Bay Reclamation. The High Court did not find favour with the contentions raised by the State and allowed the writ petition vide Order dated 29/09/2009. Being aggrieved thereby, the State approached the Apex Court by way of the present appeal.

Issue Involved

Whether the High Court was right in holding that the State Government had no power to demand any premium before transferring the flat.

Held

The Court observed that after the land was allotted to the said builder on lease basis in the year 1972, the 1983 Resolution came into effect. The 1983 Resolution provided for grant of land to co-operative societies of different categories on concessional rates. After the 1983 Resolution, the Government noticing that, with the passage of time and the policy being nearly 15-16 years old, it was necessary to modify and revise the said policy. The 1999 Resolution was nothing but in continuation of the 1983 Resolution, which is applicable to the co-operative societies to whom the government lands are sanctioned on concessional rates.

In the peculiar facts and circumstances of the case, since the land was not allotted to a society but to a builder on lease, who constructed flats for private individuals, who subsequently formed a Cooperative Society, the 1983 Resolution and 1999 Resolution would not be applicable to the members of such a society. Accordingly, the Appeals were dismissed.

BALRAM SINGH VS KELO DEVI – ORDER DT. 23/09/2022 PASSED IN C.A. NO. 6733 OF 2022 [SUPREME COURT]

Specific Relief Act, 1963 - Suit for injunction on the basis of unregistered agreement to sell - The plaintiff cleverly prayed for a relief of permanent injunction only and did not seek for the substantive relief of specific performance of the agreement to sell as the agreement to sell was an unregistered document (as no decree for specific performance could have been passed on the basis of such unregistered document/ agreement to sell) - held - Permanent Injunction Cannot Be Sought On The Basis of An Unregistered Agreement to Sell

Facts

In the present case, the original plaintiff (i.e. Ms. Kelo Devi) filed a suit praying for a decree of permanent injunction restraining the defendant (i.e. Balram Singh, the Appellant herein) from disturbing her possession in the suit property, which was claimed on the basis of the agreement to sell dated 23.03.1996, which was an unregistered document/ agreement to sell on ₹ 10/- stamp paper.

The Trial Court dismissed the suit filed by Ms. Kelo Devi and refused to grant permanent injunction and allowed the counter-claim of Mr. Balram Singh. The First Appellate Court reversed the Trial Court judgment and decreed the Suit. The High Court dismissed the second appeal filed by Mr. Balram Singh.

In appeal, Mr. Balram Singh contended that an unregistered agreement to sell is not admissible in evidence and that the suit

filed by the original plaintiff was only for permanent injunction and she by adopting a clever drafting did not seek the relief for specific performance of agreement to sell as she was well aware that she would not succeed in the suit for specific performance on the basis of an unregistered agreement to sell.

On the other hand, Ms. Kelo Devi contended that an unregistered document can be used for collateral purpose and therefore both, the first appellate Court as well as the High Court have rightly passed a decree for permanent injunction considering the agreement to sell for collateral purpose of grant of permanent injunction.

Issue Involved

Whether the High Court was right in dismissing the Second Appeal filed Mr. Balram Singh?

Held

Allowing the appeal, the Hon'ble Apex Court bench observed:

"Having conscious of the fact that the plaintiff might not succeed in getting the relief of specific performance of such agreement to sell as the same was unregistered, the plaintiff filed a suit simplicitor for permanent injunction only. It may be true that in a given case, an unregistered document can be used and/or considered for collateral purpose. However, at the same time, the plaintiff cannot get the relief indirectly which otherwise he/she cannot get in a suit for substantive relief, namely, in the present case the relief for specific performance. Therefore, the plaintiff cannot get the relief even for permanent injunction on the basis of such an unregistered document/agreement to sell, more particularly when the defendant specifically filed the counter-claim for getting back the possession which was allowed by the learned trial Court. The plaintiff cleverly prayed for a relief of permanent injunction only and did not seek for the substantive relief of specific performance of the agreement to sell as the agreement to sell was an unregistered document and therefore on such unregistered document/agreement to sell, no decree for specific performance could have been passed. The plaintiff cannot get the relief by clever drafting"

The court therefore restored the Trial Court judgment dismissing the suit and allowing the counter-claim.

"Dare to be free, dare to go as far as your thought leads, and dare to carry that out in your life."

