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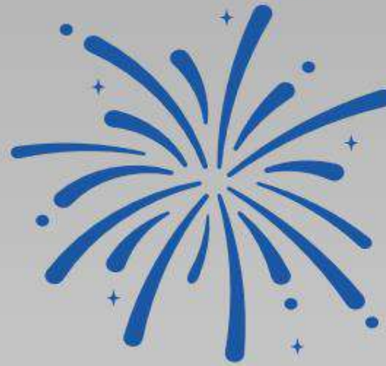

Anniversary Edition

SBS AND COMPANY LLP
CHARTERED ACCOUNTANTS

Foreword

Dear Readers,

We bring you this month our anniversary edition. We have completed 14 years and to commemorate this event, we have brought changes to the cover page of the journal. The cover page only has undergone the change but not the content.

For the anniversary edition, we have asked our team members (who never wrote) to contribute to the articles. Everyone has directly or indirectly contributed and the result is the bulky journal on your screen. A big thanks to all the contributors! This edition covers articles which are of great significance and of interest to both corporates and non-corporates.

The article on 'Game of Skill vs. Game of Chance & A Study on GST Implications on Online Gaming' focuses on the recent decision of Karnataka High Court in Gameskraft and various court's interpretation on game of skill vs game of chance. Though the judgment has said the games of skill does not fall under the ambit of GST laws and the expression 'betting and gambling' appearing in GST laws covers only games of chance, the recent decision of GST Council to treat the game of skill and game of chance as one for the purposes of GST laws is unwarranted. The GST Council is trying to re-write the settled law and this will be definitely challenged by the industry. Moreover, the taxing of the entire bet value is also unprecedented and will also be subjected to judicial scrutiny.

We have also came up with an article 'Decoding Applicability of GST on Interest – Credit Card Loan vs Standard Loan'. This article focuses on recent judgment dealing with tax implications on interest paid on loans taken using the credit card.

The next article is on 'Insolvency Proceedings against Financial Service Providers' deals with the law involved in initiation of insolvency proceedings against FSPs which was a result of sub-committee report. Apart from the said law, the article also deals with certain litigations surrounding the trails of creditors in initiating the insolvency proceedings against FSPs.

The next article is on 'Important Aspects in IBC – Revisited through Recent Judgments' details the litigation surrounding the basic (but powerful) terms under the IBC. Though the law has reached a decent maturity, there will be still a dynamic evolution on interpretation of certain basic terms like 'debt', 'threshold limit' and others. An interesting read.

From the direct taxation, we have three articles. The first one deals with the 'Non-disclosure of foreign assets and consequences under Black Money Act'. For this article, we have taken the most general foreign asset (ESOPs issued by parent foreign entity) which may not be disclosed by the tax payers at the time of filing returns. Please be noted that the law is evolving on this aspect, since, now the tax authorities started focusing. The real depth and ambit of Black Money Act will be unleashed in future. Till then, it is required to take a conservative view and accordingly the article is drafted in this background.

The second one deals with 'Residential Status of an Individual and Company under DTAA'. This article focuses on determination of residential status for an individual and company when there is a possibility of being resident both under the domestic law and treaty. An interesting read. The third one deals with 'Significant Disclosures in ITR by Individuals' which focuses on the major disclosures that need to be made by individuals while filing their returns. Having done these disclosures, an individual would be in a better position while facing scrutiny or other proceedings.

We have also collated certain important judgments under direct tax and indirect tax laws, provided our comments wherever necessary.

I hope that you will have good time reading this edition and please do share your feedback.
Thanking You,

Suresh Babu S

Founder & Chairman

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Online Rummy – Game of Skill or Game of Chance? & GST Implications on Online Gaming

The decision of Karnataka High Court in Gameskraft Technologies (P) Limited ([2023] 150 taxmann.com 252 (Karnataka)) has saved the online gaming industry. The High Court held that games of skill are not to be covered under the expression 'betting and gambling' in Entry 6 of Schedule III of CT Act. This was a huge relief for the online gaming industry, which are into organizing the games with skill. Examples can be rummy, cricket and various other games which involve skill rather than chance.

However, on the other hand, the recent decision of GST Council to bring tax on the face value instead of the service fee has rattled the industry. What is furthermore troublesome is the approach of the Council towards these games. The Council has earlier constituted a Group of Ministers (GoM) to study and propose the tax implications on Casinos, Racecourses and Online Gaming. The GoM has submitted its report as part of the 47th GST Council Meeting. The report was taken into consideration during the 50th GST Council Meeting and tax was brought on the complete bet value.

On one hand, the Karnataka High Court and various other Courts have held that games involving skill does not fall under the ambit of expression 'betting and gambling' as appearing in Entry 64 of List II of Seventh Schedule to Constitution of India. Applying the same analogy under the GST laws, the Courts (Karnataka High Court in Gameskraft and Bombay High Court in Gurdeep Singh Sachar (2019 (30) GSTL 441 (Bom))) held that games of skill does not fall under the ambit of 'betting and gambling' as appearing in Entry 6 of Schedule III to CT Act, thereby becoming actionable claims whose supply is treated neither supply of goods nor supply of services. However, as stated earlier, the way the GST Council looks at the above is in complete contradiction.

With the above background, we shall proceed to examine in this article, the various hues of the issue by analyzing the judgment of Karnataka High Court in Gameskraft and take key pointers as to how the law surrounding the gambling and betting vis-à-vis GST is to be interpreted.

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1. Before dealing with the core issue, a few aspects dealing with the scheme of GST to the extent it is

relevant to article is worth discussing.

2. A stark difference between the erstwhile indirect taxation regime to the current GST regime is the definition of 'goods'. Earlier, the actionable claims are not included in the definition of 'goods'. They used to be outside the ambit of definition of 'goods'. Under the GST laws, the definition of 'goods' specifically includes 'actionable claim'. Though, the definition of 'goods' specifically include 'actionable claim' in its ambit, the supply of all the actionable claims are not categorised as supplies under GST laws. This is evident from reading Entry 6 of Schedule III to CT Act, which lists, 'actionable claims, other than lottery, betting and gambling' as activities or transactions which shall be treated as neither supply of goods nor supply of services. Hence, supply of actionable claims (Other than lottery, betting and gambling) are neither supply of goods nor supply of services.

3. From the above, it is evident that lottery, betting and gambling are classified as 'actionable claims' and thereby brought to tax. In this article, we shall deal only with the betting and gambling, since the issues surrounding the lottery and its valuation are settled by Hon'ble Supreme Court in Skill Lotto Solutions Private Limited[1].

4. The core issue before the High Court is whether offline/online games such as 'Rummy' which are mainly/preponderantly/substantially based on skill and not on chance, whether played with/without stakes amounts to 'gambling or betting' for the purposes of GST laws?

5. Gameskraft Technologies Private Limited (for brevity 'Gameskraft') is an online intermediary company who runs technology platforms that allows users to play skill based online games against each other. The platform has over 10 lakh users from across India. A search and seizure action was undertaken on Gameskraft which led to issuance of intimation to pay tax of Rs 2,09,89,31,31,501/- (I have to take help of Google to put the above amount in words - close to Rs 2,100 Crores). The said intimation was the subject matter of the writ proceedings before the High Court. An interim order of stay was granted by the High Court. Thereafter, a show cause notice under Section 74(1) was issued to Gameskraft, which were again challenged before the High Court in writ proceedings. All India Gaming Federation and E-Gaming Federation have joined as intervenors supporting Gameskraft before the High Court.

6. The modus operandi of running the online games as explained by Gameskraft is worth knowing. Gameskraft claims that it has no role/influence in so far as the playing of the games is concerned. The users/players choose the games based on the amount they want to stake to match their skills against other players who want to play a similar amount. Gameskraft merely hosts the games and the discretion to play a game and the stake for which it is to be played entire lies within the

[1] 2020 (12) TMI 140 – Supreme Court

domain of user/player and Gameskraft does not have any say in this.

7. The same is explained by way of an example by Gameskraft, which puts the entire modus operandi in the right perspective. 'A' and 'B' after downloading the mobile application of Gameskraft, they have to deposit Rs 200/- each for participation in the game. The winner at the end of the game gets Rs 360/- as winnings. For allowing 'A' and 'B' to use its platform for participating in the game of rummy, Gameskraft would be charging Rs 20 from each, amounting to Rs 40/- in total as 'platform fee'. Gameskraft is paying tax on Rs 40/- which is the 'platform fee' and till the winner is decided, it holds Rs 360/- in a designated account, on which it does not have any right or lien.

8. The case of the tax authorities is that the Gameskraft is intentionally misclassifying their supplies as supply of services, whereas in fact, the supplies are in the nature of actionable claims (betting or gambling) that is supply of goods. Accordingly, the contention of the tax authorities is that the buy-in amounts received by Gameskraft (that is Rs 400/- in the above example) is consideration for supply of goods and accordingly tax is to be paid on Rs 400/- and not Rs 40/-. Going by this analogy, the tax authorities issued a demand notice treating the entire buy-in amount of Rs 70,000 Crores as consideration for supply of actionable claims.

<u>Core Arguments by Gameskraft:</u>

9. Gameskraft contended that the above allegation of the authorities is fallacious, perverse and without understanding the business. Gameskraft argued that more than 96% of games played on their platforms are 'based on skill' and hence do not fall under the ambit of 'betting or gambling' under Entry 6 of Schedule III. Gameskraft stated that if the analogy of the tax authorities is applied to all players, then the entire amounts received by intermediaries would be brought to tax. Since the buy-in amounts are not the property of the Gameskraft, there cannot be any tax payable on such amounts. Gameskraft refuted the argument of the tax authorities that discounts/incentives were given to induce the players by stating that the players are free to take their winnings back to their bank account or to hold them in their wallet accounts. They have also argued that just because providing discounts and incentives to market one's business and platform does not and cannot change the nature of games played on the platform and rummy continues to be a 'game of skill', whether or not discounts offered. Gameskraft also argued that playing a 'game of skill' for money does not partake the character of betting and it still remains within the realm of 'games of skill' only. The term 'betting and gambling' cannot be artificially bifurcated by tax authorities to carve out an exception by stating that 'games of skill' played with monetary stakes can also partake the character of betting and hence taxable at 28% as envisaged by the tax authorities.

Core Arguments by Tax Authorities:

10. On the other hand, the tax authorities argued that the platform of Gameskraft allows players of online rummy to place stakes and bet on the outcomes of such games. They have relied on precedents which held that profits and gains from such games of rummy would amount to betting and gambling. The tax authorities stated that rummy is 'game of chance' on the reasoning that only criteria to enter a particular table in Gameskraft's platform is to stake a particular amount and once an amount is staked, the platform places the player in a table where fellow players have also staked equal amount and the platform does not record the skill level of player and odes not disclose the skill level of a particular player to all the players seated at a table. From the above, the authorities argued that any common man can login and play the game and when skill is not the qualifying criteria, this amounts to 'game of chance' and not 'game of skill'. Gameskraft charging 10% commission as 'service fee' is to be disregarded, as service fee must be charged purely for meeting expenses and must apply uniformly across the board to all players and must most importantly be independent of the games of rummy. The authorities alleged that the service fee changes from table to table depending upon the stakes at a particular table. The profiting by Gameskraft from the games is alleged to be in teeth of judicial precedents claiming to be the 'game of chance' and accordingly prayed the High Court that the notice should be upheld. The tax authorities argued that game of skill played for stakes would still amount to betting and the Supreme Court has not specially blessed such games alone to be played with stakes.

Analysis by Karnataka High Court:

11. The Court after referring to the basic provisions of GST laws have proceeded to examine the main question that is, whether the 'game of skill', either wholly or predominantly, can be classified as lottery, betting and gambling, so that the 'game of skill' also attracts tax under the provisions of GST laws?

12. If the answer to the above question is affirmative, then even a 'game of skill' attracts tax because it falls under the category of 'lottery, betting and gambling'. However, if the response is negative, then the 'game of skill' is out of the ambit of GST laws, since it falls under the ambit of 'actionable claims', the supply which is neither considered as supply of goods nor services. Hence, it is important to examine, when a game is classified as a 'game of chance' and 'game of skill'.

Game of Skill vs Game of Chance:

13. The concept of 'betting and gambling' was considered by the Hon'ble Supreme Court and other courts in various contexts.

Musings from RMDC-1[2]:

14. The first of the lot is, RMDC-1, wherein the apex court held that any game/competition that relies

[2] State of Bombay vs RMD Chamarbaugwala – AIR 1957 SC 699

substantially upon exercise of skill cannot be classified as 'gambling'. The Supreme Court was dealing with a challenge on legislation dealing with taxation on prize competitions. The Supreme Court in RMDC-1 was asked to determine, whether the prize competitions would amount to gambling or game of skill? The Supreme Court after referring to various provisions of the act involved therein, and English judgments held that the prize competitions run by RMDC, therein fall under the ambit of gambling, since they are not based on skill. One of the categories of the prize competitions (second category) which RMDC argued that it would be a game of skill, the Supreme Court turned down such argument. The Court held that even such categories of prize competitions were called as gambling.

15. The High Court rejected the tax authorities stand that the activities of Gameskraft fall under the second category and thereby the game of skill are also covered under the ambit of gambling as held by Supreme Court in RMDC-1. The High Court stated that the tax authorities have wrongly understood the conclusion arrived at by Supreme Court in RMDC-1. Even assuming that the activities of Gameskraft fall under second category, the same were held to be gambling by the Supreme Court and not a game of skill falling under the ambit of gambling.

16. The Supreme Court in RMDC-1 in clear terms held that games which are based on skill cannot fall under Entry 62 (legislations for betting and gambling) and tax on such activities can be only under Entry 60 (tax on trade). The High Court rejected the argument canvassed by tax authorities that the players of rummy for stakes are forecasting the outcome of the game for prize and are therefore gambling by stating that player who is involved in a game of skill does not forecast victory but plays in the confidence that he will win. He is not betting or gambling or something but is confident on his skills.

17. The High Court held that the game of rummy as opposed to the second category is not one where the outcome of an event is being predicted. It is a game where predominantly skill is exercised to control the outcome of the game. The game of Rummy is not one where forecasting or predicting the answer or the winner against stakes in the activity of the player. The game is one, where exercise of substantial skill is the activity of the player, and such skill controls the outcome of game and not chance. When the outcome of the game is dependent substantially or preponderantly on skill, staking on such game does not amount to betting or gambling.

18. The High Court accordingly concluded that it is not permissible for the tax authorities to read a single line in judgment of RMDC-1 shorn of the context and say that the game of Rummy falls under the second category. The Court stated that there is an element of 'chance' in each game and a 'game of skill', may not necessarily be such an activity where 'skill' must always prevail. It is well settled in law, wherein, an activity the 'exercise

of skill' can control the 'chance' element involved in the particular activity, such that the better skill would prevail more often than not, such activity qualifies as game of skill. Hence, the High Court held that game of Rummy played with stakes cannot be viewed as a 'forecast' or a shot at the 'hidden target'.

Musings from RMDC-2[3]:

19. The Supreme Court was seized with a challenge to the constitutionality of the Prize Competitions Act, 1955. The petitioners argued that the definition of 'prize competition' included not only gambling competitions but also those acts in which success depend to a significant degree on skill. The Supreme Court reiterated the ratio in RMDC-1 and held that the distinction between the two types of competitions is as distinct as the distinction between commercial and wagering contracts. The Supreme Court then stated that those competitions that had skill as the main deciding factor of the outcome of the competition would not come within the ambit of Prize Competition Act, 1955. Finally, the Court held that phrase 'betting and gambling' appearing in Entry 34 of List II does not include the games of skill. The High Court accordingly held that from the reading of RMDC-1 and RMDC-2 it is sufficient to indicate that the same completely support the case of Gameskraft and the intervenors.

Game of Skill when played for stakes – amounts to Gambling?:

Musings from Satyanarayana's Case[4]:

20. This judgment of Supreme Court in fact in clear terms stated that the game of Rummy is game of skill and not chance. The above judgment was relied (specifically Para 12) by the tax authorities to state that when a game of skill played with stakes involved, the same turns to be a game of gambling.

21. The High Court turned down this allegation by stating that it is true that the Supreme Court in Satyanarayana's case observed that when an owner of the house or club is making a profit or gain from the game of rummy or any other game played for stakes, the offence of operating a 'common gaming house' may be attracted and this cannot be taken to suggest that games of rummy when played for stakes would take into the realm of gambling and such an inference cannot be accepted. The High Court also held that the club in question in Satyanarayana's case was a 'Members Club' and what was held to be possibly illegal was charging a 'heavy charge' on the members for playing in card room for the purpose of making profit or gain and the said scenario cannot be extended to Gameskraft's platform.

22. The High Court held that once a game is called as a game of skill, then the same cannot be falling foul of the common gambling house. This is

[3] RMD Chamarbaugwala vs Union of India – AIR 1957 SC 628

[4] State of Andhra Pradesh vs. K Satyanarayana & Ors – AIR 1968 SC 825

because, said common gambling house is prohibited from making profit or gain from a game based on chance and not game based on skill. Since Rummy was held to be game of skill, then profit or gain earned by common gambling house cannot be said to be prohibited. If such an interpretation is taken then the judgment of Satyanarayana will contradict Para 5 of RMDC-2, which permits running business involving games of skill. The High Court also held that last portion of Paragraph 12 in Satyanarayana's case states that the offence of being 'common gambling house' is attracted when the club itself is concerned with the outcome of the game (or if there is side betting), as recognised by Kerala High Court's judgment in Head Digital's case[5]. The High Court stated that it is no one's case that Gameskraft is concerned/interested on the outcome of a game played by players on its platform and accordingly concluded that the contention of tax authorities to picture Gameskraft platform as common gambling house is erroneous.

Musings from MJ Sivani's case[6]:

23. The tax authorities has placed huge reliance on the judgment in case of MJ Sivani to state that game of skill when played for stakes amounts to gambling. The question before the Supreme Court in this case was, whether a video game is a game of skill or chance and liable to be regulated under Mysore Police Act, 1963. The Supreme Court considering the fact that several persons lose their livelihood in video gaming which on facts could be mixed game of skill and chance and that these activities could be subjected to licensing. The High Court held that this judgment does not in any way help the case of tax authorities. The High Court also referred to the decision of its divisional bench in All India Gaming Federation[7], where the tax authorities took the same plea based on MJ Sivani's case and was turned down. The High Court has stated that definition of 'gaming' is confined to playing a game of chance for stake or wager and nothing more and that 'gaming' is synonymous with gambling. In other words, the said definition nowhere holds that playing a game of skill for stake or wager also amounts to 'gaming' or 'gambling'. The High Court held that the Supreme Court in MJ Sivani's case does not hold that the 'video gaming' is akin to 'gambling' and accordingly granting such games protection under Article 19(1)(g) of Constitution. The High Court stated that nowhere in judgment of MJ Sivani, it was held that playing a game 'predominantly of skill' played with money or money's worth or for stakes amount to 'gaming' or that such an activity amounts to 'gambling'. Hence, the High Court repelled the contentions of tax authorities.

[5] Head Digital Works Private Limited vs. State of Kerala – 2021 SCC Online Ker 3592

[6] M.J.Sivani and Ors vs State of Karnataka (1995) 6 SCC 289

[7] All India Gaming Federation vs State of Karnataka & Ors – 2022 SCC OnLine Kar 435 (DB)

Musings from K.R.Lakshmanan's case[8]:

24. The Supreme Court in this case was seized with the validity of legislation dealing with abolition of horse races. The petitioner's contended that horse riding is a universally recognised sport, and it involves special skill to win a match and not based on betting or gambling. The petitioner's relied on the judgment of Satyanarayana (supra), RMDC-1 (supra) and RMDC-2 (supra). On the other hand, the State contended that horse riding is a form of betting which involves a skill neither from the horse nor from the rider but from the better who has to keep a keen check over the horses to determine its capability by observing various matches, which is a pure skill that any better should possess and State legislature reserves its authority under Entry 34 of List II of Seventh Schedule to the Constitution to make the act abolition of horse riding.

25. The Supreme Court came to the conclusion that for a game/sport is not considered as betting or gambling and to enjoy protection under Article 19(1)(g), it must have a substantial degree of skill which makes it unique. Since the horse riding involves special skills of the horse and rider, the said activity cannot be called as gambling or betting and thus declared the abolition of horse riding as unconstitutional.

26. The High Court stated that in K.R. Lakshman's case, the Supreme Court clearly notes that 'gaming' can only be interpreted in light of law laid down in RMDC-1 RMDC-2 and Satyanarayana's case i.e., competition/game which substantially depend upon skill is not gambling. The Supreme Court in K.R. Lakshman's case concluded that even if there is wagering or betting with the club it is on a game of mere skill and as such, it would not be gaming. The High Court held that from the above observation, it is evident that wager or betting on a game of skill does not amount to gambling.

27. The High Court further rejected the argument of tax authorities that predicting the winner of horserace for stakes is held to be gambling in the judgment of K.R. Lakshman's case by Supreme Court by stating that such an inference is uncalled for, since the Supreme Court did not deal with such an issue. Assuming it has dealt, even then, the same cannot be applied to Rummy because Rummy is not a game where the outcome is being predicted or forecasted, but is a game being played where success and the outcome of the game is substantially and preponderantly dependent on the exercise of skill of the player. Accordingly, the High Court held that in games of skill, the person places a stake based on his confidence and even third parties would do so is also clear and under these circumstances, the K.R. Lakshman's case completely supports Gameskraft.

[8] Dr KR Lakshmanan vs State of Tamil Nadu (1996) 2 SCC 226

Musings from Head Digital Works case (supra):

28. The High Court of Kerala came to the conclusion that playing for stakes or playing not for stakes can never be a criterion to find out whether a game is a game of skill or chance. Online Rummy played with or without stakes remains to be a 'game of skill'. It was held that since the game does not come within the meaning of 'gaming' or 'gambling', providing a platform for playing the game, which is nature of business cannot be curtailed.

Musings from Junglee Games case[9]:

29. The High Court then referred to the judgment of Madras High Court in Junglee Games. The Madras High Court held that 'gambling' and 'gaming' have attained secondary meanings in judicial parlance and that the principles of *nomen juris* cannot be shrugged off to understand such words to mean or imply anything other than how they have been judicially interpreted. The Madras High Court held that game of skill may not necessarily be such an activity where skill must always prevail, it would suffice for an activity to be regarded as a game of skill if, ordinarily, the exercise of skill can control the chance element involved in the activity such that the better skilled would prevail often.

Conclusion by Karnataka High Court:

30. The High Court concluded by stating that the words 'gaming', 'gambling', 'game of chance' and 'game of skill' have developed meaning in judicial parlance and they have to be interpreted only in a way that the law understands. As discussed in above paragraphs, it is evident that game of Rummy is a game of skill and not a game of chance.

31. The High Court stated that the expression 'betting and gambling' appearing in erstwhile Entry 62 of List II was amended and the said expression was omitted for the reason to subsume the same into the GST regime. The High Court placing reliance on the judgment of State of Karnataka vs State of Meghalaya[10] [wherein the Supreme Court held that the interpretation of the expression 'betting and gambling' in context of Entry 34 of List II shall apply to the expression 'betting and gambling' under Entry 62 of List II] held that 'betting and gambling' appearing in Entry 6 of Schedule III of CT Act[11] should also be interpreted in the same way as interpreted for Entry 62 of List II.

32. Accordingly, the High Court held that the terms 'betting and gambling' appearing in Entry 6 of Schedule III must be given the same interpretation given to them by Courts, in the context of Entry 34 of List II. Accordingly, the games of skill cannot be falling under the ambit of 'betting and gambling' as appearing in Entry 6 *ibid.* Hence, the games of skill that is in the instant case, Rummy, is covered under the actionable claims part in Entry 6 of Schedule III and thereby

[9] Junglee Games India (P.) Ltd. v. State of Tamil Nadu — 2021 SCC OnLine Mad. 2762

[10] 2022 SCC OnLine SC 350

[11] Central Goods and Services Tax Act, 2017

does not constitute 'supply' for the purposes of CT Act. This holds good whether the game of Rummy is played for stake or not. This holds good even if the definition of 'business' vide Section 2(17) of CT Act includes the wager in its ambit.

