



Newsletter

Sharp View

June 2022

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June 2022

June marks the beginning of the monsoon in India. Also, 5 June is observed as world environment day to inspire people to protect and preserve the environment. World environment day was conceptualised 50 years back by the United Nations (UN) whose primary objective is to take action on environmental protection. The theme for 2022 is 'Only One Earth.' Today, 193 member nations are part of the United Nations Environment Programme (UNEP) and mark this day by organising various programmes. India is focussing on clean & sustainable energy and low carbon emissions, and it is watched as one of the key countries to partner with the UN.

India and the UN signed a Host Country Agreement in Glasgow in November 2021. To quote India as per Ms. Anderson (Executive Director, UNEP): "India plays a hugely important role in global action on the triple planetary crisis of climate change, biodiversity loss and pollution and waste, we at UNEP look forward to deepening our partnership with India, towards strengthening the country's ability to deliver on the environmental dimensions of sustainable development."



Assurance

Joint Ventures (JV) and Joint Operations (JO)

Businesses enter into joint arrangements wherein they are in a position to exercise control jointly over their investees. Such arrangements are either classified as joint ventures or joint operations as per Ind AS. Mr. Rathnakiran Potnuru (Bangalore office) explains briefly, such joint arrangements, their classification for accounting and certain additional reporting requirements in the financial statements of the investor.



Assurance | Joint Ventures (JV) and Joint Operations (JO)

I. Objectives of entering into joint arrangements (JA)

In commercial parlance, JA is a business arrangement in which parties agree to pool their resources for accomplishing a specific task i.e., a new project or a specific business activity whereas in terms of Ind AS 111 and Ind AS 28, a JA is an arrangement of parties having joint control. A JA can either be a JO or a JV, which eventually determines the accounting treatment. The objectives of an entity entering into a JA include:



II. Control

Degree of control vs. Degree of consolidation

The level of consolidation in the books of the investor is proportionate to the level of control the investor has over the entity. Further, as the JO is proportionately consolidated for its share in the sfs of the investor, it implies that a JO is treated as an extension of the investor rather than an independent separate entity, under the Ind AS. The method of consolidation of any entity with its investor depends on control assessment (as indicated below)



Assurance | Joint Ventures (JV) and Joint Operations (JO)

Type of control	Type of entity	Likely % of voting rights in the entity	Reporting in the financial statements	Whether considered as a consolidation?
The investor controls the entity by itself	Subsidiary	>50%	Line by line consolidation in cfs* of the parent in accordance with Ind AS 110	Yes
The investor has joint control over the entity	JA, i.e. JO or JV	40 to 60%	JO: Proportionate line by line consolidation in sfs** of joint operator	No
			JV: Account for interest under equity method in cfs* of joint venturer	Yes
The investor has significant influence over the entity	Associate	>20%	Account for interest under equity method in cfs*	Yes
No significant influence over the entity	Financial instrument	<20%	Account for investment in accordance with Ind AS 109 in sfs**	No