— *Swami Vivekananda*

CA Vijay Bhatt
Hon. Jt. Secretaries

CA Mehul Sheth
Hon. Jt. Secretaries

THE CHAMBER NEWS

Important events and happenings that took place online/ physical between **1st September, 2022 to 30th September, 2022** 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 15th September, 2022 are as under:

Type of Membership	No. of Members
Life Member	06
Ordinary Member	14
Student Member	05
Total	**25**

II. PAST PROGRAMMES

Sr. No.	*Date*	*Topic*	*Speaker*
COMMERCIAL & ALLIED LAWS			
1.	02.09.2022	Lecture Meeting on "Recent Supreme Court decision in Ganpati Dealcom Pvt. Ltd. under Benami Act"	Saurabh Soparkar, *Senior Advocate*

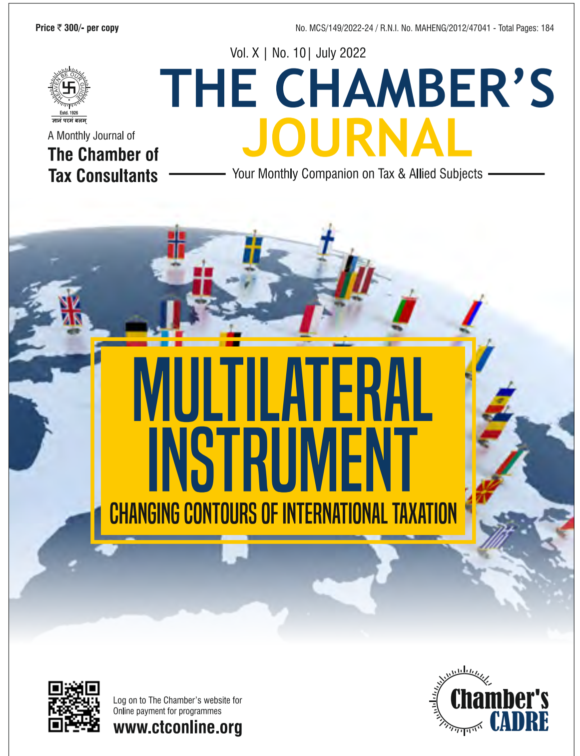
Sr. No.	Date	Topic	Speaker
2.	15.09.2022	Recent Supreme Court decision in Vijay Madanlal Choudhary & Ors. under Prevention of Money Laundering Act, 2002	Dr. Dilip K. Sheth
3.	17.09.2022	Lecture Meeting on "Adjudication and Compounding procedures under Companies Act, 2013	Dr. S. K. Jain
DELHI CHAPTER			
1.	20.09.2022	Towards Inclusive Framework - Pillar 1 and Pillar 2 update	*Chairman* Mr. S. P. Singh *Speakers*: CA Partho Dasgupta CA Monica Wadhani
DIRECT TAXES			
1.	12.09.2022	Pre-recording session of Anti-abuse - History, Background and Broad Overview of The Anti-Abuse Provisions	CA Vinod Ramachandran
INDIRECT TAXES			
1.	14.09.2022	IDT Study Circle on Critical Issues emerging from Recent Important Judicial pronouncements under GST	*Group Leader*: Raj Khona *Chairman*: Shushil Solanki
INTERNATIONAL TAXATION			
1.	07.09.2022	FEMA Study Circle on Analysis of the new FEM Overseas Investments Rules and Regulations (Part 1)	CA Tanvi Vora Mr. Sanjit Chatterjee
2.	08.09.2022	INT Tax Study Circle on Master File Documentation - Practical Aspects and Issues	CA Sagar Jhalani, CA Kunal Sawardekar, CA Chaitanya Maheshwari

Sr. No.	*Date*	*Topic*	*Speaker*
3.	16.09.2022	FEMA Study Circle on Analysis of the new FEM Overseas Investments Rules and Regulations (Part 2)	CA Tanvi Vora
		MEMBERSHIP & PR	
1.	13.09.2022	SAS on Setting up systems and processes in company	CA Sriniwas Vakati
		PUNE STUDY GROUP	
1.	16.09.2022	Pune Study Group Meeting on Issues in section 194R of Income Tax Act, 1961	CA Bhaumik Goda
		STUDY CIRCLE & STUDY GROUP	
1.	03.09.2022	Issues in filing of IT return of Charitable Trust & some Recent Amendments	*Group Leader*: CA Ravi Gupta *Moderator*: CA Vipin Batavia
2.	06.09.2022	Issues in Clause 30C of Tax Audit Report (*Jointly with Indirect Taxes Committee*)	Dr. (CA) Mayur Nayak

"After every happiness comes misery; they may be far apart or near. The more advanced the soul, the more quickly does one follow the other. What we want is neither happiness nor misery. Both make us forget our true nature; both are chains--one iron, one gold; behind both is the Atman, who knows neither happiness nor misery. These are states, and states must ever change; but the nature of the Atman is bliss, peace, unchanging. We have not to get it, we have it; only wash away the dross and see it."