Our Comments:

33. The High Court after surveying various decisions have come to conclusion that the expression 'betting and gambling' has to be understood in light of the judicial precedents. It is important to note that though there was a definition for 'betting or gambling' under the service tax law, there does not exist one under the GST laws. Even considering the definition of 'betting or gambling' under service tax law, it covers activities which are based on chance. Hence, even under the previous regime, the games of skill are not covered under the ambit of 'betting or gambling'.

34. The absence of specific definition under the GST laws tilts the balance to the favour of taking the meaning from the judicial precedents. However, as discussed above in the opening paras of the article, the GoM does not differentiate between the game of chance and game of skill. They proceed with an assumption that the expression 'betting and gambling' as appearing in Entry 6 of Schedule III of CT Act covers both the game of skill and game of chance. This is in complete contradiction to the judgments detailing that games of skill are out of the ambit of 'betting and gambling'. Whether this convenient ignorance of the distinction is in accordance with the law or ultra-vires, the courts have to finalise. Till then, the gaming industry would be under severe hardship considering the recent council decisions.

Goods and Services Tax

Decoding GST Applicability on Credit Card Loans: A Case Study

In recent times, banks are offering several types of loans like personal loan, pre-approved loan, and instant loan etc., based on credit card usages and credit rating. Now the question arises whether these loans provided by the banks will fall under the credit card services or all together a different loan transaction? In this context, one particular issue that has come before the Honorable High Court of Calcutta in the case of Ramesh Kumar Patodia (2023 (7) TMI 1102 - CALCUTTA HIGH COURT) and in this article, we will delve into the applicability of GST on credit card loans by analyzing the above case which sheds light on this complex issue.

-Contributed by CA Sri Harsha & Bharadwaja

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Background of the case:

1. In the present case, the appellant has a credit card provided by the bank and he was offered with 'increased pay lite loan' with equated monthly installments for a period of 12 months. The offer has been accepted by the appellant and the bank discharged the same by account payee cheque. Thereafter, the appellant regularly disbursed the monthly EMIs along with the credit card payments and cleared the loan within the stipulated time.

2. However, at a later point of time, the appellant came to know that IGST[12] was charged on the interest portion that paid by him. Since the interest on loan or advances are exempted[13] from tax, the Appellant has challenged the levy of tax on the interest component.

3. The whole issue arisen before the said forum is due to exemption entry provided for interest. The specific exemption entry[14] excludes the interest component on the credit card services and hence, the same amounts to taxable. Since the credit card services is taxable, the bank has accordingly charged the IGST also on the interest component on the loan provided to the Appellant. Hence in the given case, whether the interest component charged is related to the credit card services or the services in by way of extending a loan transaction?

[12] Integrated Goods and Services Tax
[13] Serial No. 28 of N. No. 9/2017 – IT (R) dated 28.06.2017
[14] Serial No. 28 of N. No. 9/2017 – IT (R) dated 28.06.2017

Distinction between Credit Card Services and Loans:

4. Since the Credit Card Services is not defined in the GST laws, the appellant has referred to the definition of 'Credit Card Services[15]' in the Services Tax laws and accordingly contended that to be a credit card service, the transaction should take place through the card provided by the bank. Further, he also contended that the issuer of the card levies an annual fee or interest in case of deferred payment by the holder of the card. However, the loans are the financial assistance provided by the financial institutions for which interest is charged by them in lieu of such services.

Appellant's Argument:

5. Appellant has argued that the bank provided the loan through a distinct agreement, without involving use of credit card in the transaction. He also emphasizes that monthly EMI mentioned in the credit card statement, that does not mean the interest charged on such loan is related to the credit card services. He also asserted that the interest charged on the said loan is distinct from the interest charged on the credit card transactions.

Bank's Counter Argument:

6. On defense, the bank argued that the loan was provided as a part of credit card services and the bank also contended that appellant has agreed to the conditions laid down in the agreement at the time of providing the loan. Further, one of the conditions in the agreement is the tax chargeable on the interest component, which is also deemed to be accepted by the appellant and accordingly, the tax is charged and collected from the appellant in his monthly EMIs.

The Court's Interpretation:

7. The court's interpretation clarifies that for a service to be considered a "credit card service," it should involve a direct relationship between the issuer of the card and the cardholder, and such relationship should be connected to the holding, operation, or use of the card, including transactions made using the card. The court emphasizes that if a bank issues a card to a customer who also holds an ordinary savings account with the bank, the services related to the ordinary account holding are distinct from the services provided to the same customer as a cardholder.

8. In the present case, the loan provided to the appellant was not advanced through the use of the credit card. The bank declared the appellant eligible for the loan, and the loan amount was disbursed through a separate means, such as a cheque or draft. The loan transaction was not generated by charging the appellant's card. The monthly statement issued by the bank, which included information about the loan amount and EMIs, was merely a statement of account. The loan transaction should be treated as a separate transaction, unrelated to the services rendered in

[15] Section 65(33A) of the Finance Act, 1994

connection with the credit card. As a result, the court concludes that the transaction between the appellant and the bank cannot be categorized as a "credit card service" and, therefore, is not subject to GST.

Conclusion:

9. The above case law distinguished the credit card services and the loans services. Thereby, the loans granted to the credit card holders should be treated as standard loans for GST purposes and the borrowers are now not liable to pay the GST on the interest component of such loans. Further, the financial institutions are now prohibited from charging GST on the interest component on such services, unless the judgment is reversed in the higher forum, or an amendment is made to the law.

International Taxation

Determination of Residential Status of a Person under DTAA

Determination of residential status of a person is pre-requisite for computation of tax liability under the Income Tax Act, 1961 in India. This is because, as per the provisions of section 5 of the IT Act, global income earned by a resident is taxable in India. Section 6 of the IT Act prescribes methods for determination of residential status of a person in India. Similarly, other countries/tax jurisdictions may also contain rules for determination of residential status of person. In such a situation, 'How to determine the residential status of a person?' is a big question. A Double Taxation Avoidance Agreement entered between two countries provides answer to the above question. In this Article, determination of residential status of a person including individual, company and other persons` have been discussed in detail.

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Introduction:

1. In order to levy a tax on any income earned by a person, there should be a nexus. The nexus can be a source or residence/citizenship. Under the source rule, a country may levy tax on the total income earned by a person in that particular country. Similarly, a country may levy tax on the total income earned by a resident/citizen whether or not such income earned in that country.

2. For determination of such nexus viz source or residence, different countries may follow different approaches thereby conflicts may arise in taxing a particular income. The conflicts are generally categorized into following types:

   i. **Source – Source Conflicts:** A country may follow its own approach for determination of source of income under the domestic laws of such country. Similarly, other country may also follow its own approach under the domestic law for determination of source of income. This conflict may not be eliminated even under the treaty[16] unless both countries agree to do so.

[16] Double taxation avoidance agreement between two countries.

ii. ***Resident – Resident Conflict: Similar to the source rule, a country may incorporate its own rules for determination of residential status of a taxable person under the domestic laws of such country. When two different countries provide different parameters for determination of residential status, a person may become resident of both the countries. This conflict has been eliminated under the treaty.***

iii. **Source – Resident Conflict:** as discussed above, a country may tax total income earned in that particular state and also total income earned by resident of such state thereby a person is taxed in two jurisdictions in respect of same income earned by that person. This conflict is called as source-resident conflict. This approach results in juridical double taxation.

3. In this Article, the discussion is limited to resident - resident conflict. Let us proceed to analyse, determination of residential status of a person under the treaty.

<u>Residential status of an individual:</u>

4. Before understanding the residential status under the treaty, it is required to analyse the residential status under the domestic law[17]. Section 6(1) of ITA[18] states that an individual is considered as a resident in India if he stays in India for a period of 182 days or more during the year, or 60 days or more in the current year and 364 days or more in the preceding four years. However, the above limit may vary subject to satisfaction of conditions specified in Explanation 1 to section 6(1)[19].

5. Once an individual is considered as resident under section 6 of the ITA, total income earned by such person is taxable in India whether or not such income is earned in India. Similarly, other country may follow domestic laws of such country for determination of residential status of an individual. In certain situations, such an individual may become resident in both the countries under the domestic laws of those countries. In such a scenario, it is required to analyse the residential status of such an individual under the provisions of the treaty.

6. Article 4 of OECD MTC[20] deals with the concept of resident. Para 1 of Article 4 is reproduced below:

   'For the purposes of this Convention, the term "resident of a Contracting State" means any person who, ***under the laws of that State, is liable to tax therein by reason of his domicile, residence, place of management or any other criterion of a similar nature****, and also includes that State and any political subdivision or local authority thereof as well as a recognised pension fund of that State. This term, however, does not include any person who is liable to tax in that State in respect only of income from*

[17] Resident status under the Indian 'Income Tax Act, 1961' is considered for the purpose of this paper.
[18] Income Tax Act, 1961.
[19] For a detailed understanding of residential status of an individual, read our Article at various-issues-of-residency-under-section6.pdf (sbsandco.com)
[20] Model Tax Convention on Income and on Capital

sources in that State or capital situated therein.'

7. Para 1 of Article 4 states that a person is treated as resident of a particular country if such person is liable to tax in such country by reason of his domicile, residence, place of management or any other criterion of a similar nature. From the above, it can be understood that two conditions need to be satisfied in order to consider a person as a resident of a particular country.
   - He shall be liable to tax in such country: and
   - Such liability arises by reason of his domicile, residence, place of management or any other criterion of a similar nature.

8. The word liable to tax plays a vital role in determination of residential status of an individual. OECD Commentary on Article 4 of MTC states that a person shall be liable to tax in a particular country on comprehensive basis in order to satisfy the above condition. The commentary further states that a person is considered as 'liable to tax' in that country on comprehensive basis even if such country does not impose tax on such person (or provides exemption from taxation).

9. The Hon'ble Supreme Court of India in the case of Azadi Bachao Andolan[21] has analysed the concept of liable tax and held that *'liability to taxation'* is a legal situation whereas payment of tax is a fiscal fact. For the purpose of application of Article 4 of the DTAC, what is relevant is the legal situation, namely, liability to taxation, and not the fiscal fact of actual payment of tax.

10. Once the above condition is satisfied, one needs to analyse the second condition i.e., whether such liability arises by reason of his domicile, residence, place of management or any other criterion of a similar nature.

11. In this regard, the OCED Commentary states that the definition refers to the concept of residence adopted in the domestic laws. As criteria for taxation as a resident, Article 4 mentions domicile, residence, place of management or any other criterion of a similar nature. As far as individuals are concerned, the definition aims at covering the various forms of personal attachment to a State which, in the domestic taxation laws, form the basis of a comprehensive taxation (full liability to tax). It also covers cases where a person is deemed, according to the taxation laws of a State, to be a resident of that State and on account thereof is fully liable to tax therein.

12. Which means that for determination of residential status of a particular person, one needs to go back to the provisions of the domestic laws of particular country. If such an individual satisfies the conditions in domestic laws of both the countries, there arises resident - resident conflict. In order to eliminate this conflict, a tie breaker rule has been provided in

[21] [2003] 132 Taxman 373 (SC)

the treaty for determination of residential status of an individual.

Tie Breaker Rule under the treaty:

13. As stated above, if an individual is considered as a resident of both the countries, residential status of such individual shall be determined based on the tie breaker rule provided in para 2 of Article 4 of treaty. Para 2 of Article 4 of treaty is produced below:

    '2. Where by reason of the provisions of paragraph 1 an individual is a resident of both Contracting States, then his status shall be determined as follows:

    a) he shall be deemed to be a resident only of the State in which he has a permanent home available to him; if he has a permanent home available to him in both States, he shall be deemed to be a resident only of the State with which his personal and economic relations are closer (centre of vital interests);

    b) if the State in which he has his centre of vital interests cannot be determined, or if he has not a permanent home available to him in either State, he shall be deemed to be a resident only of the State in which he has an habitual abode;

    c) *if he has an habitual abode in both States or in neither of them, he shall be deemed to be a resident only of the State of which he is a national;*

    d) *if he is a national of both States or of neither of them, the competent authorities of the Contracting States shall settle the question by mutual agreement.'*

14. Para 2 of Article 4 provides comprehensive procedure for tie breaker test. In order to determine the residential status of an individual, above steps have to be followed:

    i. Permanent Home: permanent home test is first test in tie breaker rule. Under this test, an individual is considered as a resident of particular country in which such person has a permanent home. Let us proceed to analyse the concept of the 'permanent home available' to the individual. Para 13 of OECD commentary on MTC states that any form of home viz own house or rented house, apartment or building may be considered for the purpose of this test.

    However, permanency of the home is essential for the purpose of determination of residential status. This means that the home shall be available continuously and not occasionally for a short duration viz.travel for pleasure, business travel, education travel or attending a course. Further, even the assessee is having a home available to him shall not be considered as permanent home if such home is rented out and effectively handed over to an unrelated party so that the individual no longer has the possession of the house and the possibility to stay there.

The Indian Income Tax Appellate Tribunal (Mumbai Bench) in the case of Shalini Seekond[22] has held that the availability of permanent home as is referred to in Article 4 has nothing to do with ownership of an home, and due to the marriage with an Indian national and actually moving to India to stay with the husband post marriage clearly indicates that the assessee permanent home is now arranged, established and is available to such individual in India along with her husband and children, if any after marriage despite the fact she might not be owning an house in India as the condition as stipulated in Article 4 is regarding availability of permanent home in the state of residence and it no-where stipulates that the assessee should own an house in the State of residence.

The High Court in Ireland in the case of O'Brien v Quigley[23] has held that the interpretation of permanent home required not only that abode is available, but it should be a home and permanent. Home requires a personal link which means that either individual or his belongings should be there, and it should be permanent in nature but not for short duration or visits.

From the above, it seems that one cannot determine the test of permanent home easily and facts of each case have to be analysed on case-to-case basis. The next aspect is, if an individual has permanent home in both the states, then, such individual has to proceed to analyse the next step.

ii. **Centre of vital interests:** If such an individual has permanent in both the countries, such person shall be considered as a resident of a country in which his personal and economic relations are closer. In this regard, OECD commentary states that while determining the personal and economic relations, due regard has to be given to family and social relations, his occupations, political, cultural or other activities, his place of business, the place from which he administers his property etc. OECD Commentary further states that personal acts of the individual must receive special attention in determining the center of vital interests.

For example, Mr. X has a permanent home in country A where he has worked and where his family reside. While retaining the first house in country A, he has acquired another property in country B which satisfies the test of permanent home. In this scenario, the OECD commentary states that though Mr. X has a permanent home in country A and country B, as his personal interests are located in Country A, he would be considered a resident of country A.

[22] [2016] 71 taxmann.com 120 (Mumbai - Trib.)

[23] [2013] IEHC 398

The Indian Income Tax Appellate Tribunal (Bangalore Bench) in the case of Shri Kumar Sanjeev Ranjan[24] has held that though the individual is a resident in India under the domestic laws, as such individual is possessing personal belongings, voting rights, driving license, dependent members, investments, social security is in USA, he would be considered to have personal interests in USA hence, he would be considered as a resident of USA.

iii. **Habitual abode:** If the center of vital interest cannot be determined, or if such an individual does not have permanent in both the countries, such an individual is considered as a resident of a country in which such person has habitual abode.

This step covers two types of scenarios, one where individual has permanent home in both the countries, but his center of vital interests cannot be determined. Second, where an individual does not have permanent home in either of the countries.

OECD commentary provides a detailed guidance on determination of habitual abode of an individual. It states that in determination of habitual abode, stay of an individual both in permanent home and other places (in the first scenario) and other places (as such person does not have permanent home in the second scenario) shall be considered. However, habitual abode shall not be determined in a country where he spent more days in a year. If one follows that approach, the individual does not fall under the next category i.e., having a habitual abode in both the countries. In order to determine the habitual abode, OECD commentary provides a test called ‘frequency, duration and regularity’.

However, relevant period of determination of habitual abode shall not be limited to the period of test and much longer period has to be considered for such determination. For Example, an individual living in country A from long back has moved to country B for shorter period for the purpose of employment in country B. In this scenario, in order to determine the habitual abode, instead of considering the period of employment in country B, a much longer period has to be considered.

iv. **National:** if such an individual has habitual abode in both the states or neither of them, such an individual is considered as a resident of a country of which he is a national. The term national is defined in Article 3 to mean, in the case of an individual, any individual possessing the nationality or citizenship of a country.

[24] [2019] 104 taxmann.com 183 (Bangalore - Trib.)

v. **MAP:** If such an individual is a national of both or neither of them, the competent authorities of both the countries determine the residential status of such individual. As a last resort, if residential status of an individual cannot be determined based on the above tests, such individual may invoke the mutual agreement procedure as specified in Article 25 of the treaty to determine the residential status by the competent authorities of the both the countries.

Residential status of a company:

15. Let us proceed to understand the provisions of the ITA and the treaty for determining the residential status of a company.

16. Section 6(3) of the ITA states that a company is said to be resident in India in any previous year, if:
    i. It is an Indian company; or
    ii. Its place of effective management, in that year, is in India.

17. Clause (i) deals with the Indian company. The term 'Indian company' has been defined under section 2(26) of the ITA to mean a company incorporated under the provisions of the Companies Act. Which means that company incorporated in India is considered as resident in India under the provisions of ITA.

18. The next clause deals with those companies which are not considered as Indian companies i.e., companies incorporated outside India. It states that a company incorporated outside India is also considered as resident in India if its place of effective management, in that year, is in India.

19. For the purpose of above clause, Explanation to section 6(3) of ITA states that "place of effective management" means a place where key management and commercial decisions that are necessary for the conduct of business of an entity as a whole are, in substance made. In addition to the above, CBDT vide its Circular[25] issued guideline for determination of POEM[26] in India.

20. Which means that a company which is incorporated in India becomes resident in India. Further, foreign company may also become resident in India if POEM of such company is India.

21. Similarly, a foreign company may become resident under the domestic laws of such country based on the residential status of such country thereby such a company may become resident of both the countries. Let us proceed to understand the determination of residential status of a company under the treaty.

22. As stated in para 7 above, a company is treated as resident of country if company is liable to tax in that country based on place of management or other criteria of similar nature.

23. Which means that, even in the case of a company, residential status shall be determined based on

[25] Circular No 6 of 2017 dated 24.01.2017.

[26] Place of Effective Management.

the domestic laws of a particular country. Hence, a company may become a resident of two countries as per Article 4(1). In order to eliminate this conflict, a tie breaker rule has been provided in the treaty for determination of residential status of a company.

24. Unlike in the case of individual, tie-breaker rule in the case of company does not provide specific test. Article 4(3) of OECD MTC states that when a person other than an individual becomes resident of both the countries, the competent authorities of the countries shall agree determine the residential status of such a company by MAP[27] route.

25. OECD Commentary on MTC provides some guidance to the competent authorities for determination of residential status of a company under MAP. Para 24.1 of the Commentary states that competent authorities are expected to consider following factors under MAP:
    - Where the meeting of the board or equivalent body are usually held;
    - Where CEO and other senior executives usually carryout their activities;
    - Where the senior day-to-day management of the company is caried on;
    - Where the company headquarters are located;
    - Which country's law govern the legal status of the person;
    - Where its accounting record is kept;
    - Whether such determination of residential status would carry the risk of improper use of the provisions of the treaty.

26. The above Article further states that in the absence of such agreement between the competent authorities, company is not entitled to any relief under the treaty except to the extent as may be agreed upon by such competent authorities.

Authors' comments:

27. From the above analysis, it may be concluded that the residential status of individual, in the case of dual residence, cannot be determined by using a hard and fast rule. Though the treaty between two countries provides tiebreaker rule for determination of a residential status of an individual, application of such rule requires more fact-based analysis, and each case has to be analysed based on the facts involved in such case. While determining the residential status of an individual, one can take recourse to the OECD commentary and judicial precedents (domestic as well as foreign).

28. In the case of companies, when such a company becomes resident of both the countries, the only option available to such person is to invoke MAP under Article 25 of the treaty in order to resolve the resident-resident conflict.

[27] Mutual Agreement Procedure

Income Tax and Black Money

Non-Disclosure of Foreign Assets and Consequences under Black Money Act!

To tackle the issue of Black Money, Central Government has come with specific Act namely Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015. The main objective of the said Act is tax the undisclosed income and asset located outside India held by a resident of India. Though the Act aims to tax undisclosed asset and income outside India, there are severe penalties even for non-disclosure of legitimate earning and assets in the ITR filed by a resident in India.

In this Article, concept of disclosure requirements and consequences under the Income Tax Act and Blac Money Act has been discussed.

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Background:

1. In order to counter the tax avoidance by residents in India by way of non-disclosing the income earned outside India, Central Government has introduced Black Money Act[28] with effective from 01.07.2015. Though the IT Act[29] levies tax on global income earned by residents, as there are inherent limitations for applicability of IT Act. The objective of the Black Money Act is to levy tax on undisclosed foreign income/or assets located outside India.

2. Every resident and ordinarily resident, while filing the return of income, shall disclose all foreign assets (including investment in shares and securities) and income on such foreign assets in Schedule FA. Non-submission of such Schedule FA in the return attracts consequences under the Black Money Act. In this Article, concept of ESOPs has been considered for better explaining the consequences under the IT Act and Black Money Act. The same principles would equally apply to other nature of assets as well.

3. It is general practice that a multi-national company allots stock to its employees or

[28] Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act,2015

[29] Income Tax Act, 1961

employees of its Indian subsidiary under the global/normal ESOP[30] scheme. In recent times, non-reporting of such employee stock options in the income tax returns has created a buzz in the industry. In some news media, it was highlighted that the Government of India was in possession of information that many of the residents have not disclosed such ESOPs in their returns and hinted that the non-reporting of such ESOPs in India is liable for a huge penalty.

4. Companies may provide stock to employees either by way of ESOPs or RSU[31]. The difference between the ESOPs and RSU is that in the former case, a company issues ESOPs to its employees at pre-determined exercise price. Once the conditions of granting ESOPs have been satisfied by the employee, after the expiry of vesting period, he can exercise the option to purchase the shares of the company at the price determined at the time of granting ESOPs.

5. However, in the case of RSU, a company issues shares of a company to its employee at free of cost. These RSU would be vested with employee subject to satisfaction of terms. Though there are conceptual differences between ESOPs and RSUs, there is no difference in taxation of underlying stocks under both the schemes.

6. In this Article, consequences, and reporting requirements under the provisions of the IT Act and the Black Money Act have been discussed in detail. The article has been divided into three parts, following the life cycle of ESOPs:

   - Consequences & Reporting Requirements at the time of issue of ESOPs.
   - Consequences & Reporting requirements in respect of income earned from such stocks.
   - Consequences & Reporting requirements at the time of disposal/alienation of stocks.

7. Before understanding the consequences and reporting requirement, it is required to understand the method of exchange of information between two countries. In order to combat the possible tax evasion, G20 and OECD countries have agreed to develop CRS[32] on Automatic Exchange of Information. Under the above initiative, Government of India has joined Multilateral Competent Authority Agreement under which Government of India is receiving information from more than 90 countries across the world. We believe that based on the above arrangements, Government of India would be in a position to obtain information of the assets located outside India which are held by Indians.

A. <u>Consequences & Reporting requirements at the time of issue of ESOPs[33]:</u>

<u>Head of income:</u>

8. Section 17(2) of the IT Act states that any stock issued by the employer to its employee at free of cost or at concessional rate is considered as perquisite in the hands of the employee and such perquisite is chargeable to tax as income

[30] Employee stock option scheme.
[31] Restricted stock units.
[32] Common Reporting Standard.
[33] Same is applicable to SRUs as well.

from salary.

Year of taxability:

9. The question arises is in which year such perquisite is taxable i.e., whether it is year of granting, over period of vesting period or year of vesting or year of exercise.

10. Under Section 17(2) of the IT Act, perquisite by way of ESOP is taxable in the year in which the option is exercised by the employee. However, in the case of RSU, as stocks are automatically vested, such stocks are taxable in the year of vesting.

Value of perquisite:

11. Once it is determined the year of taxability, it is required to determine the value of perquisite. As stated above, in the case of ESOPs, the employee purchases stock at a predetermined price. In such a scenario, the difference between the FMV[34] as the date of exercise and amount paid by the employee for such ESOP is considered as value of perquisite.