*cfs: consolidated financial statements

**sfs: standalone financial statements

Subsidiary Vs. JA

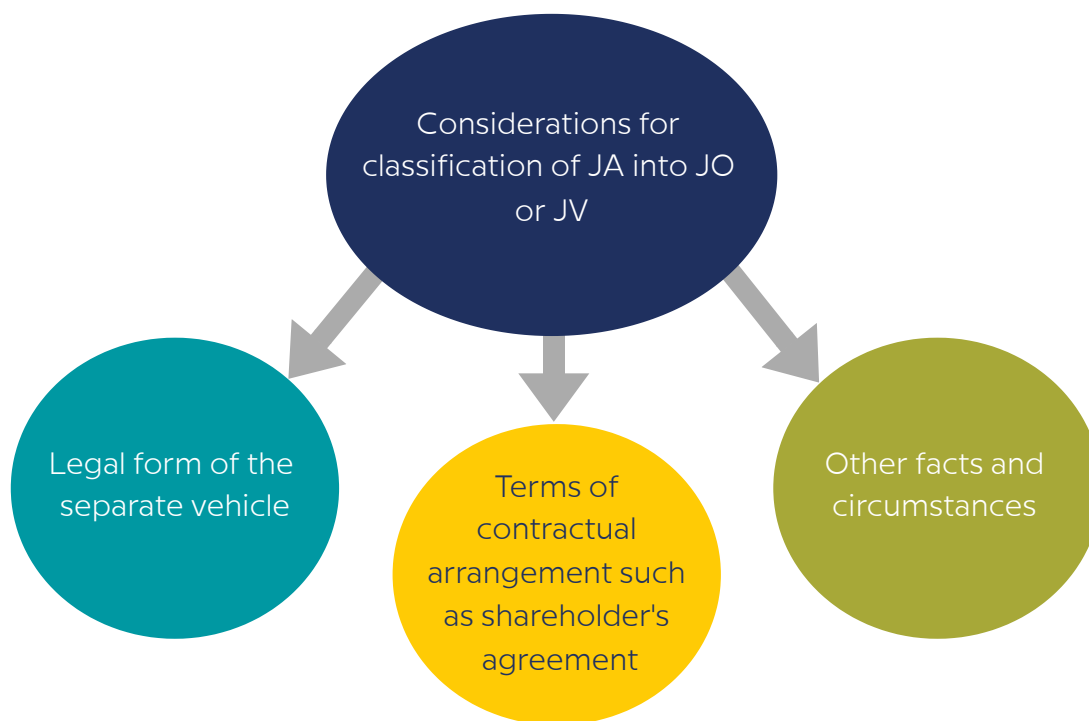
Under Ind AS, control evaluation depends on power over the investee, exposure or rights to variable returns from the investee and ability to use power over the investee to affect the investor's returns. Control assessment poses key challenges under Ind AS as it does not solely depend on the percentage of voting rights in the investee.

The objectives are set by the shareholders before the entity is incorporated or formed (in case of JA). The investors may ensure that their objective and form of the entity are in synchronisation with the definitions and interpretations of Ind AS to result in JV/JO or respective desired accounting outcomes.

Classification of JA into JO or JV as per Ind AS

A JA not structured through a separate vehicle is a JO. However, JA structured through a separate vehicle can either be a JO or JV. The major challenge for the investor is the evaluation of his rights to net assets or rights to assets and obligations for liabilities of the JA, which will ultimately decide its classification.





Legal form of the separate vehicle

- Though not the ultimate deciding factor for classification, the legal form of JA determines whether the investor has rights to net assets of the entity or rights to the assets and obligations for liabilities of JA.
- Company and LLPs provide the investor with the rights to the net assets of the entity. The assets and liabilities belong to such JA; the investors have no right to assets of JA and no liabilities for obligation of JA. Accordingly, the arrangement may result in classification into JV.

Terms of the contractual agreement

- In certain cases, the parties may use contractual arrangement to modify the rights and obligations conferred by the legal form of the JA. In the below cases, the arrangement results in classification of JA into JO.
 - The contractual arrangement may provide for ownership of certain assets to the certain investors or
 - certain liabilities of JA shall be discharged by funds from certain investors or
 - the basis for allocation of revenues and expenses instead of allocation of net profit or loss from the JA.
- It is a common practice for investors to provide guarantees in respect of obligations of its group companies. In case of guarantees provided to JA, one shall not conclude that the obligations of JA are the obligations of the investor, instead other terms, facts and circumstances of the arrangement shall be taken into consideration.

Other facts and circumstances

- The other facts and circumstances shall only be considered if the legal form of JA and contractual arrangement of the parties indicate that JA may be a JV. The agreements between JA and the investors may be considered.
- Sometimes, the entire output of JA forms part of inputs/input services of the investor. In such cases, JA is fully dependent on investors for all its cash flows and hence be classified as a JO.

III. Additional reporting requirements in independent auditor's reports on sfs of the investor

Consolidation of a JV under the equity method into cfs of the investor does not pose major challenges. However, the proportionate consolidation of JO into sfs of the investor poses some below-mentioned challenges:

1. Reporting in independent auditor's report

The investor's auditor shall express an audit opinion on sfs which will also include the JOs accounted on proportionate basis. Hence the auditor is required to mention that sfs of the investor include such JOs.

2. Reporting on the internal financial controls over financial reporting (ICFR) under the Companies Act, 2013

The auditor of the JO is not required to opine on ICFR as the Companies Act does not apply to unincorporated JOs. Hence the auditor of the investor may express his opinion in his report only in respect of the investor and the JOs that are incorporated as companies.

3. Reporting in respect of CARO 2020

The auditor of unincorporated JOs (i.e. those other than companies) is not required to report on CARO 2020. The investor's auditor shall apply professional judgement whether to report only in respect of the investor and the JOs which are companies covered by CARO 2020 or also the JOs based on materiality.

