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By

SBS and Company LLP
Chartered Accountants

CONTENTS

Dear Readers,

Greetings for the season!

In this edition, we bring to you certain important articles on various aspects.

The article on 'Changes to Real Estate Sector – GST Perspective' deals with the recent notifications issued in the context bringing changes to taxation aspects in real estate sector dealing with residential apartments. The rate of tax of 5% which is applicable for new projects which commences on or after 01.04.19 is coming without credit. Even though the new rate appears to be lower than old rate of 12%, the customer would be paying more tax because the credit which was erstwhile allowed and now not being allowed would sit in the cost of project on which customer would be asked to pay 5%. However, under the erstwhile scheme certain builders were collecting 12% and also not passing the benefit of input tax credit which has put the customer in highly disadvantageous position. Now that the builder is not allowed to avail credit, the question of passing of such benefit would not arise and accordingly the customer is benefitted to such an extent.

Further, the granting of exemption of development rights by the land owner to the builder is a welcome move and such an act of Government has helped a bit to the dying model of joint development agreement. Hence, I request all the readers to go through the said article to align their projects to the new scheme of taxation.

The article on 'FEMA Compliances vis-à-vis Statutory Audit' throws certain items which the Statutory Auditor has to examine before expressing true and fair view on the financial statements. Since this is the season of audits, I think this will help fellow professionals to have an understanding as to what aspects have to be examined from the FEMA perspective before expressing true and fair view.

The next article is on 'Evolution of HR Audit' deals with the overview of audit of HR function, the purposes as to why HR audit is required for the organization, the design and conduct of HR Audits and the process involved in HR Audits. Needless to say, HR is an important function of an organization and making sure that such HR activities align with the objectives of the organization and having an audit check on such process would help the organization in the long run.

The next article is on 'Supplies made by SEZ to EOU – Taxability – SEZ Act vs Customs vs GST' deals with the important issue as to whether supplies made by SEZ unit to EOU are taxable or not. From the perspective of SEZ Act, the tax on such supplies is required to be paid by EOU, however GST laws state that tax on such supplies shall be paid by SEZ unit. Hence, my team has made an attempt to reconcile both the laws and suggested view point on taxability of such supplies.

I hope that you will have good time reading this edition and please do share your feedback. I will also urge clients to mail us topics or issues on which you want us to deliberate in our future editions, so that we can contribute to the same.

Thanking You,

SANNAREDDY SURESH BABU

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AUDIT

EVOLUTION OF HR AUDIT

Contributed by CA Sandeep Das

Background:

Human Resource Audit is a systematic formal process, which is designed to examine the strategies, policies, procedures, documentation, structure, systems and practices with respect to the organization's human resource management. It systematically and scientifically assesses the strengths, limitations, and developmental needs of the existing human resources from the larger point of view of enhancing organizational performance. HR audit is an important management control device. It is a tool to judge organization's performance and effectiveness of HR management. Human Resource Audit means the systematic verification of job analysis and design, recruitment and selection, orientation and placement, training and development, performance appraisal and job evaluation, employee and executive remuneration, motivation and morale, participative management, communication. HR audit is very much useful to achieve the organizational goal and also is a vital tool which helps to assess the effectiveness of HR functions of an organization.

The people in an organization are the prime sources that have to be effectively allocated and engaged in various affairs of business. Many Indian companies are handling innovative practices to motivate and retain their talented pool. It has to be assured by a systematic procedure which is called HR audit that is deliberate and detailed analysis of HR standards. The scope of an HR audit can range from a simple review of workplace policies to an extensive examination of practices, policies, procedures and measurements to determine how close the alignment is between the organization's strategic goals, direction and HR functions that support the company's strategy. HR audit may either evaluate the company's operational HR policies, practices and processes or review of current HR indicators

Evolution is a process of change. In recent years we have seen a significant change in the human resources auditing process, in the value derived from HR auditing, and in the tools that companies are using to audit HR.

HR audits have evolved from a simple checklist of dos and don'ts or periodic affirmative action plans to a comprehensive, sustainable process that is an integral part of the organization's internal controls, due diligence, and risk management function. HR audits are a fundamental activity of strategic and operational management and use sophisticated auditing products and consulting services. Increasingly, HR audits are conducted of HR, rather than by HR.