12. However, in the case of RSU, as such stocks are issued at free of cost, FMV of such RSU as on the date of vesting is considered as value of perquisite.

13. Once it is determined the value of perquisite, it is required to determine how to discharge tax liability on such perquisite. In this regard, section 192 of the IT Act states that the employer is responsible for deduction of tax at source. Which means that while issuing the stocks to its employees, employer would deduct tax from such stocks and remit the same to government exchequer.

14. Though the stocks of the parent company have been issued, the company in India being the employer is under the obligation to deduct tax at source. As the stocks are issued in kind, for the purpose of such TDS, employer may opt for any of the following method:
    - May deduct tax from the salary paid in cash/bank.
    - May withhold/transfer some of the stock issued to employees to meet the tax deduction requirement.
    - Collect the amount from the employee.

15. Once the stocks have been issued to employees and tax has been deducted on such stocks, the employee is required to file an ITR[35] and disclose such income as income from salary.

Consequences under the Black Money Act:

16. These provisions are applicable to residents other than non-ordinarily resident in India. To mean that these reporting requirements are not applicable to non-residents and residents but not ordinarily residents in India.

17. However, provisions of Black Money Act are applicable to non-residents, and residents but not ordinarily residents if foreign income was earned or asset was acquired while he was a

[34] Fair Market Value

[35] Income Tax Return

resident in India. Though the provisions of Black Money Act are applicable to non-residents and residents but not ordinarily residents, disclosure in Schedule FA is applicable only to residents and ordinarily residents.

18. As discussed earlier, a company in India may issue stocks of a parent company located outside India. In such case, in addition to reporting the income from such stocks in India, as such stock acquired is considered as foreign asset in the hands of the employee, it is required to disclose details of such assets in the Schedule FA in the ITR.

19. Such a disclosure is required to be made every year till the disposal of the asset located outside India. Failure to report such assets located outside India in the ITR may attract a penalty, under section 42/43 of the Black Money Act, of an amount of Rs.10,00,000/- without considering the value of asset located outside India.

20. Further, in addition to the above penalty, prosecution may be initiated on such person with a punishment of rigorous imprisonment for a term which shall not be less than 6 months, but which may be extended to 7 years.

B. <u>Consequences & Reporting requirements in respect of income earned from such stocks:</u>

21. Once the stocks have been issued to an employee, it yields a return in the form of a dividend. When the employee receives any dividend from a company which is located outside India, such dividend shall be duly included in the total income in India for the purpose of payment of tax.

22. This is because, under the provisions of the IT Act, global income received by a resident in India is taxable in India. However, such income in the form of dividend may also be liable to tax in the foreign country under the domestic laws of such country.

23. When such an income is liable to tax in India, it is required to determine whether there is a DTAA[36] between India and respective country.

24. If the answer to the above question is affirmative, employee is eligible to claim tax paid in foreign country as credit while computing tax liability in India under section 90/90A of the IT Act. If the answer to the above question is negative, an employee is eligible to claim credit of tax paid in a foreign country under section 91 of the IT Act.

1.1. For example, if an employee receives any dividend from a company located in USA, such income is liable to tax in USA at the rate of 25%[37]. Once the tax has been paid/deducted from such dividend income in USA, employee is required to include such dividend in India and claim credit of tax paid in USA. After claiming the credit of tax paid in USA, balance tax payable, if any shall be paid in India.

[36] Double Taxation Avoidance Agreement

[37] Article 10 of India – USA DTAA.

25. In order to claim such credit of foreign taxes, employee is required to submit Form 67 within the due date specified under section 139(1).[38] Further, as such income is not chargeable to tax under the head salaries (as dividend is chargeable to tax under 'income from other source'), company in India (employer) is not under any obligation to deduct tax in India unless such income is declared by the employee for deduction of tax at source under section 192.

26. Hence, it is the responsibility of the employee to make sure that the dividend income is included in the total income for the purposes of tax computation in India.

27. Further, in certain scenarios, instead of paying the dividend into the bank account of the employee in India, such dividend received by the employee may be re-invested into shares of the listed parent company. In such a case, dividend income shall be reported as 'income', and purchase of shares from such dividend re-investment shall be reported as 'asset' under Schedule FA.

Consequences under the Black Money Act:

28. If any dividend income is not included in the total income while filing the ITR, such an income may be considered as an 'undisclosed foreign income' under the Black Money Act. Once the income is considered as an 'undisclosed foreign income', such income is assessed to tax under the Black Money Act at the rate of 30%[39].

29. Further, as such income is assessed to tax under the Black Money Act, it may be difficult to obtain credit for taxes paid in foreign country. Which means that such income may be taxable at the rate of 30% without any credit. Continuing with the above example, the employee may end up paying 55% in taxes (25% withholding done in USA and 30% under Black Money Act in India).

30. In addition to the tax payable at the rate of 30% on 'undisclosed foreign income', a penalty of 300% of tax may be levied under the Black Money Act.

31. Further, any failure to disclose such dividend income in Schedule FA (even such income is included in total income in India) may attract a penalty of Rs.10,00,000 under Section 42/43 of the Black Money Act and imprisonment as stated above.

C. Consequences & Reporting requirements at the time of disposal/alienation of Stocks:

32. Finally, an employee may dispose of the stock and receive amount into his bank account. When the shares of a company have been transferred by the employee, any gain arising from such transfer is considered as capital gains.

Head of income:

33. Such gain/loss arising from the transfer of stock received is chargeable to tax in the hands of the

[38] However, CBDT provided a relaxation stating that such Form 67 may be filed within the end of relevant assessment year provided the return if filed under section 139(1) or section 139(4).

[39] No additional cess/surcharge

employee as income from capital gains. Further, in order to compute tax liability, it is required to classify such gain into short-term capital gains and/or long-term capital gains.

34. Short term capital gain arising from the transfer of equity shares listed in any stock exchange in India is chargeable to tax at the rate of 15%. If such shares are not listed on any recognized stock exchange in India, such short-term capital gain is chargeable to tax at applicable slab rates.

35. Similarly, long term capital gain is chargeable to tax at the rate of 20%[40] with indexation benefit. However, gain arising from transfer of equity shares listed in any recognized stock exchange in India, such long-term capital gain is chargeable to tax at the rate of 10% without indexation (or 20% with indexation).

36. In the case of shares listed in any recognized stock exchange in India, if such shares are held for a period not more than 12 months, such gain is considered as short-term capital gains. However, in the case of shares which are not listed in any recognized stock exchange, the period of holding for determination of capital gain is 24 months.

<u>Year of taxability:</u>

37. Such capital gain arising from the transfer of shares is chargeable to tax in the year in which such transfer took place.

<u>Value of perquisite:</u>

38. For the purpose of value of capital gains, the amount received from the transfer of shares is considered as sale consideration and value taken for the purpose of perquisite (i.e., FMV as on the date of exercise) would be considered as cost of acquisition.

39. Accordingly, the difference between sale consideration and value of perquisite is considered as capital gains chargeable to tax under the head capital gains.

40. For example, an employee receives stocks of value Rs.1,000 and pays the tax on such stocks as perquisite under the head salary (tax is deducted by the company). Subsequently, such stocks have been sold for a price of Rs.1,200. Hence, the difference of Rs.200 is considered as gain chargeable to tax in the hands of the employee.

<u>Consequences under the Black Money Act:</u>

41. The consequences and reporting requirements under the Black Money Act are the same as discussed in para 27 – 30.

D. <u>Case Study:</u>

42. In certain cases, it is observed that the company, in order to meet the tax deduction requirements under section 192, is transferring part of stock issued to its employees. Let us proceed to understand the tax consequences of such a case.

43. For example, Mr. X is an IT employee working with a global corporate. Mr. X has been granted

[40] Provisions of section 112A are not applicable if STT is not paid.

stocks of a parent company located outside India under the employee stock reward scheme.

- Total stocks granted 1,000 units.
- Stocks vested during the current year 200 units.
- FMV of such stock as on the date of vesting is USD 1,000/-.
- In the above situation, the company (Indian subsidiary) being an employer needs to deduct tax at applicable slab rate. For the sake of understanding, the tax rate is considered as 30% (flat rate).
- In order to meet the tax liability, the company automatically transfers 30% of the stock and discharges its TDS obligation.
- The company instructs to deposit 200 units into the stock account of the employee and transfers 60 units (30%) on the same day or the next day.
- Accordingly, tax of 30% would be deducted by the company in India and duly issues Form 16 to its employee.

44. In the above, in the first instance, USD 2,00,000/- i.e., USD 1,000*200 units is considered as perquisite taxable under the head salary.

45. Hence, such income is to be included in the total income while filing the ITR in India. In addition to the above, as Mr. X holds assets in a foreign country, such assets shall be duly reported in the Schedule FA.

46. Further, in this case, as the company is transferring 30% of shares, such transaction has to be reported as 'capital gains'. This reporting has to be made whether or not any gain received by the employee.

1.2. For example, if share is transferred at USD 1,100 per share, the difference of USD 100 needs to be reported as gain under the head capital gains. If the same is transferred for USD 1,000, though there is no gain, such transaction shall be reported under the capital gains as NIL.

47. In these circumstances, as the company is deducting the taxes, employees are under the assumption that no additional reporting or disclosure is required. However, the above reporting and disclosure shall be made.

48. Further, the foreign company is issuing a dividend in respect of shares held on the recorded date. Such dividend is also required to be reported in India for the purpose of tax. However, the employee can claim credit of taxes paid in the foreign country by submitting the Form 67.

49. Non-reporting and/or disclosing of assets and foreign income (capital gains and dividend) attract severe consequences under the IT Act and Black Money Act as discussed in the above paras.

50. If any person failed to report or disclose the above-mentioned assets or income, it is advisable to file revised return (for the AY 2023-24) or updated return [for the previous years

subject to time limits and subject to satisfaction of conditions provided under section 139(8A)] in order to comply with the reporting and disclosure requirements under the IT Act and Black Money Act.

E. FAQs:

51. ***Who is under the obligation to comply with the reporting and disclosure requirements?***

The above reporting and disclosure requirements are to be made by every resident and ordinarily resident.

52. ***Whether a deemed resident under section 6(1A) is required to comply with the above requirements?***

No, as deemed residents are considered as residents but not ordinarily residents, the above reporting requirements may not be applicable.

53. ***When a person acquires stock while he was a non-resident. Whether such a person is required to make any disclosures?***

Though the stocks have been acquired by an individual while he was a non-resident, such person is required to disclose those assets under Schedule FA immediately once such person becomes resident and ordinarily resident in India.

54. ***Whether a resident is required to report those stocks every year? Or only in the year of acquisition?***

Under the Schedule FA, residents are under an obligation to report any foreign assets held by such person every year. Hence, such person is required to report stocks held by such person every year till the disposal of such asset.

55. ***Whether employee is required to report stock received under the previous employment?***

The above reporting requirements are applicable to every resident and hence such employee, whether or not he continues to be in employment or not, is under the obligation to comply with the above reporting requirements.

56. ***A person retired from the employment and does not have taxable income in India but holding shares acquired under ESOPs during the employment. Whether such a person is required to file ITR and disclosure those stocks in Schedule FA?***

Under the provisions of IT Act, every person whose income exceeds the maximum amount is under the obligation to file ITR in India. However, proviso to section 139(1) states that in addition to the above-mentioned person, a person who is holding any asset or beneficial interest outside India is liable to file ITR in India. Hence, such a person is required to file ITR in India and disclose assets in Schedule FA.

57. ***What are the major consequences under the Black Money Act if any resident fails to comply with the above requirements?***

When any foreign income is not included in the total income, such income is considered as undisclosed foreign income and taxable at the rate of 30% (without any deductions) and

penalty may be levied at the rate of 300% of the tax payable.

Further, interest under section 234A, section 234B and section 234C of the IT Act would be levied at the time of recovery of tax payable under the Black Money Act.

58. ***If tax is deducted on ESOPs and included the same in the ITR, whether the penalty is levied for non-disclosure of assets in the Schedule FA?***

Provisions of Section 42/43 of the Black Money Act states that any person failed to disclose or file return of income despite holding foreign assets or failure to disclose such foreign asset is liable to penalty of Rs.10,00,000/-.

However, considering the spirit behind the Black Money Act, one can argue that disclosure is paramount, whether in the specified schedule in the ITR or in the total income. Since disclosure is made to the tax authorities, it can be pleaded that the same should be seen enough compliance under the Black Money Act.

Further, in certain cases, taxpayers whose total income exceeds a prescribed threshold, they are mandated to file the statement of assets and liabilities. In such statements, the taxpayers (employees) would have invariably disclosed the ESOPs/underlying shares as investments. This should also be considered as adequate disclosure for the purposes of the Black Money Act. Further, judicial fora have held that penalty proceedings are not automatic but can be initiated only when there is an intentional failure on the part of the assessee[41].

Considering the above, one may take a stand that since ESOPs are disclosed by way of withholding of tax by the employer, it amounts to adequate disclosure and compliance under the provisions of Black Money Act.

59. ***What is the time limit to issue a notice under the Black Money Act to assess foreign undisclosed income?***

Unlike the IT Act where the time limit is 3 years to reopen the assessment (6/10 years in certain cases), there is no time limit to issue a notice under the Black Money Act.

60. ***Can a person file a revised or updated return to comply with the above requirements?***

A person may file a revised return at any time on or before 31st December of the relevant assessment year. In such a revised return, the employee may comply with the above reporting requirements.

Further, a person may file updated return within a period of 2 years from the end of relevant assessment years (additional tax is required to be paid under updated return).

However, an updated return cannot be filed in certain circumstances which *inter alia* includes where any proceedings under the IT Act are

[41] Read our Article Penalties under Black Money Act - 'must' or 'may'? - Taxmann

pending or completed for the assessment year, or department has received any information from the foreign country under the agreement referred to in section 90/90A and same has been communicated to the assessee.

Though the notice issued to employees does not specifically mention that the notice is a consequence to the information in possession received by them under the arrangements referred in Section 90/90A, the tax authorities may harp on the same and there is a possibility for rejecting the updated return.

61. ***When the income has been assessed to tax under the Black Money Act, whether same is taxable under the provisions of the IT Act? And penalties levied under both the Acts?***

Section 4(3) of the Black Money Act states that once the income or asset is assessed to tax under the provisions of the Black Money Act, same shall not be subject to tax under the provisions of the IT Act. This is because, as the Black Money Act has been brought in to deal with special assets/income, it should prevail over general laws. Further, the Delhi Tribunal in the case of Ashok Kumar Singh[42] has held that once the provisions of Black Money Act has been invoked, revenue shall not invoke provisions of IT Ac to deal with the same set of facts. Hence, once the provisions of Black Money Act have been invoked, for the same set of facts, provisions of IT Act may not be invoked.

62. ***Are penalties under the Black Money Act qua undisclosed asset or undisclosed income or qua each year?***

Under the Black Money Act, different penalty provisions are applicable for different non-compliances.

For example, section 41 of the Black Money Act deals with the penalty when undisclosed asset or income is assed to tax. Section 42/43 deals with the failure to file return of income despite holding foreign assets/income and/or failure to make disclosure of foreign assets and income in the ITR. The above question arises with respect to failure to disclose such foreign assets in Schedule FA in the ITR as schedule FA is required to report every year.

In this regard, though the Black Money Act is silent, as a legal prudent, penalty cannot be levied for each year for failure to make disclosure in Schedule FA.

63. ***When disclosure of asset is made (through TDS route of Statement route), is the income arising from such an asset to be separately disclosed? Is it adequate that when an asset is shown, the income (which springs out of the asset) need not be shown?***

Scope of Black Money Act has been specified under section 4 read with section 2(12) under which any income from a source outside India which is not disclosed in the ITR shall be treated

[42] [2023] 151 taxmann.com 207 (Delhi - Trib.)

as undisclosed foreign income.

Mere disclosure of foreign assets is not sufficient but income from any source outside shall also be disclosed in the ITR. Here, disclosure does not mean disclosing the assets/income in the Schedule FA but including such income in the total income for the purpose of computation of tax liability in India. Hence, there are high chances that foreign income which is not included in the total income in India to be considered as undisclosed foreign income and thus attracting the provisions of Black Money Act.

64. ***Can the authorities attach a bank account pending conclusion of proceedings?***

Modes of recovery under the Black Money Act has been clearly provided under section 30-section 40. The said recovery proceedings starts only when the notice of demand under section 13 is issued by the tax authority. Hence, it may not be possible to attach the bank account unless the proceedings under the Black Money Act have been completed and notice of demand is issued.

65. ***Can the authorities in a routine manner initiate prosecution proceedings?***

From the reading of various provisions of the Black Money Act, it can be understood that these provisions are very stringent in nature. Initiation of prosecution has been provided under Chapter V of the Black Money Act which states that prosecution may be initiated when there is willful violation of the provisions of the Act. However, the Black Money Act presumes such culpable mental state of the assessee, and such person has to prove in the court of law that there is no culpable mental state.

Given the above, in certain circumstances, when the foreign income is duly included in the ITR and tax has been paid but such income is not disclosed in the Schedule FA, these failures do not seem to be valid grounds for initiation of prosecution. However, when the assessee willfully fails to include the foreign income in the total income, there are high chances of initiation of prosecution.

Income Tax

Significant Disclosures in Income Tax Returns by an Individual

An individual who has earned income which is taxable under the provisions of the Income Tax Act, 1961 is required to file a return of Income in India. While submitting the return of income, a person is required to submit details of income earned and details of tax liability on such income. Such an individual, in addition to submission of details income and tax, is required to make certain specific disclosures and required to submit proper information to the Government of India. Non-disclosure or failure to submit specific information may attract severe penal provisions under the Income Tax Act,1961, Black Money Act,2015 etc.

In this Article, significant disclosures that are required to be made in the return of income has been discussed.

-Contributed by CA Lokesh and Kanakaraj

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Introduction

1. In India, individuals who earn taxable income as per the provisions of ITA[43] are required to file their ITR[44] electronically. ITR is a self-declaration form filed by these individuals before the ITD[45] not only to report their source(s) of income but also the assets and liabilities being held by them. These ITRs are attachment-free forms, which makes the life of the individuals hassle-free as they no longer need to attach supporting documents while filing their returns. This simplification streamlines the process and reduces the burden of collecting and organizing numerous documents. However, it is essential to note that the absence of attachments does not imply a relaxation of compliance standards. On the contrary, taxpayers must retain all the relevant documents and receipts as supporting evidence for at least six years from the end of the assessment year. The ITD reserves the right to summon, and such individuals must be prepared to furnish necessary documents if requested.

2. However, while filing ITRs, a considerable number of individuals are, intentionally or

[43] Income Tax Act, 1961
[44] Income Tax Return
[45] Income Tax Department

unintentionally, failing to disclose and report some of the significant details, which subsequently leads to receiving notices from the Income Tax department. The point to be noted here is that failing to file income tax returns or filing but inaccurately reporting income and assets can lead to severe legal implications. It may result in penalties, fines, audits, and even legal proceedings. By fulfilling the responsibility of filing returns and accurately reporting the information, individuals can avoid legal complications along with the associated financial and reputational risks. In this article, we will shed light on the crucial pieces of information that must be disclosed while filing income tax returns. Before diving directly into the core topic, let us understand who are mandatorily required to file their ITRs and which forms are applicable to which individual.

Persons required to file ITR:

3. An individual whose income does not exceed the basic exemption limit is not required to file their ITR. In other words, Income Tax Returns must be filed by individuals whose total income exceeds the basic exemption limit prescribed by the ITA. The threshold for this exemption may vary from year to year. However, if any of the below-mentioned conditions is fulfilled by the individual, then they are obliged to file the ITR irrespective of their income.

a. Individual, being a beneficiary of any asset (including any financial interest in any entity) located outside India.

b. Aggregate deposit exceeds Rs 1 crore in one or more current accounts.

c. Aggregate expenditure exceeds Rs. 2 lakhs for travel to a foreign country.

d. Aggregate expenditure exceeds Rs. 1 lakh on consumption of electricity.

e. Any person who has satisfied the conditions as may be prescribed under section 139(1)(iv)

- If total sales, turnover or gross receipts, in the business exceeds Rs. 60 lakhs during the previous year. or
- If his total gross receipts in profession exceeds 10 lakhs during the previous year.
- If the aggregate of tax deducted at source and tax collected at source during the previous year is Rs. 25,000 (50,000 for resident senior citizen) or more
- If the deposits in one or more savings bank account of the person, in aggregate, is Rs. 50 lakhs or more, during the previous year.

Glimpses of ITRs applicable to an individual:

4. Individual must choose an appropriate ITR form to disclose his source of income as follows:

S No	Form	Conditions
1	ITR 1	A resident individual whose income ≤ Rs. 50 Lakhs from salary/pension, one house property, and income from other sources.
2	ITR 4	A resident individual whose income ≤ Rs. 50 Lakhs from salary/pension, one house property, income from other sources, and business/professional income which is eligible for presumptive scheme.
3	ITR 2	An individual whose income > Rs. 50 Lakhs from salary/pension, more than one house property, income from other sources or having any or all the following incomes: - Capital gains, foreign income/asset, crypto income (capital in nature), holding directorship in a company or holding unlisted equity shares.
4	ITR 3	An individual whose income is as mentioned in ITR – 2 and having any or all the following incomes: - Business/Professional income, crypto income (other than capital in nature) or is acting as a partner in a firm(s).

Opting of New Tax Regime under section 115BAC:

5. A new tax regime under section 115BAC has been introduced by the government through Finance Act 2020 in order to provide reduced tax rates to the individual subject to certain conditions. However, when compared to the old tax regime, certain deductions related to various allowances and investments are not allowed. Further, some of the provisions of this section are being amended from time-to-time to cope with the inherent limitations and to encourage every individual to opt for their income computation under this new tax regime.

6. An Individual who wishes to opt for a new tax regime having Income from business or profession need to furnish Form 10 IE through the income tax portal before filing their ITR. A 15 – digit acknowledgement number will be generated upon successful submission of the form which needs to be disclosed in the ITR. In other words, individuals (for new regime of taxation) who are required to file their ITR using Form ITR-3 or ITR-4 must first ensure successful submission of Form 10-IE. Only after successfully completing and submitting Form 10-IE can they proceed to file their income tax return using the respective ITR forms.

Persons governed by Portuguese Civil Code under section 5A:

7. While filling the ITR Form, one may come across a question 'Are you governed by Portuguese Civil Code under section 5A?' Under this section, the income of every eligible individual and their spouse shall be equally apportioned between them under each head except salary income. Each such spouse shall only disclose their share of income in their individual ITR. Additionally,

Schedule 5A needs to be filled up with the apportionment information. However, these provisions shall be applicable only to the residents of Goa, and union territories of Daman and Diu and Nagar Haveli. Before disclosing their income as per this section, such individuals are required to update their respective profile by selecting the applicability of the code.

Directorship in a company:

8. Every individual serving as a director in a company is obliged to provide the details including the name of the company, Permanent Account Number (PAN), Director Identification Number (DIN) of the individual. Additionally, individuals must specify whether the shares of the company they are associated with are listed on a recognized stock exchange or not.

Partnership details in a firm:

9. If an individual is a partner in any firm, the disclosure of relevant information in 'Schedule IF' regarding that firm becomes mandated along with the closing balance of capital as on 31st March. This also includes Name and PAN of the firm, percentage of profit sharing in the company and the amount of share in profits.

Deemed Ownership:

10. Deemed Ownership refers to an individual who is considered to be the owner of the property for income tax purposes, even if such individual does not possess any legal ownership on such property. This concept follows the rule – 'Substance Over Form' which has been dealt with under section 27 in order to reduce the tax evasion cases and to ensure that income from such properties is taxed appropriately. There are various scenarios under which an individual can be deemed to be the owner of the property, such as:

a. **Transfer to Spouse:** If an individual transfers their property to their spouse otherwise than for adequate consideration (except in cases of a transfer in connection with an agreement to live apart), the individual will be deemed the owner of that property.

b. **Transfer to Minor (other than minor married daughter):** If an individual transfers their property to their minor child otherwise than for an adequate consideration, they will be considered the deemed owner of that property.

c. **Joint Ownership:** In cases of joint ownership where one of the co-owners does not contribute to the property's cost, the contributing co-owner is deemed to be the owner of the entire property.

d. **Beneficial Interest:** If an individual has a beneficial interest in a property, then they may be deemed owner of that property for income tax purposes, even if the legal title is held by someone else.

e. **Holder of an Impartible Estate:** Where an estate cannot be divided or partitioned among the family members, then income from such estate can be clubbed and taxed in the hands of the holder.