4. Other matters paragraph

In all of the above audit reporting, the auditor of the investor shall include other matters paragraph in his report in respect of JOs not audited by him, the fact that such JOs were not audited by him and the financial information of such JOs, the fact that his opinion on ICFR of such JOs and/or CARO 2020 is based on corresponding reports of the auditors of such JOs incorporated as companies in India.

5. Compliance and disclosure requirements as per schedule III of the Companies Act, 2013

The financial statements of unincorporated JOs are not general-purpose financial statements and are considered special purpose financial statements prepared under the financial reporting framework (FRF) of the investor for the specific purpose of consolidation with the investor. The auditor of the investor shall communicate the FRF and group accounting policies of the investor to the auditor of the JO to ensure compliance and consistent application of Ind AS and Schedule III of the Companies Act, 2013, as determined necessary by the management.

Takeaway

Enterprises planning to enter into Joint Arrangements should assess their objectives and understand the impact of the key terms of the agreement – namely control, ownership of assets and liabilities and legal form, with the definitions/accounting treatment mentioned in Ind AS. This will enable the management to better position their terms in order to satisfy the operating as well as accounting & disclosure objectives.



Catalyst Recovery

Catalysts are widely used in manufacturing industries. They help in minimising the processing time without themselves being consumed in the production process. Catalyst recovery plays an important role in production processes. Mr. Nimesh Somani (Vadodara office) briefs us on catalyst recovery and certain good practices in the catalyst recovery process.



Introduction - Catalyst









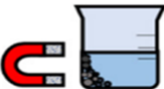



A catalyst is some material that speeds up chemical reactions. Molecules which might take a longer time to interact do so faster with the presence of a catalyst.

Catalytic action is a chemical reaction between the catalyst and a reactant, forming chemical intermediates that are able to react more readily with each other or with another reactant, to form the desired end product.

So, to conclude a catalyst is a substance that speeds up a chemical process/reaction or lowers the temperature or pressure needed to start the chemical reaction, without itself being consumed. Catalysis is the process of adding a catalyst to facilitate a reaction.



The recovery of a catalyst is important from the economic and the environmental point of view. Usually, once it is separated from the reaction mixture, a catalyst is recycled a number of times. When the activity of a catalyst goes below a particular threshold, it is usually regenerated and reused.

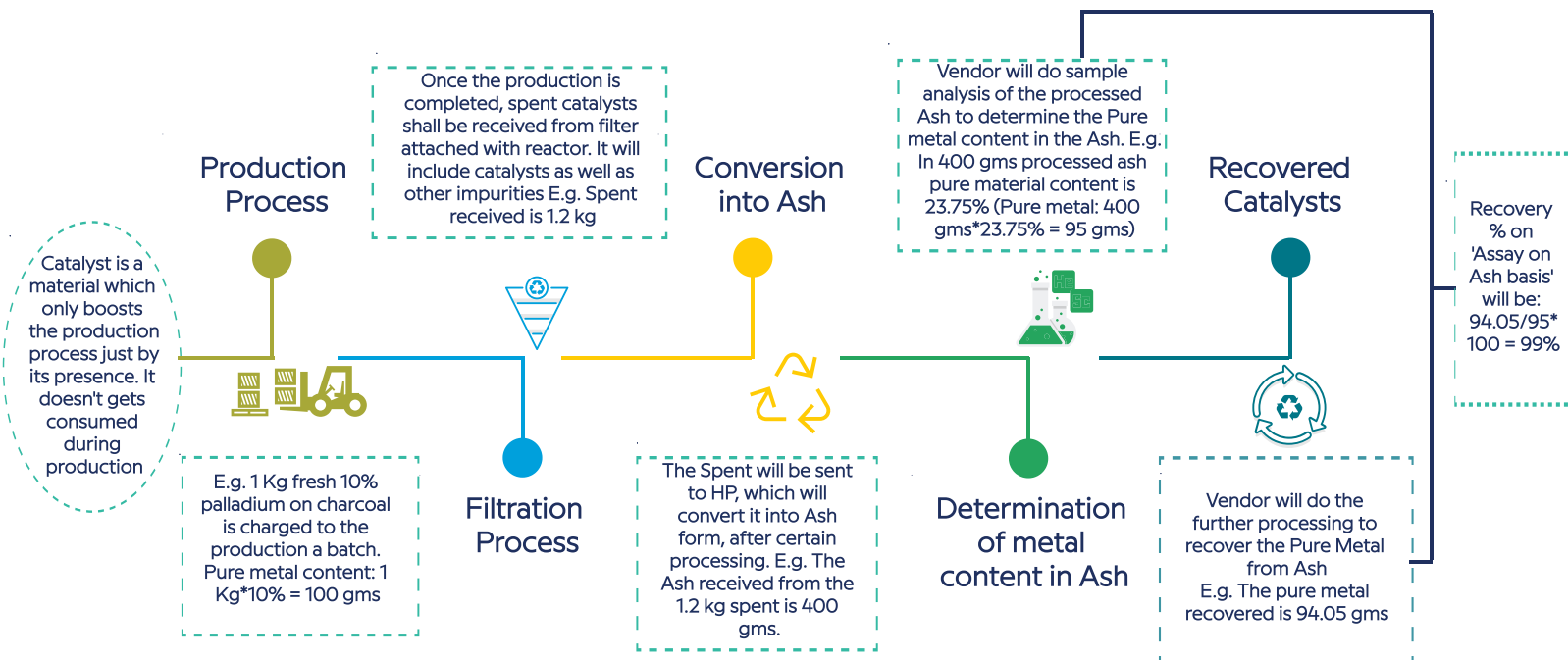
Recovery Methods	High Efficiency	Low Energy Consumption	Low Time Consumption
Filtration 			
Centrifugation 			
Magnetic Separation 			