HR audit overview

The HR auditing process is — or should be — an independent, objective, and systematic evaluation that provides assurance that:

1) compliance and governance requirements are being met;
2) business and talent management objectives are being achieved;
3) human resource management risks are fully identified, assessed, and managed; and
4) the organization's human capital adds value.

Under this definition, HR audits are more than an audit activity that solely collects and presents evidence of compliance. HR audits are increasingly expected to look behind and beyond the organization's assertions of sound and proper HR management practices and to assess the assumptions being made, to benchmark the organization's processes and practices, and to provide the necessary consultative services that help the organization achieve its business goals and objectives.

Numerous external forces and factors have had an impact on the demand for and scope of HR audits. First, in the global economy, human capital is becoming the single most important determinant of competitiveness, productivity, sustainability, and profitability. Increasingly, the organization's human capital is being recognized as the source of innovation and a driver of business success. Thus, to be effective in the global economy, HR audits must be diagnostic, predictive, and action oriented.

Second, a confluence of economic, political, and social factors—including corporate scandals, the failure of the financial industry to adequately assess risks and increasing stockholder initiatives—have resulted in increased statutory and regulatory requirements, demands for greater transparency, and increased internal and external audit activity.

Purpose of HR Audit

The purpose of an HR Audit is to recognize strengths and identify any needs for improvement in the human resources function. A properly executed Audit will reveal problem areas and provide recommendations and suggestions for the remedy of these problems. Some of the reasons to conduct such a review include:

- Ensuring the effective utilization of the organization's human resources
- Reviewing compliance in relation to administration of the organization
- Instilling a sense of confidence in management and the human resources function
- Maintaining or enhancing the organization and the department's reputation in the community
- Establishing a baseline for future improvement for the function

Designing and Conducting HR Audits

While an organization's size, industry, financial health, commitment to becoming a "best place to work," and business objectives and imperatives affect the scope and urgency of the HR audit process, we have noted some common features, attributes, and objectives in HR audits recently conducted.

First, HR audits are becoming increasingly complex and multi-dimensional. While ensuring compliance is still a basic goal of HR audits, other objectives include:

- Ensuring the alignment of HR management and employment practices with the organization's business objectives.
- Assessing the outcomes of the organization's employment processes, policies, practices, and procedures.
- Ensuring due diligence, including uncovering hidden liabilities and assets, identifying vulnerabilities to be corrected, and identifying opportunities to be attacked.

- Developing HR auditing procedures that become an ongoing and sustainable element of the organization's internal controls.
- Assessing and managing employment related fraud.
- Developing HR auditing procedures that become an ongoing and sustainable element of the organization's risk management program.

Benefits of HR Audit

Advantage of Human Resource auditing includes the following:

- Foresee changes
- Increases productivity
- Helps individual employee to aspire
- Provides scope for advancement
- Identifies strength and weakness of the existing workforce

HR Audit Process

Activities: The starting point of the HR auditing process is a review of the organization's activities. These are the tasks and actions that create or implement employment policies, practices, procedures, and programs. Activities include such actions as the promulgation of an EEO policy statement, a sexual harassment policy, and other employment policies, and the posting of required employment posters. The activities component of HR audits is typically evaluated by using a "checklist approach," that is, the item is checked off when it is completed.

Behaviors: Behaviors in this context are actions and conduct that affect either positively or negatively the implementation or effectiveness of the organization's policies, practices, procedures, and programs and demonstrate the organization's commitment to stated goals and objectives.

Examples of behaviors include: the creation of a corporate culture that values and promotes equal employment opportunities, diversity, and compliance; the visible and unequivocal support by senior management for the organization's diversity efforts; and the budgeting of sufficient resources to achieve EEO compliance and diversity goals. Behaviors are frequently assessed using qualitative measures, such as culture scans and employee satisfaction surveys.

Risk Assessment: Risk assessment is the identification of current and future events that have the potential to cause loss, peril, or vulnerabilities, and management's willingness to accept those risks. Risk assessment is also the identification of events or conditions that create new opportunities for the organization to achieve its business objectives. Risk assessment provides management with the information to make informed decision about the allocation of the organization's human, physical, and financial capital and about effective ways to eliminate, mitigate, control, or transfer those risks.