Virtual Digital Assets:

11. Virtual digital assets, popularly known as cryptocurrencies, are a form of digital or virtual currency that use cryptography for secure financial transactions and control the creation of new units. Unlike traditional currencies issued by governments and central banks, cryptocurrencies operate on decentralized networks based on blockchain technology. In order to tax the income from such virtual digital assets, the Government of India has inserted a new section 115BBH to tax gain arising from those assets.

12. While reporting the income from such digital assets, an individual is required to provide details of date of acquisition and cost, date of transfer and consideration, head of income, Income from transfer of virtual digital assets in Schedule virtual digital asset.

Set-off and carry forward of losses:

13. Set-off of losses allows the individual taxpayer to adjust their losses from one head of income with the profit earned in another head of income, however, within the same financial year. When a taxpayer has losses under a particular head of income such as business or profession, then those losses can be set-off against the income earned in another head like capital gains or other sources. Whereas carry forward of losses allows the individual taxpayers to offset their losses of one financial year against the profit of another upcoming financial year(s) within the same head of income. When an individual taxpayer's total income shows a loss under a particular head of income, the unadjusted loss can be carried forward to subsequent years for set-off against the future profits from the same head.

14. However, there are certain rules and restrictions provided under IA. The ITA has mandated to disclose the figures of loss incurred during the year in 'Schedule-Current Year Loss Adjustment (CYLA)'. Information relating to such losses which are brought forward and set off needs to be disclosed in 'Schedule – Brought Forward Loss Adjustment (BFLA)'. These brought forward losses can be carried forward for 4-8 years depending upon the type of losses and shall be disclosed in 'Schedule – Carry Forward of Losses (CYL)'.

ICDS:

15. Income Computation and Disclosure Standards (ICDS) are issued by the Central Board of Direct Taxes (CBDT), which provide guidelines for computation of taxable income and disclosure of certain items for the purpose of computation of income tax. These standards have been introduced to maintain uniformity and consistency while computing the taxable income of an individual. ICDS lays down only the principles which cover the various aspects like accounting policies, revenue recognition, construction contracts, inventory valuation, tangible and intangible assets, effects of changes in forex rates, government grants and borrowing costs.

16. These principles need to be adopted by the individual while computing their taxable income. However, these standards are to be followed by

those individuals having income under the heads 'Profit and gains from business or profession' or 'Income from other sources' and who are liable for tax audit under section 44AB. Such individuals are required to disclose the information in Schedule ICDS along with the effects of ICDS adjustment on the profit.

Disclosure while claiming deductions under section 80G:

17. The government has always extended its full support towards charitable services and provides tax relief by allowing deductions on the amounts donated. Under section 80G, every individual whether resident or non-resident, is eligible for claiming deductions ranging from 50 percent to 100 percent of the amounts donated. In such cases, Schedule 80G needs to be filled-up in the ITR with details like Name, PAN and address of the donee, total amount of donation along with the break-up on amounts paid in cash or any other mode and the amount of donation eligible for deduction. Further, it has mandated every eligible donee to issue certificate of donation in form 10BE and relatively a new column 'ARN' i.e., Donation Reference Number has been introduced in the Schedule 80G by the government.

Specified Person Income:

18. There is special provision in the ITA, that whenever a minor child has earned income (not due to their own talent), the income of such minor child needs to be clubbed in the hands of such parent whose total income is higher. In such cases, the ITA has mandated to disclose the details like name of the person of income to be clubbed, PAN/Aadhaar, relationship with the individual, amount of income in 'Schedule – Specified Person Income (SPI)'.

Disclosure of Assets and Liabilities:

19. The government has taken many measures to track financial transactions and prevent money laundering and circulation of black money. One of such measures is that it has mandated to disclose the details of their assets and liabilities, such as land and buildings, bank deposits, shares, securities, jewellery, bullion, vehicles, insurance policies, vehicle loan, personal loan, housing loan etc., in 'Schedule – Asset & Liabilities (AL)' when an individual's total income exceeds Rs 50 lakhs.

20. However, if such individual is classified as a non-resident or resident but not ordinarily resident, only the details of assets and liabilities located in India may be disclosed.

Disclosure of investment in shares of a private limited company shares:

21. If an individual is holding unlisted shares of any company registered under the Companies Act, 2013, then the details of such shares must be disclosed. This disclosure is required even if such unlisted shares are held at any time during the financial year. Details such as PAN of the company, opening balance of shares, shares acquired and transferred during the year, and closing balance of shares must be reported.

Disclosure related to foreign assets and foreign income:

22. Many countries have implemented stringent reporting requirements and signed multiple agreements under various acts for exchange of financial information to reduce the tax evasion cases, to combat money laundering and to promote global transparency. As a part of this, residents are required to disclose the ownership of any foreign assets or beneficial interests held in any foreign assets/entities in 'Schedule – Foreign Assets (FA)'. This helps the authorities in tracking and assessing the accurate tax liability, leaving no room for laundering of money and in preventing financial crimes. However, non-residents or resident but not ordinarily residents are not required to file Schedule FA as it is applicable only to resident individuals with foreign assets.

23. The foreign assets can be foreign custodial accounts, foreign equity and debt interest, foreign depository accounts, shares held in any listed or foreign company, cash value/surrender value of foreign insurance contract, trusts created under any foreign country laws in which such individual is a trustee. A point to be noted is that these amounts should be mentioned after converting them into Indian rupees. For the purpose of filling this schedule, assets or liabilities held at any time during the calendar year ending as on 31st Dec shall be taken.

24. However, resident individual having foreign source of income which is taxable in India and has paid tax in foreign country under the foreign laws, is mandated to file 'Schedule – Foreign Source of Income (FSI)' along with 'Schedule – Tax Relief (TR)', in order to claim tax relief against that income in India. In this Schedule, the details of income, which is accruing or arising from any source outside India needs to be reported. The relevant head of income under which such foreign source income has been reported should also be duly mentioned. Country code and Taxpayer Identification number in the country where tax has been paid is to be filled-up.

25. Furthermore, if any taxes are being paid on the foreign source of income in another country, and tax relief is being claimed in India under the provisions of the Double Taxation Avoidance Agreement (DTAA), it is crucial to specify the relevant article of the applicable DTAA in the tax return.

26. Individual being a non-resident is required to submit additional information related to dividend income earned by such non-resident from Indian companies, dividend income of Foreign Institutional Investors (FIIs), and dividend income subject to tax as per DTAA rates in 'Schedule – Other Sources (OS). Individuals are required to provide specific details such as amount of income, country name and code in which such NRI is a resident, article of DTAA, rate as per the DTAA, section under which such income is governed, rate of income tax.

Foreign Exchange Management

Acquisition of Immovable Property in India by a Non-Resident - FEMA

Investment in immovable property is one of the best investment plans for any person. When a person being non-resident outside India wishes to invest in immovable property, the question arises is 'Whether he is allowed to make investment in immovable properties in India? What are the conditions for such an investment and how to repatriate the amount post transfer? Further, a person may acquire the property by inheritance or by gift from other resident/non-resident. In such a case, a question may arise as to what are conditions and procedure for such acquisition?

In this Article, conditions and procedure for acquisition, holding and transfer of immovable property in India by a non-resident individual are discussed in detail.

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1. An individual may leave India for various purposes which inter alia includes for the purpose of employment or business. While such individual is earning income outside India, one of the investment options that they explore is investing in immovable property being a land or building in India. Central Government also encourages the non-residents of India to invest in various assets viz. shares and securities, immovable property and other securities in India as India receives convertible foreign exchange into India. Unlike the investment in securities, investment in immovable property needs close monitoring. Accordingly, investment in immovable property is allowed subject to certain conditions and restrictions. In this Article, the concept of investment in immovable property by non-residents (individuals) has been discussed in detail.

2. Before understanding the procedure for investing in any immovable property in India, we need to understand certain definitions:
   - **<u>Resident outside India:</u>** section 2(w) of the FEMA defines the term 'person resident outside India' to mean a person who is not resident in India. Section 2(v) defines the term 'person resident in India' to mean a person residing in India for more than 182 days during the course of the preceding financial year but does not include—

     A. a person who has gone out of India or who stays outside India, in either case—

        a) for or on taking up employment

outside India, or

b) for carrying on outside India a business or vocation outside India, or

c) for any other purpose, in such circumstances as would indicate his intention to stay outside India for an uncertain period;

B. a person who has come to or stays in India, in either case, otherwise than—

a) for or on taking up employment in India, or

b) for carrying on in India a business or vocation in India, or

c) for any other purpose, in such circumstances as would indicate his intention to stay in India for an uncertain period.

3. From the above definition, it can be understood that in order to determine the residential status of a person, the period of stay in the preceding years needs to be considered. Further, in addition to the period of stay, the purpose of leaving India also needs to be taken into account for determination of residential status. For example, an individual who leaves India for the purpose of employment outside India becomes resident outside India though such person stays in India more than, for 182 days during the preceding year. Whereas under the provisions of the Income Tax Act,1961, period of stay during the current years needs to be considered. Whereas under the provisions of the Income Tax Act,1961, period of stay during the current year needs to be considered. So, in certain scenarios, a person will be resident of India under Income Tax Act, and resident outside India under FEMA.

- **<u>Non-Resident Indian ('NRI'):</u>** Non-Resident Indian means a person resident outside India who is a citizen of India.
- **<u>Overseas Citizen of India ('OCI'):</u>** OCI means a person resident outside India who is registered as an Overseas Citizen of India Cardholder under Section 7(A) of the Citizenship Act, 1955.

<u>Part I: Acquisition of immovable property by a person resident outside India:</u>

4. Section 6 of the FEMA[46] deals with the capital account transactions. Section 6 (2A) of FEMA empowers the Central Government to regulate capital account transactions not involving debt securities. Further, section 6(5) states that a person resident outside India may hold, transfer or invest in any immovable property in India, if such property is acquired when such person was a resident in India or inherited from a person who was a resident in India.

5. Given the above, there are provisions which deals with the acquisition, holding and transfer of immovable property in India by a person resident outside India. Let us proceed to discuss procedure to be followed for making investment immovable property in India by non-residents.

6. In exercise of the powers conferred under section 46 (2) (aa) and (ab), the Central Government has notified FEM (Non-Debt Instruments) Rules,

[46] Foreign Exchange Management Act, 1999

2019, as amended from time to time, which inter alia deals with investment in immovable property in India.

7. A person may acquire the immovable property in either of the following ways:
   - Purchase of immovable property for cash.
   - Acquisition of immovable property by gift.
   - Acquisition of immovable property by inheritance.

Purchase of Immovable Property:

8. An NRI or OCI is eligible to acquire an immovable property in India by way of purchase subject to following conditions:
   - Investment in agricultural land or farmhouse or plantation property is prohibited.
   - Funds for purchase of such immovable property to be purchased may be made out of funds received in India by way of inward remittance from outside India or funds held in any non-resident account maintained by such person in India.
   - Payment shall not be made either by traveller's cheque or in foreign currency notes.

9. When funds are received from outside India, in order to make investment in immovable property in India, NRI or OCI needs to provide 'inward remittance purpose code' to the AD Bank. For this purpose, NRI or OCI may provide 'P0099' as inward remittance purpose code to its AD Bank. Further, such investment by individuals is not considered as foreign direct investment, as the same is not in to any entity in India, and accordingly, Hence, there is no specific compliance reporting compliance for the investment in immovable property in India by an NRI or OCI.

Acquisition of immovable property by gift:

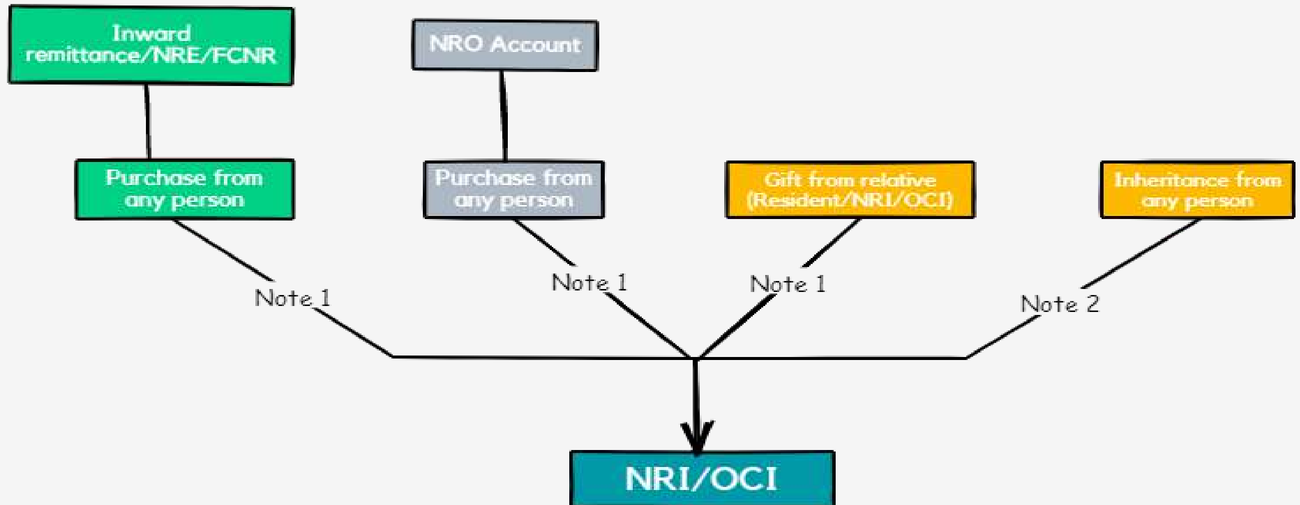
10. An NRI or OCI is eligible receive an immovable property by way of gift from any person resident in India or from NRI or OCI who is a relative of such person as defined under section 2(77) of the Companies Act,2013. However, acquisition of immovable property being an agricultural land or farmhouse or plantation property by way of gift is prohibited.

Acquisition of immovable property under inheritance:

11. An NRI or OCI is eligible to receive an immovable property by way of inheritance from a person resident outside India who had acquired the property in accordance with the provisions of the FEMA Regulations at the time of acquisition.

12. An NRI or OCI is eligible to receive an immovable property by way of inheritance from a person resident in India. On a careful reading of above, it can be inferred that there is no restriction on NRI or OCI from inheriting immovable property being an agricultural land or farmhouse or plantation property in India either from a person resident outside India subject to certain conditions and also from a person resident in India.

The pictorial presentation of the above discussed provisions in relation to acquisition, is as below:



Note 1
Any immovable property other than agricultural property, farmhouse or plantation property

Note 2
Any immovable property

Note 3
In the case of inheritance from a person resident outside India, such person shall acquire the property in accordance with the provisions of FEMA

Part II: Transfer of immovable property by a person resident outside India:

13. An NRI or OCI may transfer any immovable property in India to a person resident in India. This immovable property may include immovable property acquired when such persons was a resident in India, purchased from any person, received as a gift or inheritance.

14. However, in the case of transfer of immovable property to another NRI/OCI, such NRI/OCI may transfer any immovable property other than agricultural land, farmhouse or plantation property. Further, an NRI/OCI may transfer the immovable property under a gift only to a relative as defined under section 2(77) of the Companies Act.

Repatriation of sale proceeds of immovable property:

15. Once the NRI/OCI transfers any immovable property, next question that arises is what are the conditions for repatriation of funds to outside India? This question needs to be answered considering the source of acquisition of such immovable property in India.

Regular Repatriation:

16. If the amount of consideration has been paid in foreign exchange received through banking channels or out of funds in NRE account or FCNR

account, then NRI or OCI is allowed to repatriate sale proceeds to outside India.

Remittance under USD 1 million scheme:

When a person acquires immovable property under any modes specified under section 6(5), i.e., was acquired, held or owned by such person when he was resident in India or inherited from a person who was resident in India, then such a person is not allowed to repatriate sale proceeds to outside India. However, such a person may remit the amount under 'Foreign Exchange Management (Remittance of Assets) Regulations, 2016' popularly known as USD 1 million remittance scheme.

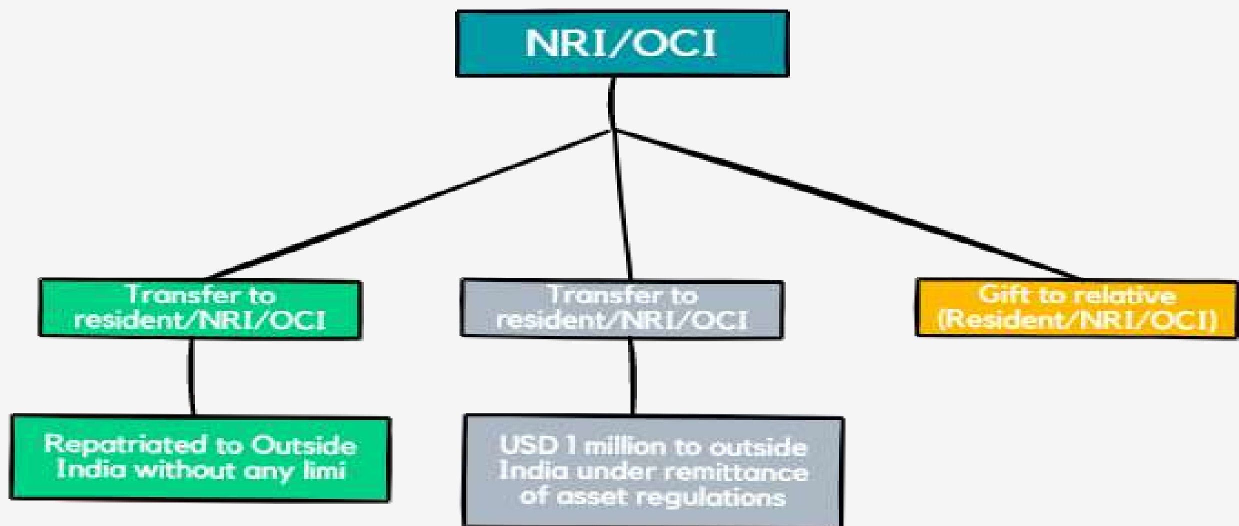
17. Further, if such NRI or OCI[47] acquires immovable property with the borrowed funds and repayment of such loan has been made from inward remittance or NRE account and FCN account, then such immovable property is deemed to be acquired with foreign funds and hence, such NRI or OCI is allowed to repatriate funds to outside India.

Restriction/limit in repatriation in some cases:

In the case of repatriation of sale proceeds from sale of house properties, such repatriation is restricted to two residential house properties.

18. In order to make remittance under the USD 1 million scheme or repatriation of sale proceeds, AD Bank may request the NRI or OCI to submit Form A2 along with the declaration stating that the amount is eligible to remit or repatriate as the case may be. In addition to the above, AD Bank insist upon certificate for discharging of income tax liability in India. Further, as the amount is not repatriated under the LRS scheme, TCS provisions under section 206C(G) are not applicable[48].

The pictorial presentation of the above discussed provisions in relation to repatriation, is as below:



[47] Under the erstwhile regulations, PIO is eligible to acquire immovable property in India. Hence, such person is also allowed to repatriate funds if such property is sold after the commencement of current regulations.

[48] For a detailed understanding of remittances under the these regulations and LRS, read our Article at Remittance of Assets Regulations vs Liberalised Remittance Scheme - A Comparison under FEMA and Income Tax - Taxmann

Acquisition by other persons:

19. **Acquisition by spouse of NRI or OCI:** In addition to the NRI or OCI discussed above, spouse of NRI is also eligible to invest in immovable property in India subject to the following conditions:
    - Investment can be made in any immovable property other than agricultural land, farmhouse or plantation property.
    - Such property shall be acquired jointly with his/her NRI or OCI spouse.
    - Consideration shall be made either by inward remittance or any non-resident account.
    - The marriage should be registered and subsisted on for a period of 2 years immediately preceding acquisition of immovable property.

20. **Acquisition by long-term Visa holder:** Long term Visa holders who are residing in India (being a citizen of Afghanistan, Bangladesh or Pakistan belonging to minority communities in those countries viz. Sikhs, Jains, Buddhists, Parisis and Christians) are allowed to invest in one residential property for dwelling and one commercial property for self-employment subject to other conditions as prescribed therein.

21. **Acquisition by foreign diplomats:** Foreign Embassy / Diplomats / Consulate General may purchase or sell immovable property in India (other than agricultural land, farmhouse or plantation property) subject to obtaining approval from the Ministry of External Affairs.

22. **Acquisition of immovable property for business activities:** A person being a resident outside India, who has established any branch or office any other place of business in India (other than liaison office), may acquire immovable property which is necessary or incidental to the activity carried on in India subject to following conditions.
    - Such a person shall file Form IPI within the 90 days of acquisition.
    - Acquisition by the persons of Pakistan or Bangladesh or Sri Lanka or Afghanistan or China or Iran or Hong Kong or Macau or Nepal or Bhutan or Democratic People's Republic of Korea requires prior approval of RBI.
    - Such a property may be mortgaged to any AD Bank for any borrowing.

Prohibition of acquisition of immovable properties in India:

23. Citizens of Pakistan, Bangladesh, Sri Lanka, Afghanistan, China, Iran, Nepal, Bhutan, Macau, Hong Kong and Democratic People's Republic of Korea cannot, without prior permission of the Reserve Bank, acquire or transfer immovable property in India, other than on lease, not exceeding five years. However, if such a person is an OCI, the prohibition is not applicable.

Insolvency and Bankruptcy Code

Insolvency Proceedings Against 'Financial Service Provider' under the IBC, 2016

Financial Service Providers (for the sake of brevity "FSPs"), play a crucial role in maintaining the financial stability of a country's economy. The Insolvency and Bankruptcy Code, 2016 (for the sake of brevity "IB Code"), excluded IFCs from the ambit of the code. Owing to the Financial crisis of big financial houses, resulting in series of investigations and enquiries, the Government has brought the Insolvency and Bankruptcy (Insolvency and Liquidation Proceedings of Financial Service Providers and Application to Adjudicating Authority) Rules, 2019, under Section 227 of the code, to bring such Financial Service Providers/categories of Financial Service Providers, as may be notified by the Central Government from time to time, under the ambit of the rules and listed out the resolution process of such stressed FSPs.

The Article is an attempt to understand the term "**Financial Service Provider**" under the IB Code, and the Insolvency and Bankruptcy (Insolvency and Liquidation Proceedings of Financial Service Providers and Application to Adjudicating Authority) Rules, 2019, and also on the recent litigations involving commencement of CIRP against the Financial Service Providers, and the decisions of authorities, in this regard.

-Contributed by CS D V K Phanindra & CA Sri Harsha
phanindra@sbsnadco.com

1. The Insolvency and Bankruptcy Code, 2016 (IBC), revolutionized India's insolvency framework by providing a consolidated and time-bound process for resolving corporate insolvencies. While the IBC primarily focuses on corporate entities, it also encompasses a critical aspect concerning Financial Service Providers (FSPs). These FSPs play a crucial role in maintaining the financial stability of the country's economy.