Types of Catalyst:

- i. Inorganic catalyst : Potassium permanganate, Platinum, Palladium, Iron, Vanadium oxide
- ii. Organic catalyst : Proline, Diastase, Lactase, DNA Polymerase, Alkaline Phosphate

Key Areas

Tracking Mechanism – As per the agreed terms with the Vendors



Generally, the agreement entered into by the companies is based on the recovery of the minimum percentage on the agreed 'assay on an ash' basis. Companies track the same based on the net input & final output basis. This will ultimately result in the loss of costly material (Platinum/ Palladium)

Example.

Company's agreement reads: recovery to be made on agreed 'assay on ash' basis & metal purity will be 99.95%

- i. 1 kg – 10% Pd/c charged to production (Pure Metal -100 gm i.e. 1 Kg *10%)
- ii. 1.2 kg spent received – Obtained after filtration including metal and other Impurities and sent to respective stores department and in turn to the vendor.
- iii. 400 gm ash received after burning spent at high temperature
- iv. 23.75% Metal content analyzed by vendor QC after sample testing of the Ash, i.e. pure metal analyzed $400 * 23.75\% = 95$ gms
- v. On an actual basis, 94.05 gms pure metal obtained by the vendor after processing, material dispatched is 0.9405 kg.

The issue in the above process is

Companies track recovery on the actual Input and final output basis i.e. $94.05/100*100 = 94.05\%$ which is not as per the agreement and accept the materials received from the job worker. Recovery monitoring should be instead $94.05/95*100 = 99\%$. So here the company is receiving materials less than the agreed terms.

Some Good Practices in Case of Catalyst Recovery

- Bill of materials to be accurately prepared of the materials in which catalysts are used & spent ratio should be defined in the BOM.
- Records for actual spent generation record and catalysts consumed to be maintained.
- Challan to challan reconciliation of the spent (Catalyst) sent for the recovery to the vendors should be maintained and verified with the contractual terms.
- Quarterly reconciliation sheets should be obtained from the vendors
- Metal content after burning of spent needs to be obtained from the recovery vendor.
- Approval mechanism should be defined in case of metal content if the burning is below the agreed level.



Taxation

Supreme court judgement - constitutional validity of IGST on ocean freight in CIF contracts

In certain circumstances, GST is required to be paid by the recipient of services, popularly called the reverse charge mechanism (RCM). Whether it is constitutionally valid to apply RCM in the case of an Indian importer on ocean freight services between the foreign shipping line and the foreign exporter, both located in a non-taxable territory was the issue before the Supreme Court. Mr. Shouvik Roy (Mumbai office) discusses the facts and throws light on the apex court judgement.



UNION OF INDIA VS MOHIT MINERALS PVT LTD

Background and factual matrix:

The applicant (Mohit Minerals Pvt. Ltd.) was engaged in the activity of import on cost, insurance and freight (CIF) basis of coal from various countries. The applicant discharges customs duty at the time of import, wherein the CIF value includes ocean freight.

In the case of a CIF contract, the freight invoice is issued by the foreign shipping line to the foreign exporter, (both of who are physically located outside the taxable territory of India) without the involvement of the importer. Ocean freight is paid by the importer only when goods are imported under a Free-on-Board ('FOB') contract.