— *Swami Vivekananda*

June 2022



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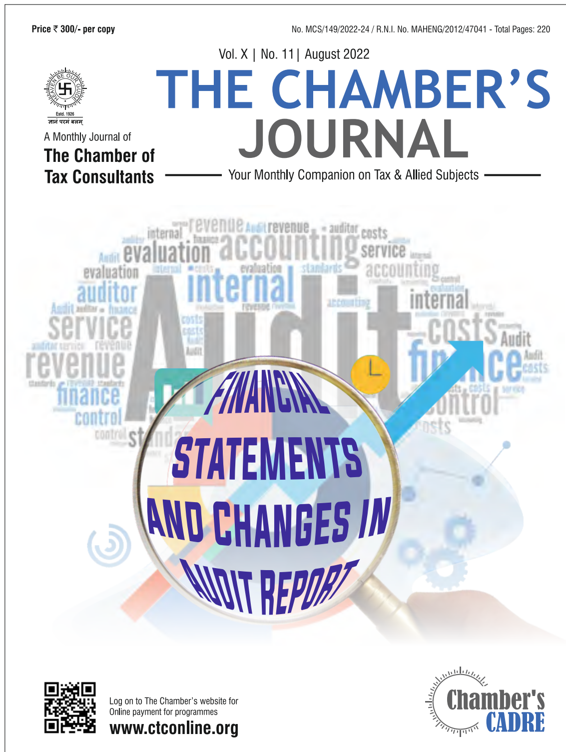

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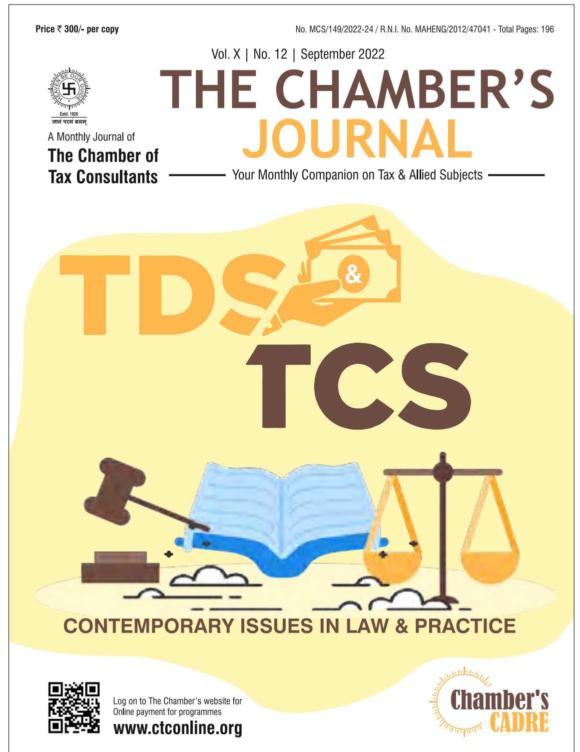

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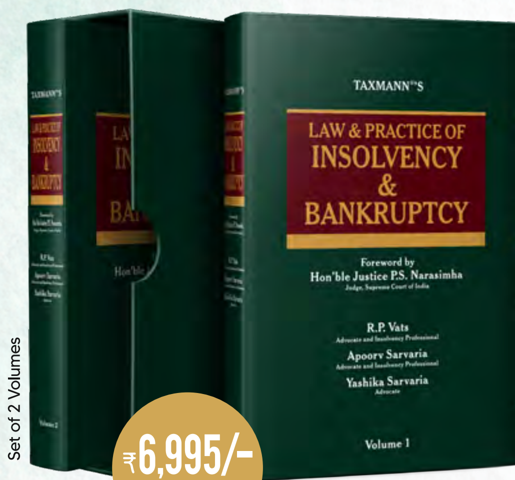

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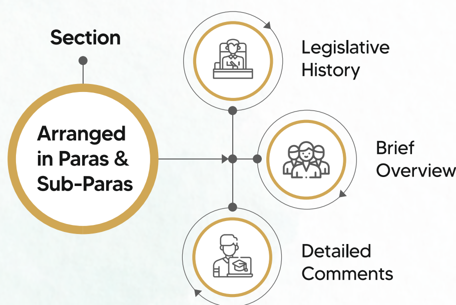

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