2. To understand the term "Financial Service Providers" in totality, we need go through a series of definitions, detailed under Section 3 of the IB code:

   (7) "Corporate Person" means a company as defined in clause (20) of Section 2 of the Companies Act, 2013 (18 of 2013), a limited liability partnership, as defined in clause (n) of sub-section (1) of Section 2 of the Limited Liability Partnership Act, 2008 (6 of 2009), or any other person incorporated with limited liability under any law for the time being in force but shall not include any financial service

provider;

(8) "Corporate Debtor" means a corporate person who owes a debt to any person;

(11) "Debt" means a liability or obligation in respect of a claim which is due from any person and includes a financial debt and operational debt;

(12) "Default" means non-payment of debt when whole or any part or instalment of the amount of debt has become due and payable and is not paid by the debtor or the corporate debtor, as the case may be;

(16) "Financial Service" includes any of the following services, namely:

(a) accepting of deposits;

(b) safeguarding and administering assets consisting of financial products, belonging to another person, or agreeing to do so;

(c) effecting contracts of insurance;

(d) offering, managing or agreeing to manage assets consisting of financial products belonging to another person;

(e) rendering or agreeing, for consideration, to render advice on or soliciting for the purposes of:

(i) buying, selling, or subscribing to, a financial product;

(ii) availing a financial service; or

(iii) exercising any right associated with a financial product or financial service;

(iv) establishing or operating an investment scheme;

(v) maintaining or transferring records of ownership of a financial product;

(vi) underwriting the issuance or subscription of a financial product; or

(vii) selling, providing, or issuing stored value or payment instruments or providing payment services;

(17) "Financial Service Provider" means a person engaged in the business of providing financial services in terms of authorisation issued or registration granted by a financial sector regulator;

(18) "Financial Sector Regulator" means an authority or body constituted under any law for the time being in force to regulate services or transactions of financial sector and includes the Reserve Bank of India, the Securities and Exchange Board of India, the Insurance Regulatory and Development Authority of India, the Pension Fund Regulatory Authority and such other regulatory authorities as may be notified by the Central Government;

3. From the foregoing definitions, it is clear that the Code provides for a wide range of entities, including Banks, NBFCs, Insurance Companies, pension funds, and other intermediaries involved in the provision of financial services.

4. From the combined reading of the definitions 3(16), 3(17) and 3(18) with 3(7) and 3(8), we get to understand that a Financial Service Provider, cannot be termed as a Corporate Person, and accordingly do not fall under the ambit of Corporate Debtor.

5. There is no second thought that the stability and smooth functioning of these FSPs is essential for maintaining the overall financial health of the economy. However, they are not immune to financial distress or insolvency.

6. A sub-committee was constituted by the Government, seeking recommendations on the notification of the FSPs under Section 227 (zk) of the Code. The Committee has submitted its Report[49] Dated: 04.10.2019, suggesting the Tentative Distribution of FSPs for the Purpose of Applicability of the IBC, and also on the CIRP and Liquidation process of FSPs.

7. Following this, the Central Government, vide Notification[50] Dated:15.11.2019, had notified the Insolvency and Bankruptcy (Insolvency and Liquidation Proceedings of Financial Service Providers and Application to Adjudicating Authority) Rules, 2019 [herein after referred to as "Rules"], to bring such Financial Service Providers or categories of Financial Service Providers, as may be notified by the Central Government from time to time, under the ambit of the rules and listed out the resolution process of such stressed FSPs.

8. This rule ensures that the resolution process for FSPs remains distinct from other corporate entities to safeguard financial stability.

Some of the important terms/aspects of the rules are as below:

(a) The expressions "**Corporate Debtor**" wherever they occur, shall mean "**Financial Service Provider**"; and

(b) The expressions "Insolvency Professional", "Interim Resolution Professional", "Resolution Professional" or "Liquidator", wherever they occur, shall mean "Administrator".

(c) CIRP initiation:

No corporate insolvency resolution process shall be initiated against a financial service provider which has committed a default under section 4 of the Code, except upon an application made by the appropriate regulator, in the same manner as an application by a financial creditor under section 7 of the Code.

(d) Appointment of Administrator:

On admission of the application, the Adjudicating Authority shall appoint the individual proposed by the appropriate regulator in the application as the Administrator. The Administrator shall act as an insolvency professional, interim resolution professional, resolution professional or liquidator, as the case may be. An Administrator shall have the same duties, functions, obligations, responsibilities, rights, and powers of an insolvency professional, interim resolution professional, resolution professional or liquidator, as the case may be,

[49] https://ibbi.gov.in/uploads/resources/ca0c7be35204c196451a5f4918e08292.pdf

[50] https://ibbi.gov.in//uploads/legalframwork/cb1d53c7fe47f8f22ab36a40f441db2c.pd

while acting as such in an insolvency resolution and liquidation proceeding of a financial service provider.

(e) Moratorium Period:

An '**Interim Moratorium**' shall commence on and from the date of filing of the application till its admission or rejection. The license or registration which authorises the financial service provider to engage in the business of providing financial services shall not be suspended or cancelled during the interim-moratorium and the corporate insolvency resolution process.

(f) Advisory Committee:

(i) The appropriate regulator may, where deemed necessary, constitute an Advisory Committee, within 45 days of the insolvency commencement date, to advise the Administrator in the operations of the financial service provider during the corporate insolvency resolution process;

(ii) The Advisory Committee shall consist of 03 or more Members, who shall be persons of ability, integrity and standing, and who have expertise or experience in finance, economics, accountancy, law, public policy or any other profession in the area of financial services or risk management, administration, supervision or resolution of a financial service provider;

(iii) The terms and conditions of the Members of the Advisory Committee and the manner of conducting meetings and observance of rules of procedure shall be such as may be determined by the appropriate regulator;

(iv) The compensation paid to the Members of the Advisory Committee shall be part of the insolvency resolution process costs;

(v) The Administrator shall chair the meetings of the Advisory Committee.

(g) Resolution plan:

(i) The resolution plan shall include a statement explaining how the resolution applicant satisfies or intends to satisfy the requirements of engaging in the business of the financial service provider, as per laws for the time being in force;

(ii) Upon approval of the resolution plan by the committee of creditors under sub-section (4) of section 30, the Administrator shall seek 'no objection' of the appropriate regulator to the effect that it has no objection to the persons, who would be in control or management of the financial service provider after approval of the resolution plan under section 31;

(iii) The appropriate regulator shall without prejudice to the provisions contained in section 29A, issue 'no objection' on the basis of the 'fit and proper' criteria applicable to the business of the financial service provider;

(iv) Where an appropriate regulator does not refuse 'no objection' on an application

made under clause (ii) within 45 working days of receipt of such application, it shall be deemed that 'no objection' has been granted.

(h) Liquidation Process:

The provisions of the Code relating to the liquidation process of the corporate debtor shall, mutatis mutandis apply, to the liquidation process of a financial service provider subject to the following modifications, namely: —

(i) The license or registration that authorises the financial service provider to engage in the business of providing financial services shall not be suspended or cancelled during the liquidation process, unless an opportunity of being heard has been provided to the liquidator;

(ii) The Adjudicating Authority shall provide the appropriate regulator an opportunity of being heard before passing an order for —

(a) liquidation of the financial service provider under section 33, and

(b) dissolution of the financial service provider under section 54

(i) Voluntary Liquidation Process:

The provisions of the Code relating to voluntary liquidation process of the corporate debtor shall, mutatis mutandis apply, to the voluntary liquidation process of a financial service provider subject to the following modifications, namely:-

(a) the financial service provider shall obtain prior permission of the appropriate regulator for initiating voluntary liquidation proceedings under section 59 of the Code;

(b) the affidavit referred to in clause (a) of sub-section (3) of section 59 shall include a declaration that the permission under clause (a) has been obtained;

(c) the Adjudicating Authority shall provide the appropriate regulator an opportunity of being heard before passing an order for dissolution of the financial service provider under section 59.

(j) Assets of third parties, etc.:

(i) Third-party assets or properties in custody or possession of the financial service provider, including any funds, securities and other assets required to be held in trust for the benefit of third parties.

(ii) The Administrator shall take control and custody of third-party assets or properties in custody or possession of the financial service provider, including any funds, securities and other assets required to be held in trust for the benefit of third parties only for the purpose of dealing with them in the manner, as may be notified by the Central Government under section 227.

9. Vide Notification[51] Dt: 18.11.2019, the Central Government, had notified the Insolvency Resolution and Liquidation Proceedings of the following categories of financial service providers shall be undertaken in accordance with the provisions of the Insolvency and Bankruptcy Code, 2016, read with the Insolvency and Bankruptcy (Insolvency and Liquidation Proceedings of Financial Service Providers and Application to Adjudicating Authority) Rules, 2019, ("Rules") and the applicable Regulations:

Sl. No.	Category of Financial Service Provider (rule 2 of the Rules)	Appropriate Regulator [clause (a) of sub-rule (1) of rule 3 of the Rules]	Dealing with third-party assets (rule 10 of the Rules)
(1)	(2)	(3)	(5)
1	Non-banking finance companies (which include housing finance companies) with assets size of Rs. 500 crores or more, as per last audited balance sheet.	Reserve Bank of India	To be notified separately

10. From the above definition, we can understand that a Corporate Person, undertaking the provision of Financial Services, under authorisation or registration from a Financial Sector Regulator, shall be called "**Financial Services Provider**", and cannot be termed as a "**Corporate Debtor**", to be excluded from the general CIRP proceedings, at par with other Corporate Debtors, but only to proceeded with by virtue of the Insolvency and Bankruptcy (Insolvency and Liquidation Proceedings of Financial Service Providers and Application to Adjudicating Authority) Rules, 2019.

11. Be it as it may, the interpretation and categorisation of the Financial Services, whether would fall under the "Financial Services Provider", will be the next task on hand for the Adjudicating Authorities to address. The Report of the Sub-Committee Dated: 04.10.2019 (Supra), provided its recommendations on the various types of Financial Services Providers, to be included and excluded from the purview of the IBC provisions.

12. Having said this, let us proceed to glance through some of the litigations which have evolved around FSPs, and the decision of various foras:

A. WHERE A NBFC STOOD AS CORPORATE GUARANTOR IN RESPECT OF CORPORATE DEBTOR:

In the matter of M/s. Sungrowth Share and Stocks Limited:

13. An appeal[52] was preferred to the National Company Law Appellate Tribunal, New Delhi, against the order Dated 4-9-2019 of the National

[51] https://www.mca.gov.in/Ministry/pdf/NotificationFSPs_18112019.pdf

[52] [2023] 147 taxmann.com 495, NCLAT- New Delhi

Company Law Tribunal, Kolkata Bench, Kolkata, vide which an application under Section 7 of the Insolvency and Bankruptcy Code, 2016 (in short 'Code') filed by State Bank of India (Financial Creditor) against M/s. Sungrowth Share and Stocks Limited (Corporate Guarantor) on account of a default committed by the Corporate Debtor (M/s. Adhunik Alloys & Power Limited) in paying the financial debt of Rs.63,04,53,226/-, was admitted by the Adjudicating Authority (National Company Law Tribunal, Kolkata Bench, Kolkata).

14. M/s. Adhunik Alloys & Power Limited was already in Corporate Insolvency Resolution Process (CIRP) vide order dated 23-8-2017 of the Adjudicating Authority. M/s SPV Bhagwati Power & Steel Ltd., the Resolution Applicant in the matter, has submitted the resolution plan which has been approved by the Adjudicating Authority. In the said proceedings, the State Bank of India, has submitted its claim of Rs. 324.73 Crores, which was though considered in the plan, and now the Respondent filed an application under section 7 of the Code against M/s. Sungrowth Share and Stocks Limited, who stood as a Guarantor, to the extent of Rs.30 Crores for recovery of balance outstanding of the Corporate Debtor (M/s Adhunik Alloys & Power Limited).

15. It was argued before the NCLAT that the application filed under section 7 of the Code was not maintainable and the Adjudicating Authority had no jurisdiction to initiate the proceedings because M/s. Sungrowth Share and Stocks Limited was a NBFC, registered with Reserve Bank of India (RBI) vide certificate of registration no. B.05.03435, in accordance with Section 45 IA of the RBI Act, 1934. The certificate was issued on 28.03.2001, to carry on business of NBFC, without accepting public deposits subject to the conditions given in the said registration certificate.

16. The application under section 7 was filed on 08.06.2018, whereas the NBFC Registration certificate Dated:28.03.2001, was cancelled on 09.07.2018 and intimation was given to M/s. Sungrowth Share and Stocks Limited, about it on 11.07.2018.

17. It was further argued that the day on which the application under section 7 was filed i.e. 08.06.2018, the registration of M/s. Sungrowth Share and Stocks Limited, as NBFC was in operation, therefore, the application under section 7 of the Code was not maintainable. Reference to Section 3(7), 3(8), 3(17), 3(18) and Section 5A of the Code to refer to the definitions of the Corporate Person, Corporate Debtor, Financial Service Provider, Financial sector regulator and Corporate Guarantor. It was also submitted that proceedings against the Financial Service Provider could have been initiated only in terms of Insolvency and Bankruptcy (Insolvency And Liquidation Proceedings Of Financial Service Providers And Application To Adjudicating Authority) Rules 2019, which came into force w.e.f. 15.11.2019, in terms of section 227 read with clause (zk) of sub-section 2 of 239 of the Code.

18. Decisions of the Appellate Tribunal in the matters of Randhiraj Thakur v. Jindal Saxena Financial Services (P.) Ltd[53], and Housing Development Finance Corporation Ltd. v. RHC Holding (P.) Ltd54, were also relied upon.

19. For the Respondents, it was argued that the Appellant was not doing financial services as defined under section 3(16) and therefore, the registration of the Appellant dated 28-3-2001 was cancelled vide order dated 9-7-2018/11-7-2018. It was further submitted that even if the application under section 7 of the code was filed on 8-6-2018 and at that time the certificate of registration was in operation but it came to end during the pendency of the proceedings on 9-7-2018/11-7-2018, therefore, the application filed under section 7 of the Code by State Bank of India, was in accordance with law.

<u>The NCLAT observed the following:</u>

20. Section 3(7) defines corporate person. It categorically states that it will not include any financial service provider. Section 3(8) defines corporate debtor, which means a corporate person. Meaning thereby in order to become corporate debtor entity has to be a corporate person but a financial service provider is not a corporate person. The financial service provider is defined in section 3(17) which says that any person to whom registration is granted by a financial sector regulator. Section 3(18) defines financial sector regulator which includes the Reserve Bank of India. Financial service is defined under section 3(16) which according to the decision of this court in the case of Housing Development Finance Corporation Ltd. (supra) is inclusive and not limited to one which is provided in the said provision.

21. The present proceedings have been initiated against M/s. Sungrowth Share and Stocks Limited, as a Corporate Guarantor. Section 5A of the Code, defines Corporate Guarantor which means a corporate person. Accordingly, the Appellate Tribunal was of the view that from any angle, M/s. Sungrowth Share and Stocks Limited, having the registration in terms of section 3(17) as financial service provider by the financial service regulator in terms of section 3(18) by RBI as on 28-3-2001 which continued up to 9-7-2018/11-7-2018 cannot in any case be called a banking institution. It has to be called a non-baking financial institution and in such scenario the application filed under section 7 of the Code on 8-6-2018 was not maintainable on that date and therefore, the Adjudicating Authority had no jurisdiction to invoke its power for the purpose of initiation of CIRP proceedings. The Appellate Tribunal was of the view that the Adjudicating Authority has committed an error in initiating the proceedings under section 7 of the Code though it was not apprised of the facts that M/s. Sungrowth Share and Stocks Limited (Corporate Guarantor) was a financial service provider.

[53] [2018] 94 taxmann.com 340/2018 SCC Online NCLAT 508, NCLAT, New Delhi.

[54] [2019] 107 taxmann.com 200/155 SCL 4/2019 SCC Online NCLAT 398, NCLAT New Delhi.

22. The Hon'ble Appellate Tribunal also noted the decision of Hon'ble Supreme Court in the case of Dr. Jagmittar Sain Bhagat v. Dir Health Services[55] , in which it has been held that if the Adjudicating Authority does not have the jurisdiction to initiate the proceedings then the said proceedings are non-est in the eyes of law and such an issue can be raised even in appeal also.

23. Accordingly, the Hon'ble Appellate Tribunal found merit in the appeal and allowed the same, thereby and the impugned order of the NCLT, was set aside.

In the matter of M/s. AKJ Fincap Limited:

24. M/s. Agnipa Energo Private Limited [AEPL] approached Bank of India the financial creditor and the financial creditor agreed to sanction an aggregate loan amount of Rs.10.65 crores. The corporate guarantor M/s. AKJ Fincap Limited., offered its corporate guarantee and signed and executed the Deed of Guarantee.

25. AEPL failed to pay instalments of the term loan account. The term loan account was classified as NPA. The financial creditor issued a reminder letter to AEPL, to pay the interest and loan instalments. Moreover, AEPL while admitting its liability submitted a One Time Settlement proposal, but the same could not be accepted by the financial creditor.

26. An application[56] was filed under section 7 by the financial creditor and an ex-parte order was passed by the instant Adjudicating Authority observing that notice was served on the corporate debtor, but there was no appearance.

27. Aggrieved by that Order, I.A. No. 45 of 2020 in the application, was filed by M/s. AKJ Fincap Limited, seeking a direction to set aside the ex-parte Order. The Adjudicating Authority dismissed the said IA on the ground that the Tribunal has no power to review or set aside its own Company Petition Admission Order[57] as per settled proposition of law. Before the NCLAT the Counsel for M/s. AKJ Fincap Limited, strenuously argued that the Adjudicating Authority has the power to set aside this ex-parte Order, but has erroneously dismissed the I.A. on the ground that the Order dated 18-3-2020 dealt with 'Admission of the Application' filed under section 7.

28. Aggrieved by said order an application was filed by Corporate guarantor seeking a direction to set aside the ex-parte order, which was dismissed by the Adjudicating Authority on the ground that the Adjudicating Authority had no power to review or set aside its own company petition admission order as per settled proposition of law.

29. On appeal with the National Company Law Appellate Tribunal, filed by Corporate Guarantor, the ex-parte order was set aside subject to costs of Rs. 25,000/- on Corporate guarantor to be paid to the financial creditor and parties were directed to appear before the Adjudicating Authority. As

[55] [2013] 10 SCC 136

[56] CP (IB) No. 04/GB/2020, NCLT, Guwahati Bench,

[57] Power of NCLT to recall it own order was discussed in the December, 2022 edition of wiki, which can be accessed at https://sbsandco.com/blog/sbs-wiki-e-journal-dec-2022

per the order of NCLAT, Corporate Guarantor paid Rs. 25,000/- to the financial creditor and the petition filed by the financial creditor under section 7 was taken up by the Adjudicating Authority i.e., National Company Law Tribunal, Guwahati Bench, afresh.

30. During the proceedings, it is submitted to the Adjudicating Authority that basis the documents submitted and agreed by both the financial creditor as well as the corporate guarantor that the corporate guarantor is a NBFC/Financial Service Provider and Certificate is issued to this effect by the RBI. The financial creditor has also admitted in its submission in the affidavit filed by it enclosing the latest balance sheet of the corporate guarantor for the financial year 2019-20, downloaded from the MCA site, that the total assets of the corporate guarantor stands at Rs. 15.63 crores only.

31. The Tribunal also noted the provisions of section 3(7) reads that 'Corporate Person' means a Company as defined in clause (20) of section 2 of the Companies Act, 2013, a limited liability partnership, as defined in clause (n) of sub-section (1) of section 2 of the Limited Liability Partnership Act, 2008, or any other person incorporated with limited liability under any law for the time being in force but shall not include any financial service provider. The Adjudicating Authority also noted that the Insolvency and Bankruptcy (Insolvency and Liquidation Proceedings of a Financial Service Providers and Application to Adjudicating Authority) Rules, 2019 with effect from 15.11.2019, and vide notification Dt: 18.11.2019, it was notified that the Non-Banking Finance Companies' including 'Housing Finance Companies' with assets size of 500 crores or more, the proceedings shall be undertaken in accordance with the provisions of I&B Code 2016 to be read along with these rules by the appropriate Regulator through Administrator and in the instant case Reserve Bank of India is designated.

32. The Adjudicating Authority noted that the Corporate Guarantor is a NBFC/ Financial Service Provider and Certificate issued to this effect by the RBI dated 18/03/1998; The Applicant/FC has also admitted in its submission in the affidavit dated 10/08/2021 filed by it enclosing the latest Balance Sheet of the Corporate Guarantor for the Financial Year 2019-2020, downloaded from the MCA site, that the Total Assets of the Corporate Guarantor i.e., AKJ Fincap Ltd stands at Rs. 15.63 crores only.

33. The Adjudicating Authority observed that the Corporate Debtor before the Hon'ble Tribunal is a Financial Service Provider Company as per the above sections, rules etc., and accordingly did not find any merit in the arguments of the Counsel for the Financial Creditor.

34. The Adjudicating Authority opined that the Applicant FC has not followed the Guidelines and filed this Application under section 7 of IBC in respect of a Financial Service Provider without following the due process of law, and rejected the Application.

35. While rejecting the Application, the Adjudicating authority made clear that though the ***Application*** filed under section 7 of IBC is rejected but the order of rejection will not affect the right of the Applicant to seek recourse, if otherwise eligible, before other forum(*s*) as the Petitioner may determine to proceed.

B. FAILURE/CONCEALMENT ON THE PART OF THE CORPORATE DEBTOR TO DISCLOSE HIS STATUS AS FINANCIAL SERVICE PROVIDER IN KYC SUBMITTED TO THE FINANCIAL CREDITOR:

In the matter of M/s Arkay International Finsec Limited:

36. An appeal[58] was preferred to the National Company Law Appellate Tribunal, New Delhi, by a shareholder of M/s. Arkay International Finsec Ltd, against the order IA No. 203/JPR/2019 IB - 596(ND)/2018 TA No. 116/2018[59], of the National Company Law Tribunal, Jaipur Bench, vide which an application under Section 9 of the Insolvency and Bankruptcy Code, 2016 (in short 'Code') filed by M/s. Aditya Birla Money Ltd against M/s. Arkay International Finsec Ltd, (Corporate Debtor) was admitted by the Adjudicating Authority (National Company Law Tribunal, Jaipur Bench, Jaipur).

37. It was claimed by the Operational Creditor, that the Corporate Debtor availed the services of the Operational Creditor and had opened a trading account No. 1070913 through its Branch Office at Jaipur and started trading from September, 2017 and continued till November, 2017.

38. It was further claimed that after setting off the amounts to the account of the Corporate debtor, there was a debit balances, to be received from the Corporate Debtor. The Operational Creditor claimed that Notice Dt:21.12.2017 was sent to the Corporate Debtor claiming outstanding Rs. 28,90,835.10 with interest. However, the amount was not paid. Subsequently, Notice under section 8 was also issued on 15.03.2018. The Operational Creditor then filed Application under section 9 for the debt due and in default, and the Adjudicating Authority admitted the application.

39. It was submitted before the NCLAT that Appellant is NBFC which is exempted from the purview of "Corporate Person" under section 3(7) of the Insolvency and Bankruptcy Code, 2016. The Certificate of the Registration held by the Appellant along with the returns filed till date, were submitted to the Appellate Tribunal.

40. It was further submitted to the Appellate Tribunal that the Adjudicating Authority noted the above facts in the Impugned Order but still went ahead to analyse that in KYC form which was submitted by the Company to the Operational Creditor, it was not stated that the Corporate Debtor was NBFC.

41. On behalf of the Operational Creditor, a copy of the KYC Form, to submit that the Corporate Debtor claimed to be "Pvt. Ltd. Company" instead of selecting the Column "Financial Institution".

42. The Hon'ble Appellate Tribunal relied on the

[58] [2021] 128 taxmann.com 422, NCLAT, New Delhi Bench

[59] [2020] 116 taxmann.com 328 NCLT, Jaipur Bench

provisions of Section 3(7) of the code, and the learned Counsel for the Corporate Debtor submitted that there is no amendment to section 3(7) of IBC and the Corporate Debtor is still protected from application of provisions of IBC in view of said definition.

43. The Appellate Tribunal's attention was invited to the order of the Hon'ble Adjudicating Authority, wherein it had taken note of the conduct of the Corporate Debtor in concealing the information in the KYC.

44. The Hon'ble Appellate Tribunal took note of the Corporate Debtor's Certificate of NBFC registration no. 10.00021; Dated: March 3, 1998, issued by Reserve Bank of India, and Reserve Bank of India letter No. 244/09-10-207/2019-20, informing about the filing of the returns upto date by the Corporate Debtor.