Notification 8/2017 and 10/2017 of integrated goods and services tax (IGST) rate notified a rate of 5% of ocean freight services and stated that the tax was to be discharged under the reverse charge mechanism (RCM) by the importer.

The constitutional validity of the notifications, - (seeking IGST under reverse charge from an Indian importer on ocean freight services between persons located in a non-taxable territory with respect to import of goods in India on a CIF basis) - was challenged before the Gujarat High Court. The Gujarat High Court in Mohit Minerals Pvt. Ltd. vs. UOI [SCA No 726/2018] struck down such a levy of IGST as unconstitutional and ultra vires the IGST Act. It was struck inter alia on the ground that (a) the notifications amount to extraterritorial law, (b) the reverse charge payment of IGST amounts to double taxation of the same transaction in as much as IGST paid on import of goods and (c) the importer is not a "recipient of service" to be made liable to tax on a reverse charge basis.

A batch of Special Leave Petitions (SLPs) were filed before the Supreme Court by the Department against the decision of the Gujarat High Court.

Issues decided by the Supreme Court

A) Role of GST council

The 'recommendations' of the GST Council are a product of a collaborative dialogue involving the Union and States and are thus recommendatory (& non binding) in nature. Vide Article 246A of the Constitution of India, both the Union and the States are conferred equal power to legislate on GST. Thus, to regard recommendations of GST Council as binding would disrupt fiscal federalism.

The recommendation of the GST Council made under Article 279A is non-qualified, to say, there is no explanation on the value of such a recommendation. Hence, the contention that the recommendations of the GST Council transform into binding legislation under Article 246A is farfetched.

If the GST Council was intended to be a decision-making authority whose recommendations transform to

Taxation | Supreme court judgement - constitutional validity of IGST on ocean freight in CIF contracts

legislation, such a qualification would have been included in Articles 246A or 279A. Neither does Article 279A begin with a non-obstante clause nor does Article 246A provide that the legislative power is 'subject to' Article 279. The provisions of the IGST Act and CGST Act which provide that the Union Government is to act on the recommendations of the GST Council must be interpreted with reference to the purpose of the enactment, which is to create a uniform taxation system.

B) Can the importer be considered as a service recipient as opposed to the foreign exporter?

Section 13(9) of the IGST Act, 2017 creates a deeming fiction of place of supply of ocean freight service to be the destination of the goods. No specific exemption from this deeming fiction, is carved out for importers. Further the definition of "recipient" u/s 2(93) of the CGST Act, 2017 uses the phrase "any reference to a person to whom a supply is made shall be construed as a reference to the recipient."

The above phrase in the definition of recipient read along with Section 13(9) of the IGST Act, 2017, would deem that the supply of service will be made to the Indian importer. The definition of the word recipient would have to be interpreted within the context laid down in the taxation statutes and not by commercial principles. Thus the SC upheld that the Indian Importer can indeed be deemed to be the service recipient, even in the case of such CIF contracts.

C) Do the notifications 08/2017 and 10/2017 - IGST rate suffer from excessive delegation?

The SC held that once a skeletal structure of the policy has been framed in the legislature, the details can emerge through delegated legislations. The essential legislative functions vis a vis reverse charge (RCM) have not been delegated as the IGST Act and the CGST Act clearly define reverse charge, recipient and taxable persons. The stipulation of the recipient in each of the categories mentioned in the RCM notification i.e 10/2017 - IGST rate is only clarificatory. Thus, there is no excess delegation in this notification.

D) Territorial nexus of ocean freight services

Section 2(31) of the CGST Act defines 'consideration' to include payment made by the recipient or by any other person. Thus, in the case of goods imported on CIF basis, the fact that consideration is paid by the foreign exporter to the foreign shipping line would not make the levy of IGST on the India importer, extra territorial, nor stand in the way of it being considered as an Inter state supply of service under section 7(4) of the IGST Act. Further, section 13(9) of the IGST Act creates a deeming fiction of place of supply of transportation services to be in India when the destination of goods is in India.

With regards to the argument on taxable territory, the SC held that the parliament has the power to legislate over events occurring extra territorially when such events have real connection to India. The supply of ocean freight services has a two fold connection with India:- a) destination of goods is in India. b) Importer is the beneficiary of such services.

Since the destination of goods is in India, the statute itself is broad enough to cover a taxable event that has extra territorial aspects and bears a nexus to India.