45. The learned Counsel for the Appellant has relied on Judgement of Appellate Tribunal in the matter of "Randhiraj Thakur v. Jindal Saxena Financial Services (P.) Ltd; and also on Judgement of the Appellate Tribunal in the matter of "Saumil A. Bhavnagri v. Nimit Builders (P.) Ltd[60]. , wherein, the Bench made the following observations:

"This Bench finds itself in agreement with the law as explained by the Division Bench of this Tribunal (to which one of us - Justice A.I.S. Cheema was also Member). The definition of Corporate Person in Section 3(7) of IBC specifically provides that it shall not include "any financial service provider". Considering the Certificate issued by the Reserve Bank of India and also documents as placed on record by the Appellant - Corporate Debtor, we have no hesitation to hold that the Corporate Debtor in the present matter on date of Application being financial service provider, the provisions of IBC could not have been invoked against the Corporate Debtor. It would not be in the realm of Adjudicating Authority and thus, for this Tribunal to go into the details whether the conditions attached have been followed or not by the NBFC as held in the matter of HDFC (supra). If there is any violation of conditions, the aggrieved person may bring it to the notice of RBI to look into the same. According to us, whenever the Corporate Debtor demonstrates that it is financial service provider and supports the claim with evidence by Certificate by Reserve Bank of India, it is appropriate for the Adjudicating Authority to lay off its hands from such Corporate Debtor considering the definition of "Corporate Person", under section 3(7)."

46. After hearing both the parties, the Hon'ble Appellate Authority, was of the view that the Adjudicating Authority could not have initiated CIRP, when the Corporate Debtor did not fall in the concerned definition of 'Corporate Person' under IBC. Under section 3(8) "Corporate Debtor" means a corporate person who owes a debt to any person. The Application could not have been admitted as if by way of punishment for

[60] [2020] 114 taxmann.com 55/158 SCL 133, NCLAT, New Delhi Bench

concealing a particular fact in KYC. The conduct of the Corporate Debtor may attract any other action which the Operational Creditor may take. However, when it comes to invoking provisions of IBC, if the law has protected the financial service provider, IBC could not have been invoked in the manner in which it has been done, and according allowed the Appeal, and the Impugned Order of the Adjudicating Authority was set aside, thereby Section 9 application of IBC filed by Operational Creditor, against the Corporate Debtor, was dismissed, with consequential orders arising thereof.

47. Similar views were taken by the Adjudicating Authorities and the Appellate Authorities in the below mentioned cases, in connection with initiation of CIRP wherein corporate debtor was a person engaged in business of providing financial services in terms of registration granted to it by Reserve bank of India, in view of section 3(7), thereby they do not come within meaning of corporate person to whom provisions of Code were applicable and accordingly the CIRP applications filed against corporate debtors held was not maintainable:

(a) In the matter of Mrs. Parveen Chawla (OC) vs. MCF Finlease (P.) Ltd (CD)[61], before the National Company Law Tribunal, New Delhi Bench;

(b) In the matter of Punjab National Bank (FC) vs. Asharam Leasing and Finance Private Limited (CD)[62], before the National Company Law Tribunal, Kolkata Bench;

(c) In the matter of Randhiraj Thakur (for CD) vs. Jindal Saxena Financial Services Private Limited and another (FC)[63] before the National Company Law Appellate Tribunal, New Delhi Bench; Arising out of order dated 8th January, 2018 passed by National Company Law Tribunal, New Delhi Bench in C.A. No. 233(PB)/2017 in C.P. No. (IB)-84(PB)/2017[64]-Jindal Saxena Financial Services Private Limited vs. M/s. Mayfair Capital Pvt. Ltd.

(d) In the matter of Innovators Facade Systems Limited (OC) vs. Reliance Commercial Finance Limited (CD)[65], before the National Company Law Tribunal, Mumbai Bench;

(e) In the matter of Thirdwave Fiscal & Investment Services Pvt. Limited (FC) vs. Amit Vanijya Private Limited (CD)66, before the National Company Law Tribunal, Kolkata Bench.

C. SUO MOTO INITIATION OF CIRP BY THE RESERVE BANK OF INDIA, BASIS THE CREDIT INFORMATION AVAILABLE WITH IT, THAT THE FINANCIAL SERVICE PROVIDER, HAD COMMITTED DEFAULTS OF SIGNIFICANT AMOUNT IN RELATION TO FINANCIAL DEBT

[61] 141 taxmann.com 383, NCLT, New Delhi Bench - IB-788/ND/2020
[62] [2021] SCC OnLine NCLT 11444, NCLT, Kolkata Bench
[63] [2018] 98 taxmann.com 192, NCLAT, New Delhi Bench
[64] [2018] 90 taxmann.com 127, NCLT, New Delhi Bench
[65] 2019 SCC OnLine NCLT 29123, NCLT, Mumbai Bench
[66] 2023 SCC OnLine NCLT 278, NCLT, Kolkata Bench - C.P.(IB) No. 340/KB/2021

AVAILED BY IT FROM FINANCIAL CREDITORS AND DEFAULT WAS MORE THAN MINIMUM THRESHOLD AMOUNT AS STIPULATED UNDER SECTION 4(1):

48. An application[67] was filed by the Reserve Bank of India ("Appropriate Regulator") under section 227 read with section 239(2(zk) of the Insolvency and Bankruptcy Code, 2016, for initiation of CIRP against M/s. SREI Infrastructure Finance Limited (SIFL), the Financial Service Provider.

49. Before the Hon'ble Adjudicating Authority, it was averred on behalf of the Appropriate Regulator/RBI, that on the basis of credit information available to it, the RBI came to the conclusion that SIFL has committed defaults of significant amount in relation to the financial debt availed by it from various financial creditors;

50. In particular, UCO Bank has intimated vide its letter Dt: 07.10.2021, that the amount claimed to be in default in relation to working capital demand loan facility is Rs. 165,56,30,967.99. Of this the principal amount due is to the tune of Rs. 150.00 crore and the interest amount due is to the tune of Rs. 15,56,30,967.99.

51. Date of default with reference to repayment of principal sum is stated to be 13/02/2021. The default with reference to the interest amount is stated to be 01/11/2020. During the course of hearing, it was submitted that this was the earliest date of default, and that there are continuing defaults since then.

52. The relevant documents were placed before the Adjudicating Authority. The documents demonstrate that the account is in default with the status of "SMA-2", which means that the interest of principal has been overdue and remains unpaid for a period in excess of 60 days calculated in accordance with the RBI Master Circular on Prudential Norms on Income Recognition, Asset Classification and Provisioning pertaining to advances. E-mail communication evidencing classification of SIFL as a Red Flag Account by UCO Bank.

53. RBI vide its notification dated 04/10/2021, in exercise of its powers under section 45-IE of the Reserve Bank of India Act, 1934 has superseded the Board of Directors of SIFL and appointed Mr. Rajneesh Sharma as the Administrator. It has also constituted a three-member Advisory Committee to assist the Administrator of SIFL in the discharge of its duties. The RBI has proposed the same person to be appointed as the Administrator of the Corporate Debtor.

54. On behalf of the Appropriate Regulator, it was submitted that in view of the huge default committed by the respondent/FSP, there was a need to initiate CIRP against the respondents with speed, and according urged the Adjudicating Authority to pass appropriate orders expeditiously keeping in view the public interest in the matter.

[67] [2021] 133 taxmann.com 180, NCLT, Kolkata Bench -CP (IB) No. 295/KB/2021

55. The Adjudicating Authority was also informed that the challenge to the notification dated 04/10/2021 issued the RBI, in Writ Petition[68], was dismissed by the Hon'ble Bombay High Court vide order dated 07/10/2021.

56. The process of CIRP was discussed and accordingly, pursuant to Rule 5(a)(i) of the Insolvency and Bankruptcy (Insolvency and Liquidation Proceedings of Financial Service Providers and Application to Adjudication Authority) Rules, 2019, no CIRP shall be initiated against an FSP which has committed a default under section 4, except upon an application made by the appropriate regulator in accordance with rule 6. Sub-clause (ii) thereof which specifies that an application under sub-clause (i) shall be dealt with in the same manner as an application by a financial creditor under section 7.

57. Accordingly, the first requisite to be seen by the Adjudicating Authority is whether present petition satisfies the ingredients of section 7 of the Code. For this the existence of debt and default are required to be proved to the satisfaction of the Adjudicating Authority. The Adjudicating Authority was briefed of the debt and default, the total amount of the default being in excess of limits prescribed under section 4 of the Code i.e., Rs.1 Crore presently

58. Further the Adjudicating Authority was also informed that the present petition is also not hit by limitation.

59. On perusal of the documents and records, the Adjudicating Authority was of the view that records prima facie prove that there has been a default and that the sum involved in such default is in excess of the threshold limit of one crore rupees prescribed at present under section 4(1) of the Code. Moreover, since the sanction letters are in the year 2018 onwards and date of default from November 2021, the petition is not hit by limitation, and accordingly, satisfied that the case is a fit case for initiation proceedings under section 227 read with rule 5 of the Rules ibid, since the debt in question qualifies as financial debt under section 5(8) read with section 3(11) of the Code.

60. The Adjudicating Authority also noted that RBI vide its notification dated 04/10/2021 has superseded the Board of SIFL and appointed Mr. Rajneesh Sharma, ex-Chief General Manager, Bank of Baroda as the Administrator. The RBI has proposed the name of Mr. Rajneesh Sharma as the Administrator of the Corporate Debtor. He has also filed his written consent in Form 2 to act as such Administrator. The Adjudicating Authority directed the Administrator to file to file a fresh Form 2 with his unconditional consent to act as Administrator, as the one filed along with the petition were loaded with conditions relating to his engagement.

61. After filing the Petition to be in order, the Adjudicating Authority made the following orders:

[68] Writ Petition (Lodging) No. 22872/2021, before the Hon'ble Bombay High Court

a. The Petition bearing CP (IB) No. 295/KB/2021 filed by the Reserve Bank of India, the Appropriate Regulator, under section 227 of the Code read with rule 5 of the Insolvency & Bankruptcy (Insolvency and Liquidation Proceedings of Financial Service Providers and Application to Adjudicating Authority) Rules, 2019 for initiating Corporate Insolvency Resolution Process against SREI Infrastructure Finance Limited [CIN: L29219WB1985-PLC055352], the Financial Service Provider, is hereby admitted.

b. There shall be a moratorium in terms of section 14 of the Code in respect of Financial Service Provider.

c. The moratorium shall have effect from the date of this order till the completion of the CIRP or until this Adjudicating Authority approves the resolution plan under section 31(1) of the IBC or passes an order for liquidation of the Financial Service Provider under section 33 of the Code, as the case may be.

d. A public announcement of the CIRP shall be made immediately as specified under section 13 of the Code.

e. In terms of rule 5(a)(iii) of the Rules ibid, Mr. Rajneesh Sharma, 17-B, Shanaz Apartments, 90 Napean Sea Road, Mumbai 400006, e-mail id: sreiadministrator@srei.com; rajneesh_1961@yahoo.co.in, is hereby appointed as Administrator of the Financial Service Provider to carry out the functions as per the Code, subject to his filing his unconditional consent in Form 2 to act as such Administrator. The Administrator shall carry out his functions as contemplated by sections 15, 17, 18, 19 and 20 of the Code.

f. During the CIRP period, the management of the Financial Service Provider shall vest in the Administrator. The officers and managers of the Financial Service Provider shall provide all documents in their possession and furnish every information in their knowledge to the Administrator within one week from the date of receipt of this Order, failing which coercive steps will follow.

g. The Registry is hereby directed to communicate this Order to the Petitioner/Reserve Bank of India and the Administrator by Speed Post, e-mail immediately.

62. Additionally, the Administrator shall serve a copy of this Order on the Registrar of Companies, West Bengal, Kolkata by all available means for updating the Master Data of the Financial Service Provider. The said Registrar of Companies shall send a compliance report in this regard to the Registry of this Court within seven days from the date of receipt of a copy of this order.

Insolvency and Bankruptcy Code

Important Aspects in IBC Law - Revisited Through Recent Judgements.

Along with new legislations come interpretation issues on the various aspects involved therein. The landmark legislation of Insolvency and Bankruptcy Code (IBC) is not an exception to the same. Enacted in 2016, with an aim to streamline and expedite the resolution process for distressed companies, it has given rise to various interpretational issues, which have been mostly settled by the Adjudicating Authorities, Appellate Authorities, and thereon by the Apex Court. As the saying goes, "every day is a new learning", cases filed before the Adjudicating Authorities, followed by the Appellate Authorities, bring to table the debate on peculiar aspects in the already settled issues. The Article is an attempt to understand such intricate issues in the Code, taking the assistance settled cases and the view taken by the Adjudicating Authorities, Appellate Authorities followed by the Apex Court.

-Contributed by CS D V K Phanindra & CA Sri Harsha
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1. The Insolvency and Bankruptcy Code (IBC) is a landmark legislation that revolutionized India's insolvency and bankruptcy framework. Enacted in 2016, the IBC aimed to streamline and expedite the resolution process for distressed companies while protecting the interests of all stakeholders involved. There are some key terms/concepts, which are the core to the IBC law, some of them being "**Debt**", "**Default**", "**Dispute**", "**Claim**", "**Threshold**". In relation to most of the definitions /concepts/terms, the law is well settled. As the law is evolving, there emanate many scenarios, which require the necessity to re-visit the already settled provisions. In this Article an attempt is made to discuss on the some of such issues, settled through recent case laws.

<u>A. On the issue of "THRESHOLD LIMIT":</u>

2. An Appeal[69] was preferred before the Hon'ble National Company Law Appellate Tribunal (**NCLAT**), New Delhi Bench, arising out of the Order[70] Dt: 04.04.2022, of the Hon'ble National Company Law Tribunal, Mumbai Bench, by the suspended Director of the Corporate Debtor M/s. Vatsalya Builders and Developers Private Limited, wherein CIRP (Corporate Insolvency

[69] Comp. App. (AT) (Ins.) No. 498 of 2022, New Delhi Bench (Prafulla Purushottamrao Gadge v. Narayan Mangal)

[70] CP (IB) No. 725 (MB) 2021, NCLT, Mumbai Bench.

Resolution Process) was initiated against the Corporate Debtor for the default of Rs.78,65,000/.

Facts of the case:

3. During October, 2019, Mr. Narayan Mangal, the Financial Creditor filed an Application[71] under Section 7 of IBC for an amount of Rs.63,20,388/- against M/s. Vatsalya Builders and Developers Private Limited. During the course of the proceedings, both the parties came to a settlement, and to this effect, entered in a Settlement Agreement Dt; 12.12.2019. The same was informed to the NCLT, Mumbai Bench, and the case was dismissed as withdrawn on 13.12.2019.

4. In the meanwhile, the Central Government vide Notification Dt: 24.03.2020, has increased minimum threshold limit of default from Rs.1,00,000/- to Rs.1,00,00,000/, for the purpose of filing an Application under Part-II of the IBC.

5. Since the settlement terms were not honoured by the Corporate Debtor, Mr. Narayan Mangal, the Financial Creditor, filed another application on 25.06,2021, under Section 7 of IBC for an amount of Rs. 78,65,000/-. During the course of the hearing, on behalf of the Corporate Debtor, the execution of the said Settlement Agreement between the parties, was denied. However, the Tribunal noted that there was a breach of consent terms by the Corporate Debtor and the same is established by the fact that the post-dated cheques were bounced and there is a default in terms of payment of debt. The Tribunal concluded that the nature of Debt is a "Financial Debt" as defined under section 5(8) of the Code, and there is a "Default" as defined under section 3(12) of the Code on the part of the Corporate Debtor. Further the Petition was also well within the period of limitation, and vide order Dt: 04.04.2022, admitted the application and put the Corporate Debtor to CIRP.

Before the NCLAT:

6. At the appeal stage, the Corporate Debtor, submitted that the application of the Financial Creditor Dt: 25.06.2021 under Section 7 has to fulfil the requirements of threshold as introduced by Notification dated 24.03.2020, and the Adjudicating Authority has not adverted to the said issue and has admitted the Application.

7. Provisions of Clause 12 of the Settlement Agreement were referred during the arguments, where it was mentioned that in event, any default is committed in the Settlement Agreement, the Financial Creditor shall be liberty to initiate fresh legal proceedings under Section 7.

8. It was further submitted before the Appellate Tribunal that, post the withdrawal order, the Financial Creditor had filed an Interlocutory Application (I.A) No. 1128/2020, for restoration of the Section 7 Application, withdrawn on 13.12.2019. The Adjudicating Authority rejected the IA and refused to restore the earlier Section 7 Application, as the said order has become final.

[71] C.P. (IB)/3701(MB)2019, NCLT, Mumbai Bench.

9. On behalf of the Financial Creditor, it was submitted that the Application Dt:25.06.2021, is in continuation of the earlier Application filed by him which was later withdrawn, 2019 when no threshold of one Crore was applicable as the increased threshold was only introduced on 24.03.2020. Accordingly the Section 7 Application was maintainable.

Findings and Order by NCLAT:

10. The Appellate Tribunal did not agree with the submissions of the Financial Creditor that the Section 7 filed on 25.06.2021, is in continuation to earlier filed Section 7 application, which was withdrawn.

11. The Appellate Tribunal held that the Adjudicating Authority committed error in admitting the Application under Section 7 by the Financial Creditor as the same was not fulfilling the threshold of Rs.1 Crore, introduced by Notification dated 24.03.2020.

12. The Appellate Tribunal while setting aside the Order Dt: 04.04.2022, had stated that it has gone in to the merits of the contentions of the parties and the Appeal was allowed only on the ground of not fulfilling the threshold of Application under Section 7. The Appellate Authority further of the view that the provisions of Clause 12 of the Settlement Agreement Dt: 12.12.2019, provide to the Financial Creditor, that in the event of any default, is committed in the Settlement Agreement, by the Corporate Debtor, the Financial Creditor shall be liberty to initiate fresh proceedings under Section 7, but the same shall be subject to the compliance of the provisions of the Law.

B. In case of Operational Creditor (OC), "HOW TO ARRIVE AT THRESHOLD", i.e., only PRINCIPAL or PRINCIPAL + INTEREST:

13. An Application[72] was under Section 9 of the Insolvency and Bankruptcy Code, 2016 read with rule 6 of the Insolvency and Bankruptcy (Application to Adjudicating Authority) Rules, 2016, by M/s. Plastofab (Operational Creditor), seeking to initiate Corporate Insolvency Resolution Process ("CIRP") against M/s. Electroteknica Switchgears Private Limited ("Corporate Debtor").

Facts of the case:

14. Pursuant to an agreement between the Corporate Debtor and the Operational Creditor, there are was an arrangement for supply of Epoxy resin molded component and instrument transformer for switchgear.

15. Accordingly, various invoices were raised by the Operational Creditor between 26.11.2012 and 28.11.2013, which were received by the Corporate Debtor without demur. However, the Corporate Debtor failed to make full payment of the sums due thereunder. In or around 2012, hundis were sent by the Corporate Debtor for encashment by the Operational Creditor towards payment of the said dues, however, the same

[72] (2022) ibclaw.in 358 NCLT; NCLT, Kolkata Bench - CP(IB) No. 62/KB/2021

were not encashed due to insufficient funds.

16. A Demand Notice Dt:23.06.2015, was issued to the Corporate Debtor, thereby demanding the repayment of **Rs. 65,42,956/- along with interest @ 18%.** Thereafter, a letter of acknowledgement dated 21.07.2015 was sent by the Corporate Debtor for negotiation to mutually settle the old dues. The parties reached a settlement for repayment of dues by the Corporate Debtor. A balance of confirmation was issued by the Corporate Debtor on 31.03.2016 and thereafter a confirmation of dues was issued by the Corporate Debtor on 01.08.2017.

17. Subsequently, demand notices under Section 8 of the Code was issued by the Operational Creditor on 20.11.2020, and 25.11.2020 and the said notices were successfully delivered to the Corporate Debtor.

18. During the hearing, it was averred on behalf of the Corporate Debtor that effective from 24.03.2020, the threshold limit to institute CIRP proceedings has been increased from Rs.1 lakh to Rs.1 Crore. Since the petition was filed after 24.03.2020 and in the instant petition, the principal amount in default was Rs. 45,33,363/-. It was averred by the Corporate Debtor that the Operational Creditor has used the interest component being Rs. 68,23,688/- to make the total debt due cross the threshold of Rs. 1 Crore. The decision taken by Learned National Company Law Tribunal (NCLT), New Delhi in the matter of M/s. CBRE South Asia Private Limited vs. M/s. United Concepts and Solutions Private Limited[73], was relied upon by the Corporate Debtor.

19. Further, the Corporate Debtor has claimed that the instant petition is barred by limitation and that the demand notices under section 8 of the Code were not delivered to it. The Corporate Debtor has claimed that no email regarding the same was delivered to it and the postal receipts of the physical notices indicate that the said notices were returned to GPO Kolkata

Findings and Order by NCLT:

20. The Adjudicating Authority observed that the Operational Creditor had arrived at the threshold of Rs. 1 Crore, by clubbing together the principal sum of Rs. 45,33,363/- and the interest of Rs. 68,23,688/-. The Adjudicating Authority relied on the decision of the NCLT, New Delhi in the matter of CBRE South Asia Private Limited vs. M/s. United Concepts and Solutions Private Limited, wherein it was held that:

"-------it can be inferred that the 'interest' can be claimed as the financial debt, but neither there is any provision nor there is any scope to include the interest to constitute as the operational debt."

21. In reply to the contentions of the Operational Creditor that since the date of default precedes 24.03.2020, the limit of Rs. 1 Crore shall not be applicable to the instant petition, the Adjudicating Authority, relied on the judgement of Hon'ble NCLAT in the matter of Jumbo Paper

[73] CP(IB)- 797(ND)2021, NCLT, New Delhi Bench.

Products vs. Hansraj Agrofresh Pvt. Ltd.[74], wherein at Para 10 of the said Order, the Hon'ble NCLAT held that:

> *"10. The other judgments cited by learned Counsel for Appellant broadly lay down that any statute/law can be applied retrospectively only if explicit provision regarding its retrospective application is made in the statute. It is seen that notification dated 24.3.2020 (supra) makes it unambiguously clear that the threshold limit to be considered for section 9 application will be Rs. 1 crore. This threshold limit will be applicable for application filed u/s 7 or 9 on or after 24.3.3020 even if debt is of a date earlier than 24.3.2020. Since the application under section 9 which is the subject matter of this appeal was filed on 13.9.2020, therefore the threshold limit of Rs. 1 crore of debt will be applicable in the present case."*

22. Accordingly, the Adjudicating Authority without going in to the merits of the Section 9 Application, held that the interest component cannot be clubbed with the Principal Debt to arrive at the minimum pecuniary threshold of Rs. 1 Crore. The Adjudicating Authority further held that the threshold limit of Rs. 1 Crore will be applicable for applications filed under Section 7 or 9 of the Code, on or after 24.3.3020 even if the date of default precedes 24.3.2020, and is accordingly dismissed the petition.

C. In case of Financial Creditor (FC), can "ONLY INTEREST ON AN ALREADY REPAID DEBT", constitute "DEBT", "CLAIM" AND "THRESHOLD":

23. A Joint Application[75] was filed by M/s. Saraf Chits Private Limited and M/s. VKSS International Private Limited, (Financial Creditors) under the Section 7 of the Insolvency and Bankruptcy Code, 2016 (for brevity, the **'IBC, 2016'**) read with Rule 4 of the Insolvency and Bankruptcy (Application to Adjudicating Authority) Rules, 2016 against M/s. KAD Housing Private Limited ("Corporate Debtor").

24. The total unpaid Financial Debt claimed by the Applicants amounted to Rs.1,76,04,484/- and the date of default is in July, 2019.

25. During the submissions, it was stated on behalf of the Financial Creditors that the principal amount of Rs 1.5 Crore in respect of M/s. Saraf Chits Private Limited, was already been paid by the Corporate Debtor and only an amount of Rs. 64 lakh is left to be paid towards the interest component.

26. The Adjudicating Authority directed the Applicants, to convince the Bench on the maintainability of the application since, the defaulted amount subsisting has been less than Rs. 1 Crore. In response, the Applicants stated that the term "financial debt" as defined under Section 5(8) of IBC, 2016 includes the interest component, and as the Principal component was repaid during the pendency of the suit, their

[74] Company Appeal (AT) (Ins) no. 813 of 2021, NCLAT, New Delhi Bench.

[75] (IB)-255(ND)/2021, NCLT, New Delhi Bench.

application is maintainable.

27. On the other hand, the Corporate Debtor averred that since the principal amount has been paid by the Corporate Debtor, the petition needs to be dismissed.

Findings and Order by NCLT:

28. On considering the above, the issue before the Adjudicating Authority, was **"Whether the CIRP can be initiated / triggered solely on the basis of the un-paid amount of interest** when **the entire principal amount of debt has been discharged by the Corporate Debtor?"**.

29. The Adjudicating Authority discussed the definition "financial debt" as defined under Section 5(8), "Debt", defined in Section 3 (11) and "Claim" defined in Section 3 (6) of IBC, 2016.

30. Reliance was also placed by the Adjudicating Authority to Judgment of Hon'ble NCLAT in the matter of S. S. Polymers *v.* Kanodia Technoplast Ltd.[76], wherein, the NCLAT opined as follows:

"5. Admittedly, before the admission of an application under Section 9 of the I&B Code, the 'Corporate Debtor' paid the total debt. The application was pursued for realisation of the interest amount, which, according to us is against the principle of the I&B Code, as it should be treated to be an application pursued by the Applicant with malicious intent (to realise only Interest) for any purpose other than for the Resolution of Insolvency, or Liquidation of the 'Corporate Debtor' and which is barred in view of Section 65 of the I&B Code.."

31. Concurring with the decision of the Hon'ble NCLAT, the Adjudicating Authority inferred that the "interest" component alone cannot be claimed or pursued, in absence of the debt, to trigger a CIR process against the corporate Debtor. Further, the Adjudicating Authority also of the view that the application pursued for realization of the interest amount alone is against the intent of the IBC, 2016, and dismissed the Application.

D. In case of Financial Creditor (FC), can "ONLY INTEREST WHICH FELL DUE AND PAYABLE" constitute a "DEFAULT", even though the Principal amount was not due:

32. An Appeal[77] was preferred before the Hon'ble National Company Law appellate Tribunal (**NCLAT**), New Delhi Bench, arising out of the Order[78] Dt: 23.05.2022, of the Hon'ble National Company Law Tribunal, New Delhi Bench, by which an application filed by the Appellant under Section 7 of the Insolvency and Bankruptcy Code, 2016 (in short 'Code') has been dismissed on the ground that amount of interest only claimed by the Appellant is not covered by the definition of financial debt and the application under Section 7 of the Code is not maintainable.

[76] Company Appeal (AT) (Insolvency) No. 1227 of 2019, NCLT, New Delhi Bench

[77] Company Appeal (AT) (Ins.) No. 882 of 2022, NCLAT, New Delhi.

[78] IP-121/ND/2022, NCLT, New Delhi Bench.

Facts of the case:

33. The Financial Creditor was a Debenture holder of the Corporate Debtor, and the said Debentures were to be redeemed by 31.03.2026. However, the same may be redeemed by the Corporate Debtor at any time, and can be requested for redemption by the Financial Creditor after the expiry of 1 year of the issue of the Debenture Certificate. As per the terms of the issue of Debenture, the Debenture holder was entitled to get interest @ 6% per annum payable on face value plus security premium on quarterly rests.

34. The interest and security premium were due and payable on 01.07.2021, 01.10.2021 and 01.01.2022, we re not paid by the Corporate Debtor. Accordingly, an application was filed for the default of interest amount for the period of 3 quarters for the FY 2021-22.

Before the NCLT:

35. On behalf of the Corporate Debtor, it was averred that the debt claimed by the Financial Creditor is only the interest amount and not the Principal amount, and as the Principal amount is not due, the same shall not constitute a Financial Debt.

36. The Adjudicating Authority perused through the Debenture issue terms and found that the Financial Creditor has the right to seek for redemption of the Debenture along with Security Premium and interest, after the expiry of 1 year of the issue of the Debenture Certificate. However, in the present case the Financial Creditor has not claimed for the Principal amount which is due and payable, but only for the defaulted amount of interest.

37. The Adjudicating authority referred to many definitions under the Code, and placed reliance on Section 5(8) of the Code, wherein it is seen that "a Debt along with interest, if any, which is disbursed against the consideration for the time value of money comes under the definition of financial debt and includes various other items mentioned therein.

38. To initiate CIRP under Section 7 of the code, the prime consideration is that there must be existence of debt and only thereafter interest shall be added in the principal debt amount. The Adjudicating Authority was of the view that since in the present case, the Principal amount did not become due and payable, there is no debt due and payable. Accordingly, there is no default in the payment of the amount, and only interest amount claimed by the applicant, does not come under the definition of Financial Debt, and dismissed the Application of the Financial Creditor as not maintainable. Aggrieved, the Financial Creditor preferred the appeal.

Before the NCLAT:

39. Before the Appellate Tribunal on behalf of the Financial Creditor it was argued that an application under Section 7 of the Code shall be maintainable even on the component of interest if it crosses the threshold limit being part of the financial debt. In this regard, it is submitted that the financial debt is a debt with interest if any, disbursed against the consideration for the time value of money and includes debentures.

Reliance was placed to the decision of the Hon'ble Supreme Court in M/s Orator Marketing Pvt. Ltd. Vs. M/s Samtex Desinz Pvt. Ltd.[79], wherein has held that interest free loan is a financial debt and the application under Section 7 was held to be maintainable. It is submitted that on the same analogy the interest which became due and payable would attract the provisions of Section 7 of the Code.

40. On behalf of the Corporate Debtor, it was argued that as per the scheme of the Code, the financial debt means the debt along with interest and not the interest independently and further submitted that Adjudicating Authority was correct in rejection the application of the Financial Creditor. It is also argued that the decision in the case of M/s Orator Marketing Pvt. Ltd. (supra), relied upon by the Appellant is not applicable because it deals with the aspect of principal amount though advanced without interest which had become due and payable.

Findings and Order by NCLAT:

41. The Appellate Tribunal referred to the relevant definitions appearing in Part I and Part II of the Code, and explaining the scheme with the help of the decision in the case of Innovative Industries Ltd[80], and taking a cue from the decision of the Hon'ble Supreme Court in the case of M/s Orator Marketing Pvt. Ltd. (Supra), the Appellate Tribunal was of the opinion that in the facts and circumstances, the application filed under Section 7 of the Code could be maintained in respect of the component of interest which became due and payable, without asking for the principal amount which has not yet become due and payable, only if the financial creditor has to show the "default" as a condition precedent.

42. Accordingly, allowed the appeal filed by the Financial Creditor, and setting aside the order of the Adjudicating Authority.

[79] Civil Appeal No. 2231 of 2021

[80] (2018) 1 SCC 407

OTHER RELEVANT JUDGEMENTS:

In line with the above, there are some other cases, which were decided by the Adjudicating Authority/Appellate Authorities, the gist of which are provided below.

Sl. No.	Nature of Claim/Debt/Default	Decision of the Adjudicating Authority
1.	Whether non deposit of TDS amount to "DEFAULT", and accordingly, can IBC proceedings be initiated.	The NCLT[81] held that the same to be treated as default and admitted the application filed by the OC. Aggrieved with the Order of the Adjudicating Authority, an appeal was preferred. Hearing the Appeal[82], the Appellate Tribunal, held that an application under Section 9 of the Insolvency and Bankruptcy Code, 2016 ("IBC") **CANNOT** be admitted over defaults relating to non-payment of TDS (Tax Deduction at Source) amount.
2.	Whether "Time Barred Salary" is an "Operational Debt" and non payment of the same constitutes "DEFAULT", and accordingly, can IBC proceedings be initiated.	On an Application[83] filed by the ex-Director of the Corporate Debtor for claim of unpaid salary, the NCLT held that the non payment of salary, to be treated as default and admitted the application filed by the OC. The NCLT viewed that the Application of the OC was not time barred. On Appeals[84] by a group Company and the suspended Director of the Corporate Debtor, after going through the documents, the Appellate Tribunal, held that the Adjudicating Authority has not addressed either to the question of claims having been time barred nor

[81] CP.(IB)/1686(KB)/2018, NCLT, Kolkata Bench (Masters Development Management (India) Pvt. Ltd., vs. Bellagio Projects Private Limited.

[82] Company Appeal (AT) (Insolvency) No. 274 of 2022, NCLAT, New Delhi (Amitabh Roy v Master Development Management (India) Pvt. Ltd)

[83] CP.(IB)-529/ND/2021, NCLT, Delhi Bench (Anil Agarwal vs. Omega Icehill Private Limited)

[84] Company Appeal (AT) (Insolvency) No.194 of 2022, NCLAT, New Delhi

		to the issue of the existence of a 'Pre-Existing Dispute' between the parties. Accordingly, set-aside the orders of the Adjudicating Authority. Accordingly, a Time barred Salary cannot constitute "DEFAULT", and accordingly, proceedings cannot be initiated against the Corporate Debtor under IBC.
3.	Whether "Gratuity Payment" is an "Operational Debt" and non payment of the same constitutes "DEFAULT", and accordingly, can IBC proceedings be initiated	Applicant worked as an employee of the Corporate Debtor and attained superannuation on 31.10.2016 and an amount of Rs. 16.80 lakhs which includes gratuity, EL Encashment, LTC was payable to the Appellant by the Corporate Debtor but the same was not paid. The NCLT[85] rejected the Application, and dismissed the Section 9 Application, as they do not constitute "Operational Debt". Aggrieved with the Order of the Adjudicating Authority, an appeal was preferred by the OC. Hearing the Appeal[86], the Appellate Tribunal, while categorizing the dues out of service in two categories namely "service claims" which includes salary, wages, bonus and "Welfare Claims" which arise after the cessation of employment such as gratuity, leave encashment, superannuation dues which will be dependent on the tenure of the employment. It further held that though 'service benefits' like 'LTC' accrue, on account of the service rendered

[85] C.P. (IB) No. 1060/MB/2019, NCLT, Mumbai Bench (*Kishore K Lonkar vs. Hindustan Antibiotics Ltd)*
[86] Company Appeal (AT) (Insolvency) No. 934 of 2021 (Kishore K Lonkar vs. Hindustan Antibiotics Ltd)

		during the period of employment, the scope and objective of the Code is simply not just for recovery of 'dues' but Resolution of the Companies meant for 'maximization of the value of assets', to promote entrepreneurship, availability of credit and balance all interest of the stakeholders. The Appellate Tribunal in that these claims can be filed before the Resolution Professional after the initiation of CIRP, but it is not the intent and objective of the code to put the Corporate Debtor in to CIRP, on the ground of non-payment of LTC and EL Encashment, and dismissed the Appeal.
4.	Whether "Salary during Notice period", is an "Operational Debt" and non payment of the same constitutes, "DEFAULT", and accordingly, can IBC proceedings be initiated?	Applicant was employed as CFO of the Corporate Debtor Company. On 14.11.2019, the Operational Creditor resigned from the job prior to Board meeting and the Notice Period to be served ends on 12.02.2020. The Operational Creditor despite sending several e-mails seeking dues owed by the Corporate Debtor, the Corporate Debtor failed to respond. There was notice period of 2 months. On being not paid the salary for the notice period, the Applicant filed an Application[87] before the Adjudicating Authority, under Section 9 of the Insolvency and Bankruptcy Code, 2016 ("IBC") for resolution of salary of 02 months for the purported notice period.

[87] C.P.(IB)-678(MB)/2020, NCLT, Mumbai Bench.

		The perusal of the documents, submitted and the going through legal position, the Adjudicating Authority was opinion that the claim does not fall under the definition of "Operational Debt" as it was not for the salary for the actual work done by the Operational Creditor. Therefore, this Bench is of the considered opinion that the remedy of the Operational Creditor is to initiate necessary legal proceedings for recovery before appropriate legal forum and not through the route of IBC.

Audit & Assurance

Lapses in Corporate Governance & Auditing Ethics in 'Café Coffee Day' group

In the wake of SEBI and NFRA investigation into the Café coffee day group for the lapses in the corporate governance and audit aspects it is important to understand the reliance placed on the corporate governance and the responsibility of the management and the auditors to ensure the compliance of it. In this article let us understand the findings of the SEBI investigation on the Coffee Day Enterprises Limited (CDEL) and the NFRA investigation on the Auditors of the Café coffee day group making them responsible for the irregularities identified.

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1. Corporate Governance is a vital aspect of modern business that ensures transparency, accountability, and responsible decision-making within organizations. It refers to the system by which companies are directed and controlled, involving the balance of interests among various stakeholders such as shareholders, management, customers, suppliers, financiers, government, and the community. An effective corporate governance framework is the bedrock of ethical conduct, sustainable growth, and long-term success for companies, fostering investor confidence and strengthening the overall economic system. It is needless to discuss in detail the importance of Corporate Governance.
2. With the business going global, transparency, accountability is required on a multi-fold level, and in view of its importance, many initiatives have been brought by the Securities Regulator in India, SEBI. In view of the having such greater importance, the Organisation for Economic Co-operation and Development (OECD) has formulated Principles[88] of Corporate Governance, to help policy makers evaluate and improve the legal, regulatory, and institutional framework for corporate governance, with a view to supporting economic efficiency, sustainable growth and financial stability.
3. On one hand while discussing the importance of Corporate Governance and the regulators putting all sorts of checks and balances to ensure transparency, accountability, and responsible decision-making takes place in the organizations, the other-side of the coin has many instances of serious lapses of transparency in operations and lack of accountability towards the stake holders.
4. Corporate Governance and Sustainability are interrelated. An ethically driven governance

[88]https://www.oecd.org/corporate/ca/Corporate-Governance-Principles-ENG.pdf

framework enhances a company's ability to integrate sustainability practices into its operations. Sustainable business practices aim to balance environmental, social, and economic factors, thereby creating long-term value for all stakeholders. Any manner of slackness results in enrichment of a few, loss of value to the stakeholders, and irreparable damage to the image of the Entity as well as the Economy as a whole. For the lenient attitude in discharging of the Statutory duties by the Professionals, they are unnecessarily termed as being hand-in-glove with the Management, and are robbed into investigations.

5. Sector specific regulators take stalk of the situation in respect of the Companies and Corporates, flouting the regulations. Now, with the advent of National Financial Reporting Authority ("NFRA"), and it being vested with powers, the Professionals have been cast up on the duty to discharge their Audit services in a more responsible manner.

6. Having discussed the position of the law, let us now proceed in this article, to briefly analyse the lapses found during the investigation conducted by Securities and Exchange Board of India (SEBI), in connection with the diversion of funds among to Rs.3,535 crores from Seven (07) subsidiary companies of **Coffee Day Enterprises Limited** (for brevity '**CDEL**'), a listed company to **Mysore Amalgamated Coffee Estate Limited** (for brevity '**MACEL**'), an entity owned and controlled by the promoters of CDEL, and as a consequence, the investigations conducted by NFRA, against the Statutory Auditors, in accordance with the powers vested under Section 132 (4) of the Companies Act, 2013.

Introduction

7. CDEL is the parent company of Coffee Day Group. The Company, primarily through its subsidiaries, associates and joint venture companies, does business in multiple sectors such as coffee retail and exports, leasing of commercial office space, financial services, Integrated Multimodal Logistics, Hospitality and Information Technology (IT) / Information Technology Enabled Services (ITeS).

8. The downfall of Coffee Day Enterprises Limited (CDEL), started following the tragic suicide of its Chairman, Mr. V.G. Siddhartha (for brevity '**VGS**'), in July 2019, and his suicide note that he was in deep debt, sparked a series of investigations by the Company on its own and also by the Regulator Authorities. Both SEBI and NFRA conducted comprehensive inquiries into the diversion of funds from CDEL group to MACEL, an entity owned by the promoters of CDEL.

SEBI Order on CDEL:

Background and Investigation:

9. SEBI initiated a suo moto investigation, to ascertain any diversion of funds to related entities which resulted in possible violation of provisions of SEBI (Prohibition of Fraudulent and Unfair Trade Practices Relating to Securities Market) Regulations, 2003 (for brevity "PFUTP Regulations") and /or SEBI (Listing Obligations

and Disclosure Requirements, Regulations, 2015 (for brevity "LODR Regulations"). The following are the brief findings of the Investigation.

A. Diversion of Funds:

10. The SEBI order[89] on CDEL was a result of an extensive investigation into the diversion of funds amounting to **Rs.3,535 Crores** from **Seven (07)** of its subsidiaries to MACEL, as per the details below:

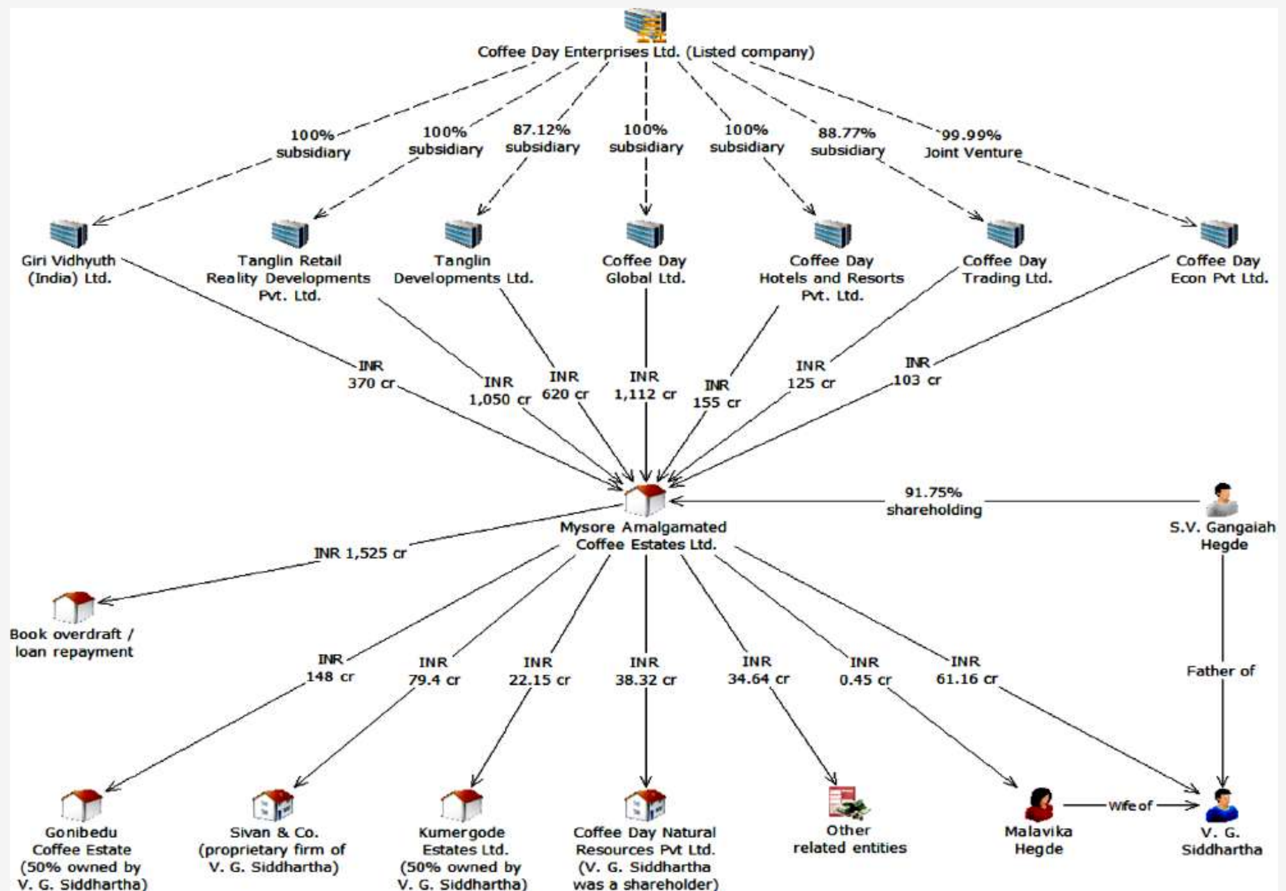
Rupees in Crores

Sl. No.	Name of the Subsidiary of CDEL	Outstanding Dues from MACEL	
		As on 31.03.2019	As on 31.07.2019
1.	Coffee Day Global Limited	65	1,112
2.	Tanglin Retail Reality Developments Private Limited	789	1,050
3.	Tanglin Developments Limited	-12	620
4.	Giri Vidhyuth (India) Limited	-	370
5.	Coffee Day Hotels and Resorts Private Limited	-	155
6.	Coffee Day Trading Limited	-	125
7.	Coffee Day Econ Private Limited	-	103
	Total	**842**	**3,535**

11. The investigation brought to light that late VGS, the Chairman of CDEL, was instrumental in making decisions to transfer these funds. The diverted funds were then routed to entities related to VGS and his relatives, leading to suspicions of fraudulent activities.

[89] SEBI Final Order No. WTM/ASB/CFID/CFID_1/23008/2022-23; Dt: 24.01.2023

12. A Pictorial[90] presentation of the money trail from CDEL to MACEL and further down flow, is as below:

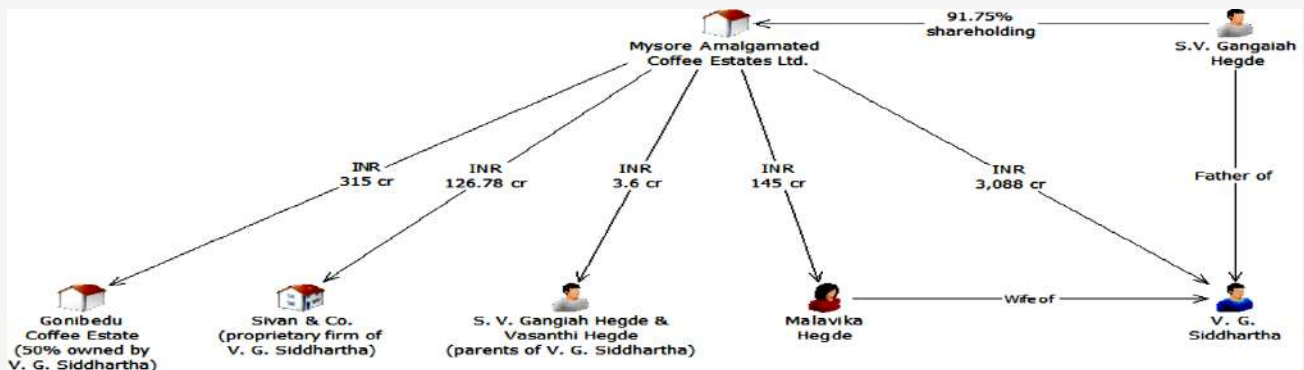


13. During the course of investigation, it was informed by MACEL that a total of Rs. 384.12 crores was transferred from MACEL to VGS and related parties, which can be seen in the second stage of flow of funds from MACEL, in the picture above.

14. However, based on independent analysis of bank statements of MACEL done by SEBI with the information provided by CA Lavitha Shetty (Auditor of MACEL), SEBI observed that the outstanding balances from VGS and his related entities to MACEL as on July 31, 2019, were much higher than what were informed by MACEL.

[90] Source-SEBI Final Order No. WTM/ASB/CFID/CFID_1/23008/2022-23; Dt: 24.01.2023

15. A Pictorial[91] presentation of the money trail from MACEL to VGS and his related entities is as below:



B. Impact on Share Price:

16. SEBI's investigation also analysed the impact of the fund diversion on the price movement of CDEL's scrip. The news of death of VGS and the involvement of the Coffee Day family in the financial transactions became public knowledge, resulting in a significant decline in the share price of CDEL and causing substantial losses to investors.

C. Violation of Related Party Transaction Norms:

17. Allegations made by SEBI against CDEL on this front were
    1. Violations of Related Party Transaction norms,
    2. Failure to obtain necessary approvals for transactions with MACEL, and
    3. Non-compliance with Listing Obligations and Disclosure Requirements (LODR) Regulations.

18. CDEL refuted the allegations of violating the Prohibition of Fraudulent and Unfair Trade Practices (PFUTP) Regulations, attributing the fall in the Share Price to the news of Mr. V.G. Siddhartha's demise. However, SEBI deemed these explanations as unsatisfactory and held CDEL accountable for the fund diversion.