E) Composite supply

The supply of services of transportation by the foreign shipper forms a part of the "composite supply" between the foreign exporter and the Indian importer, wherein the principal supply is the supply of the imported goods. In a CIF contract, the supply of goods is accompanied by the supply of services of transportation and insurance, the responsibility for which lies on the seller (the foreign exporter in this case). The supply of service of transportation by the foreign shipper forms a part of the bundle of supplies between the foreign exporter and the Indian importer, on which the IGST is payable under section 5(1) of the IGST Act read with section 20 of the IGST Act, section 8 and section 2(30) of the CGST Act.

While the notifications are validly issued under sections 5(3) and 5(4) of the IGST Act, it would be in violation of the principle of 'composite supply' enshrined under section 8 of the CGST Act and the overall scheme of the GST legislation. Provisions of GST law do not empower the Government to dissect & vivisection the constituents of composite supply, and impose a separate tax (over and above the tax already imposed on the principal supply) even on the ancillary supply.

CONCLUSION

- The judgment is significant even from the point of view of balance of power between the Union of India vis a vis States, as it defines the status of the GST Council and held their decisions to be recommendatory and non binding (on States) in nature. It is also noteworthy that the impugned notifications are held to be clarificatory and not ultra vires the IGST Act. The levy of IGST on ocean freight has been set aside on the sole ground that such levy violates the tenets of composite supply under GST
- This ruling brings in a huge relief for the importers who are not eligible to claim input tax credit or face accumulation of credit. The importers who have paid IGST on ocean freight services and have not claimed Input tax credit or claimed but not utilised the input tax credit of such IGST can claim refund claim under section 54 of the CGST Act. However, this judgment is only applicable in case the company is importing goods on a CIF basis. This judgement is not applicable in cases where the company is importing goods on a FOB basis and has hired a foreign shipping line for the ocean freight services
- Section 54 of the CGST Act, 2017 provides a limitation period of 2 years for refund applications. However it is a well settled position that this limitation period will not be applicable where tax has been collected without authority of any law. (as in this case)
- Hence refund of the GST paid under RCM may be sought by affected tax payers for the period from 1 July 2017 till date. However this refund will be subject to the bar of unjust enrichment as refund *will only be granted if ITC on the same is reversed. A tax payer cannot claim the double benefit of having taken ITC on the ocean freight component, and also applying for refund of the same IGST on the basis of this judgment*
- Hence it will be advisable to go for a refund of the RCM paid under ocean freight only when the taxpayers have not availed any ITC on the ocean freight component or a substantial component of the RCM paid had been reversed owing to the exempt outward supplies (Rule 42) or the company has accumulated ITC.

Ahmedabad

A2-807, "Palladium", Near Vodafone House,
Corporate Road, Prahalad Nagar,
Ahmedabad - 380015.

Phone: (91) (079) 2970 2082.

Bengaluru

103, Midford House, 1, Midford Gardens
Bengaluru 560 001.

Phone: (91) (80) 2555 0987.

Chennai

Parsn Manere, A Wing Third Floor,
602 Anna Salai, Chennai 600 006.

Phone: (91) (44) 2827 4368, 2822 9534.

Coimbatore

09, Verivada Street, Redfields,
Race Course, Coimbatore 641 045 .

Phone: (91) (422) 427 4500.

Goa

SF-9 , 2nd Floor , Block A Palmer Premises
Holders Co-op Soc Journalist Colony Road
Bardez Goa 403 521.

Phone: (91) 9820284854.

Mumbai - 1

Ravindra Annexe 194, Churchgate
Reclamation Dinshaw Vachha Road,
Mumbai 400 020.

Phone: (91) (22) 66338343 to 8347.

Mumbai - 2

87, Nariman Bhavan, 227 Nariman Point
Mumbai 400 021.

Phone: (91) (22) 6153 7500 / 2202 2224 / 8857.

New Delhi

205-207 Ansal Tower 38,
Nehru Place, New Delhi 110 019.

Phone: (91) (11) 4103 2506, 4103 3506.

Pune

802 Lloyds Chambers , Dr. Ambedkar Road
Opp. Ambedkar Bhavan, Pune 411 011.

Phone: (91) (20) 605 0802.

Vadodara

8th Floor, West Wing Aurum,
Behind Vasna HP Petrol Pump, Makrand
Desai Road, Vadodara - 390.007.

Phone: (91) 97268 95000 / 97278 95000.

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