Order:

19. SEBI held that CDEL's actions amounted to manipulative, fraudulent, and unfair trade practices, thereby violating Regulation 4(1) of the PFUTP Regulations and LODR Regulations. SEBI Ordered **(a)** for recovery of the entire amounts from MACEL and its related entities, along with due interest, were ordered, and in this regard directed CDEL to appoint a Law firm, in consultation with NSE, to take effective steps for recovery of the monies; **(b)** imposed a penalty of Rs. 25 Crore for fraudulent and unfair trade practices, and Rs.1 Crore for violations of listing regulations, to be paid within 45 days. Moreover, SEBI emphasized the necessity to investigate the roles of directors and key management personnel in the fund diversion.

[91] Source-SEBI Final Order No. WTM/ASB/CFID/CFID_1/23008/2022-23; Dt: 24.01.2023

20. Following the investigation by SEBI, NFRA also initiated investigation under Section 132 (4) of the Companies Act, 2013, into the Professional Conduct of the Statutory Auditors of the Subsidiary entities of CDEL, involved in the sham transactions, as below:

    1. Coffee Day Global Limited (CDGL),
    2. Mysore Amalgamated Coffee Estate Limited (MACEL), and
    3. Tanglin Developments Ltd. (TDL)
    4. Giri Vidyuth India Ltd. (GVIL).

NFRA Orders:

In the matter of CDGL - For FY 2018 – 2019 & 2019 – 2020:

21. The NFRA orders exposed several lapses and failures in the audit conducted by M/s. ASRMP & Co., Chartered Accountants and the Auditors. The auditors were broadly charged with non-compliance with independence requirements by having audit and non-audit relationships which resulting in conflict of interests, tampering with the audit file, failure to detect fraudulent transactions, and lack of competence and due diligence. The auditors' inadequate response to the charges led to penalties and debarment from acting as auditors for specified periods, as below:

Penalty for the FY 2018 - 2019[92]

On the firm	On the Audit Partner (3 No.s)
• Penalty of Rs.1 Crore on the firm; • Debarment for a period of Two Years from being appointed as Auditor or Internal Auditor or from undertaking Audit in respect of the Financial Statements or internal audit of the functions and activities of any company or body corporate.	• Penalty of Rs.10 Lakhs on CA A.S. Sundaresha; Rs.5 Lakhs each on CA Madhusudhan UA and CA Praanav G Ambedkar; • Debarment for a period of **Five Years** from being appointed as Auditor or Internal Auditor or from undertaking Audit in respect of the Financial Statements or internal audit of the functions and activities of any company or body corporate.

[92] Vide Order No. NF-23/14/2022; Dt: 12.04.2023

Penalty for the FY 2019 - 2020[93]

On the firm	On the Audit Partner (2 No.s)
• Penalty of Rs.2 Crore on the firm; • Debarment for a period of Four Years from being appointed as Auditor or Internal Auditor or from undertaking Audit in respect of the Financial Statements or internal audit of the functions and activities of any company or body corporate. (The debarment of 2 years as ordered in the order for the non-compliance in the financials for the FY 2018 – 2019, shall run concurrently.)	• Penalty of Rs.10 Lakhs on CA A.S.Sundaresha; Rs.5 Lakhs on CA Madhusudhan. • Debarment for a period of **Ten Years** in case of CA A.S.Sunderesha; and **Five years** in case of CA Madhusudhan U A, from being appointed as Auditor or Internal Auditor or from undertaking Audit in respect of the Financial Statements or internal audit of the functions and activities of any company or body corporate. (The debarment of 5 years as ordered in order for the non-compliance in the financials for the FY 2018 – 2019, in respect of CA A.S.Sundaresha, shall run concurrently.

In the matter of MACEL - for FY 2018 – 2019[94]:

22. The NFRA order highlighted major lapses in the audit conducted by another auditor. The lapses included failure to detect and report fraudulent diversion of funds, misstatements in financial statements, and violations of auditing standards and the Companies Act. Wrong reporting that MACEL was not required to obtain NBFC Licence under Section 45 IA, through the activities of MACEL changed from Coffee business to NBFC activities, on account of diversion of funds. The auditor's lack of due diligence and professional judgment resulted in penalties and debarment, for specified periods, as below:
    - Penalty of Rs.5 Lakhs on CA Lavitha Shetty;
    - Debarment for a period of **Five Years** from being appointed as Auditor or Internal Auditor or from undertaking Audit in respect of the Financial Statements or internal audit of the functions and activities of any company or body corporate.

For FY 2019 – 2020[95]:

23. This Order of NFRA presented additional audit lapses and professional misconduct charges against the Auditor. The Auditor failed to detect and report fraudulent diversion of funds, misstatements, and inappropriate recognition of finance costs and cash flow in the financial statements. The Auditors lack of due diligence, professional judgment, and compliance with

[93] Vide Order No.24/2023; Dt: 28.07.2023
[94] Vide order NO.NF-23/14/2022; Dt: 13.04.2023
[95] Vide order No.NF-23/14/2022; Dt: 25.04.2023

auditing standards resulted in violations of the Companies Act and SA 700. Additionally, the Auditor was charged with various non-compliances, including failures in internal financial control, related party disclosures, and auditing standards. The Auditors defence was rejected as unsatisfactory, leading to penalties and debarment from acting as an auditor for ten years. The Audit Firm, represented by CA Lavitha Shetty, was also held accountable for non-compliance with quality control standards. The following penalties were levied in connection with the FY 2019 – 2020:

- Penalty of Rs.10 Lakhs on CA Lavitha Shetty;
- Debarment for a period of **Ten Years** from being appointed as Auditor or Internal Auditor or from undertaking Audit in respect of the Financial Statements or internal audit of the functions and activities of any company or body corporate. (The debarment of 5 years as ordered in the order Dt: 13.04.2023, for the non-compliance in the financials for the FY 2018 – 2019, shall run concurrently.)

In the matter of TDL - For the FY 2018 - 2019[96]:

24. The Order of NFRA revealed significant lapses in the audit conducted by M/s. Sundaresha & Associates. The auditors were accused of failing to comply with auditing standards, identify fraudulent transactions, and report material misstatements. The auditor's lack of due diligence and compliance led to penalties and debarment for the periods as detailed below:

On the firm	On the Audit Partner
• Penalty of Rs.1 Crore on the firm; • Debarment for a period of Two Years from being appointed as Auditor or Internal Auditor or from undertaking Audit in respect of the Financial Statements or internal audit of the functions and activities of any company or body corporate.	• Penalty of Rs.5 Lakhs on CA C. Ramesh. • Debarment of CA C. Ramesh, for a period of Five years from being appointed as Auditor or Internal Auditor or from undertaking Audit in respect of the Financial Statements or internal audit of the functions and activities of any company or body corporate.

In the matter of GVIL - For the FY 2019 - 2020[97]:

25. The NFRA order on GVIL, exposed a series of lapses and failures in the audit conducted by M/s Sundaresha & Associates. The auditors' lack of due diligence, professional judgment, and compliance with auditing standards played a significant role in the fraudulent diversion of funds from the subsidiary to MACEL. The auditors' failure to identify red flags and report fraudulent activities resulted in severe financial consequences for the company and its shareholders. The Order also noted the failure on the part of the Auditor to assess independence, tampering with the Audit file, inadequate

[96] Vide order No.NF-23/14/2022; Dt: 26.04.2023

[97] Vide order No.NF-23/14/2022/05; Dt: 30.05.2023

verification of the related party transactions, Failure to Assess Risk of Material Misstatement, Lack of Due Diligence in Loan Audit. The following penalties were levied on the Auditors and the Firm.

On the firm	On the Audit Partners (2 No's)
• Penalty of Rs.1 Crore on the firm; • Debarment for a period of Two Years from being appointed as Auditor or Internal Auditor or from undertaking Audit in respect of the Financial Statements or internal audit of the functions and activities of any company or body corporate. (The above debarment shall <u>START AFTER THE COMPLETION OF THE</u> debarment of 2 years as ordered in the order for the non-compliance in the financials of TDL for the FY 2018 – 2019). So not concurrent.	• Penalty of Rs.5 Lakhs each on CA C. Ramesh and CA Chaitanya G. Deshpande. • Debarment of CA C. Ramesh and CA Chaitanya G. Deshpande, for a period of Five years from being appointed as Auditor or Internal Auditor or from undertaking Audit in respect of the Financial Statements or internal audit of the functions and activities of any company or body corporate. Note: The order does not provide any clarity regarding whether the above debarment of CA C. Ramesh, in GVIL is concurrent with the debarment with the Order in TDL for the FY 2018 – 2019, or will start after the completion of the debarment therein.

<u>Conclusive Remarks:</u>

26. The SEBI and NFRA orders on CDEL and its subsidiaries provide valuable insights into the lapses and deficiencies in corporate governance and auditing ethics. The investigations have exposed fraudulent activities and non-compliance with regulations, leading to severe penalties and debarment for the involved parties. These orders are a serious wake-up call that the corporates and the Auditors embrace and to strengthen governance practices, enhance transparency in financial reporting, and prioritize ethical conduct.

Only through such collective efforts and implementation of the Corporate Governance principles, in word and spirit, can India's financial markets thrive, implant confidence among investors, and ensure the protection of public interest. The regulatory actions taken against CDEL and its auditors serve as a powerful reminder of the importance of integrity, professionalism, and adherence to ethical standards in the financial world. As the nation aims for sustainable growth and development, these orders set a precedent for accountability and responsible conduct in corporate affairs and auditing practices.

Summary of GST Decisions

Gujarat High Court in the case of Tagros Chemicals Pvt. Ltd. [98] **- Denial of refund on the ground of procedural lapse:**

1. In this case, the petitioner has supplied the goods to the merchant exporter by availing the benefit NN 41/2017 – IT (R). However, while disclosing the same in the GST returns, the petitioner has mistakenly reported the said invoice with the actual rate instead of the concessional rate and the tax was paid accordingly. Later the petitioner identified the error and issued the credit note for the same and applied for refund of excess payment of tax.

2. The respondent has denied the refund of tax on the ground that the petitioner has failed to comply with the conditions mentioned therein the notification. However, the goods supplied by the petitioner has exported to place outside India within the 90 days from the date of issue of invoice. The petitioner has filed the instant appeal against the impugned order praying the same to be set aside and to grant the refund excess payment of tax.

3. On hearing both parties, the Honourable High Court held that the conditions mentioned therein has to be complied by the exporter not the petitioner in the given case. Hence, rejection of refund on merely not complying with the other conditions of the said notification is a procedural lapse and the said refund cannot be denied solely on the technical or procedural lapse. Further it was held that the substantial benefit available to the petitioner cannot be denied on the technical defects where the said error has happened mistakenly. Hence, the Honourable High Court has set aside the impugned order and order for refund of the same.

Jharkhand High Court in the case of Ambey Mining Pvt. Ltd.[99] **– Issue of show cause notice for the same cause of action where the matter has already attained finality:**

4. In this case, the petitioner has delayed the filing of returns and the interest on such delayed payment of tax has been discharged. The tax authorities has issued the show cause notice demanding the tax on the delayed filing of return but not on late payment of tax. Thereafter, the said authorities has passed the order confirming the said demand. The petitioner has filed an appeal against the impugned order before the first appellate authority and got the favourable order.

5. Later on, another wing of the tax authorities has issued fresh show cause notice for the same cause of action demanding the interest for the same period (for which the matter has been adjudicated and attained the finality). The petitioner challenged the jurisdictional legality and authority of office in issuing the said show cause notice.

[98] 2023-VIL-460-GUJ

[99] 2023-VIL-455-JHR

6. The petitioner in his pleading contended that the issuing of show cause notices for same cause of action for which the finality has been attained is wholly without jurisdiction and bad in law and the procedure and is also against the principles of res judicata.

7. The authorities contended that the first show cause notice was issued while scrutinising by the returns by the department and accordingly the order was passed under the Section 73 of the CT Act. Whereas the form in which the notice was issued was of different section. Accordingly, the Appellate Authority reviewed the matter and issued the show cause in relevant form. Later, this whole exercise is carried and taken over by the different jurisdiction and they have issued a fresh show cause notice. Further, they also contended that the simultaneous proceeding before two authorities for the same period was an administrative oversight.

8. After hearing both parties, the Honourable High Court held that the first appellate order passed by the relevant authorities has become final on the ground that the respondent has not challenged the said order within the given time limit before the next forum, and the same was not subject to review by the revisional authority. Since the stipulated time to appeal has lapsed, it deemed that the authorities has agreed to the said order.

9. Further, the High Court also stated that since the first appellate authority cannot remand back the matter to lower authority, to bypass the embargo of the law, the tax authority has issued the fresh proceedings for the same issue which has attained finality. The actions of authority in the said case are clearly to start afresh proceedings of the same issue which is bad in law, and it is without jurisdiction and the same has been hit by the principles of res judicata. Accordingly, the said show cause notices have been quashed and set aside and allowed the instant writ application.

Gujarat High Court in the case of Shree Renuka Sugars Ltd[100]. – Refund was short claimed due to clerical mistake and the supplementary refund claim for the same period was not sustainable:

10. The petitioner has been regularly filing the refund of unutilised ITC with the department for various periods and the same got sanctioned by them at regular intervals. However, in the period involved in the dispute, the petitioner has filed the refund claim shorter than the actual amount that can be claimed (as per the relevant provisions of CT Act) due to clerical mistake. After knowing the fact of short claimed, the petitioner has filed the refund claim under 'any other' category instead of 'refund of accumulated ITC in respect of export of goods without payment of tax', as the said category is not available again while filing the supplementary claim relating to the impugned period in the GST Portal.

11. The supplementary refund got rejected on the ground that they have filed the refund of unutilised ITC in wrong category. The petitioner in

[100] 2023-VIL-439-GUJ

his pleading also contended that the said category was chosen due to unavailability of option in the portal and respondent without going into the facts of the case rejected the refund claim of the petitioner.

12. In response, the respondent contended that the common portal calculates the refund amount as per the formula prescribed in the relevant provisions. As the per the said formula, the petitioner can claim the higher refund amount but claimed less than that and the same happens to be the petitioner choice and accordingly they are responsible for the same. Further, he also referred to the Circular[101] and contended that when the refund of unutilised ITC can be claimed under 'any other' category when the registered person has inadvertently filed 'Nil' application. However, in this case, the petitioner has filed the original claim and the same does not amounts to 'Nil' application. Hence, the petitioner claim has been rightly rejected by the respondent.

13. After hearing both parties, the Honourable High Court held that, the refund amount means the maximum amount that is admissible as per the provisions. However, in the present case, the respondent has not disputed the said fact but contended that the petitioner is responsible for claiming the lower amount as refund. In addition, court held that the said option chosen by the petitioner is solely due to unavailability of option in the portal and the same happens to be a technical error. Due to such technical error, the refund cannot be rejected and also there is no resort available to the petitioner to file the application except under 'any other' category. Further, Court by referring to various case laws held that if the substantive conditions have been satisfied, the refund cannot be rejected on the technical error. Due to the said fact, the petitioner is eligible to claim the refund due to such technical factor and accordingly Court allowed this writ petition and ordered the respondent to grant the refund manually.

Delhi High Court in the case of Shri Radhey Traders[102] – Registration cancelled for not filing returns for continuous period of six months with retrospective **effect:**

14. In the present case, the petitioner has filed the application for cancellation of registration for which respondent has not responded for 9 months and thereafter he issued a notice seeking for additional documents and after that, the respondent has rejected the cancellation of registration application. After said rejection of application, the petitioner filed the second application for cancellation of registration for which the respondent has dealt this application as similar as first application and issued a notice for requiring the additional information from the petitioner. Since, the petitioner business has closed long back and could not provide the additional information within the given time, the respondent has rejected the application on ground that he was not responded to the said notice.

[101] Circular No. 110/29/2019 – GST dated 03.10.2019.

[102] 2023-VIL-476-DEL

15. Later, a notice was issued to show cause why the registration should not be cancelled for not filing returns for a continuous period of six months. After the said notice, the registration has cancelled with retrospective effect from the registration date. Aggrieved by the said order, the petitioner has filed for revocation of registration and got it restored. However, the concern of petitioner was not addressed in the said order as why the said registration is cancelled with retrospective effect. The petitioner has filed the present writ petition on impugned order which cancelled the registration with retrospective effect.

16. In the said case, the Honourable High Court held that, there no other material record to justify why registration has cancelled with retrospective effect. Further, there is no dispute regarding the filing of returns by the petitioner. Since, the petitioner has closed hid business in June 2019, the petitioner should not be forced to file the returns for the period which he had closed his business. Further, the Court held that concerned authority has not applied the mind to the petitioners assertion and order passed by the adjudicating authority is belatedly and in a mechanical manner. Accordingly, the Court ordered to process the cancellation of registration from the date of closure of business based on the information provided by the petitioner.

Delhi High Court in the case of Polyplex Corporation Ltd.[103] – FTC shall be available to the Indian assessee to the extent of Thai tax payable, even when the tax is not actually paid due to any exemption available in Thailand.

1. The case involve an Indian company receiving dividend income from its subsidiary in Thailand. While calculating the Indian tax liability on its income, the company claimed credit for the tax payable in Thailand which was not the actual tax paid on account of exemption. The main question before the Hon'ble Delhi High Court was whether the company could be eligible for the Foreign Tax Credit (FTC) on the tax that was not actually paid in Thailand.

2. The court, in this case, interpreted the concept of tax sparing. Tax sparing measure goes beyond the traditional FTC approach which provides that, when a taxpayer from one country earns income in another country, the residence country grants a tax credit for the tax that would have been payable in the source country, even such income is exempt in the source country. The residence country will still grant the tax credit in the cases where no tax was paid by virtue of tax incentives or exemptions provided by the source country to promote foreign investment.

3. In this particular situation, Article 23 of the Indo-Thai Double Taxation Avoidance Agreement (DTAA) stipulates that the tax payable in Thailand is eligible for credit when determining the Indian tax liability. The term 'Thai tax payable' includes both the tax payable under the Thai Revenue Code and the tax that was exempted or reduced under the provisions of the Investment Protection Act of Thailand. In this case, the dividend income received by the company was exempted under the Investment Protection Act of Thailand for specific individuals engaged in promoted activities. Consequently, the company had not paid any tax in Thailand on the dividend income.

4. The revenue authority argued that as there is no real tax payment in Thailand, the FTC cannot be claimed to the amount of tax payable, potentially resulting in double non-taxation. However, the court has ruled that this situation does not result in double non-taxation but is instead considered a tax sparing measure aimed at promoting the economic development of the country. Additionally, the term 'Thai tax payable' was already defined in the DTAA itself, as mentioned above. Therefore, it was decided that the taxpayer is entitled to claim the FTC on the tax amount that was not actually paid.

Our Comments:

5. In the globalized economy, countries are adopting measures to facilitate foreign investment by reducing entry barriers and offering incentives. One such measure is the concept of tax sparing, which is a credit method that countries mutually

[103] [2023] 152 taxmann.com 479 (Delhi)

accept when executing tax treaty agreements. However, the Indo-Thai DTAA was amended in 2015 and the tax sparing measure was excluded from that date. Hence, any tax agreements made post 2015 cannot avail the tax sparing measure while claiming the FTC.

Kolkata Tribunal in the case of TDK India Private Limited[104] - Protocol to DTAA is integral and indispensable, hence the notifying the MFN by CBDT is not a mandatory prerequisite.

6. The Kolkata Tribunal has deliberated whether the protocol to the DTAA applies without CBDT's notification to extend the benefits of the Most Favoured Nation (MFN) clause. Additionally, the court examined whether the specified treaty rate includes surcharge and cess or requires separate charging.

7. The assessee received professional services from a Spanish company which is chargeable to tax as FTS. The applicable TDS rate is 20 percent based on Article 13 of the Indo-Spain DTAA. However, para 7 of Article 13 includes a protocol known as the Most Favoured Nation clause, stating that if India enters a treaty with an OECD member country after 1st January 1990, the TDS rate for FTS shall follow the lower rate specified in that treaty. The assessee claims that India has an FTS treaty with Portugal, an OECD member, with a 10 percent tax rate. Hence, the assessee deducted TDS at 10 percent.

8. The revenue cited a CBDT circular[105] indicating that the MFN clause's benefit is only applicable when there is a separate notification from the Government of India to extend treaty benefits. Based on this argument, the revenue contended that the MFN clause in the Indo-Spain DTAA would not apply without a specific notification.

9. The Tribunal's decision highlighted that, in case of conflict, the provisions of the statutory act take precedence over circulars or notifications. Additionally, neither Section 90 of the IT Act nor the DTAA necessitates a CBDT notification for extending the benefits of the MFN clause. According to Section 90 of the IT Act, the provisions of either the IT Act or the DTAA that are favorable to the assessee apply. Therefore, since the provisions of the Indo-Spain DTAA, along with the protocol extending the MFN clause benefit, favor the assessee in this case, they can avail the benefit without a CBDT notification, as the protocol is an integral part of the DTAA. Consequently, the Tribunal ruled that the assessee is eligible for the MFN clause benefit.

10. Furthermore, regarding the applicable tax rate, it is a well-established principle that the tax rate as per DTAA is inclusive of surcharge and cess. Article 2 of the treaty agreements defines the term 'tax' as the rate specified in the DTAA, inclusive of any surcharge. It also encompasses any identical or substantially similar taxes levied by the country. The Tribunal, in this case, relied on its co-ordinate bench ruling in DCIT vs. BOC Group Ltd.[106] which clarified that the Education

[104] [TS-393-ITAT-2023(Kol)]
[105] CBDT Circular No. 3/2022 dt. Feb 3, 2022
[106] 64 taxmann.com 386 (2015) (Kol. ITAT)

cess, introduced in the Finance Act, 2004, was considered an 'additional surcharge' on the tax rate. Consequently, by applying these considerations, it was concluded that the rate as per DTAA, i.e., 10 percent, shall include surcharge and cess.

Delhi Tribunal in the case of Religare Finvest Ltd[107] - Compulsory Convertible Debentures are termed as debt instruments until conversion into equity and hence, interest is allowed.

11. The case revolves around an assessee company that issued Compulsory Convertible Debentures (CCDs) to its Indian parent company. These CCDs would be converted into equity after a specified period. The company claimed the interest paid on the CCDs as an expenditure.

12. On the other hand, the revenue argued that because the debentures were mandatorily converted into equity at a predetermined rate, they should be considered as equity, and the interest paid should be treated as a dividend. Therefore, it should not be allowed as revenue expenditure for the company. The revenue relied on RBI circular no. 74 dated June 8, 2017, which stated that CCDs with mandatory conversion options should be treated as equity.

13. However, the Tribunal clarified that the RBI circular does not change the nature of debentures into equity. It is only for the purpose of monitoring measures to prevent misuse of the regulatory framework for debt flow in the country. The definition of convertible debentures in the circular cannot be applied in other contexts for income tax purposes, such as interest allowance on pre-conversion debentures or granting voting rights before conversion.

14. The Tribunal emphasized that the nature of securities, whether debentures or equity, should be determined at the time of interest/dividend payment. In this case, since the securities were still debentures and had not been converted into equity, the payment was considered as interest. Further, the law does not prohibit the allowance of interest as a revenue expenditure. Therefore, the Tribunal ruled in favor of the assessee, allowing the payment of interest on CCDs as a revenue expenditure.

Our Comments:

15. Numerous courts and tribunals have issued various rulings regarding the classification of interest payments on CCDs as revenue expenditure or dividends. Treating such payments as dividends based on the mentioned RBI circular would create ambiguity, especially concerning whether these debentures hold voting rights equal to equity shares. It is crucial that the treatment of income/expense based RBI norms cannot be made when the RBI circular is in the context of FDI policy to exercise control on future re-payment obligations in convertible foreign currency and shall be made from the provisions of Income tax Act when the act itself is clear and unambiguous.

[107] [TS-404-ITAT-2023(DEL)]

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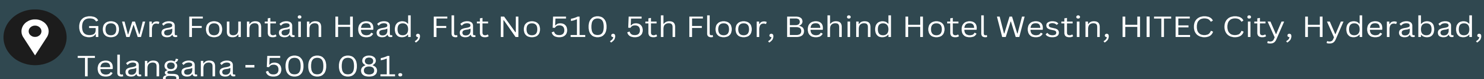

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