Human resource management and employment practices liability related risks include: employment law and regulation compliance failures; lost business opportunities due to the failure to attract, hire, and retain top talent; intangible asset losses due to turnover and the loss of top talent and key employees; ineffective staff development and succession planning; and lower profitability due to the inability to control labor costs. HR auditing activities include assessments of the external and internal factors that impact human resource management and employment practices, including the economy; legal, regulatory, and litigation trends; and demographic and structural changes in the workplace and work force.

Internal Controls: Internal controls are processes, tests, and assessments that help ensure compliance, manage risks, identify fraud, and help ensure the achievement of organizational goals. HR auditing activities include:

1) assessments of the effectiveness and efficiency of HR management processes, policies, practices, and procedures;
2) the reliability and accuracy of HR management reporting; and
3) the level of compliance with laws and regulations, industry and professional standards, codes of conduct and ethics, organizational policies, and budgets.

Outcomes: Outcomes are quantitative and qualitative measurements and metrics that measure and help assess the achievement of organizational goals and objectives. HR auditing activity includes the identification of metrics used by the organization to measure organizational and individual performance; the assessment of results by comparing actual results against projected results, budgets, and internal and external standards; and a description of the activities, behaviors, and internal controls that are needed to maintain or improve future results.

The value of the HR Audit Model is that it helps organizations:

1) assess current HR management and employment practices;
2) identify and diagnosis systemic problems;
3) evaluate and predict the impact of corrective measures;
4) develop a plan of action; and
5) determine the ROI of such actions. Using the ELLA tool, organizations enhance the value of their human capital, reduce their exposure to employment related liabilities, and improve their ability to achieve business objectives.

Conclusion:

To summarize, Human resource audit denotes people and the processes that are responsible for efficient working in organizational functions. Human resource audit can qualify its effectiveness within an organization. Human Resource audits may achieve many objectives, such as ensuring legal compliance; helping maintain or improve a competitive advantage; establishing efficient documentation and technology practices; and identifying strengths and weaknesses in training, communications and other employment practices.

HR audit saves money by identifying and correcting inefficiencies and compliance problems. This process allows a company to get a general thought of where it stands so that it can rectify any potential problems and plan for the future. Human Resource Accounting benefits the company to determine how much investment it has made on its employees and how much return it can anticipate from this asset.

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GST

SUPPLIES BY SEZ TO EOU - TAXABLE - SEZ ACT VS CUSTOMS VS GST

Contributed by CA Sri Harsha & CA Manindar

Vide Section 147 of Central Goods & Services Tax Act, 2017 (for brevity 'CGST Act'), the Central Government on recommendation of Council, may notify certain supplies of goods as deemed exports, where goods supplied do not leave India and payment for such supplies is received either in Indian rupees or in convertible foreign exchange, if such goods are manufactured in India.

In light of the powers conferred vide Section 147 of CGST Act, the Central Government has issued Notification No 48/2017 – CT dated 18th October 2017 notifying certain supply of goods as deemed exports. One of the entries vide #3, in the said notification deals with supplies made by registered person to Export Oriented Unit (for brevity 'EOU'). Hence on reading of Entry 3of Notification No 48/2017, it is evident that supply of goods by **registered person** to an Export Oriented Unit is treated as 'deemed export'.

Hence, on a plain reading the above entry, it is evident that said entry covers the units located in Special Economic Zone also and accordingly, it may be interpreted as goods supplied by registered person (SEZ unit) to an Export Oriented Undertaking is also a deemed export. Deemed exports are not exempted from payment of tax like export of goods or supplies made to unit or developer of Special Economic Zone under the cover of Letter of Undertaking or filing of bond as specified in Section 16 of Integrated Goods and Services Tax Act, 2017 (herein after referred as IGST Act).

From the above it is evident that deemed exports which are notified under Section 147 of CGST Act read with Notification No 48/2017 are not exempted from payment of tax. However, third proviso to Rule 89 of Central Goods and Services Tax Rules, 2017 (herein after referred as 'CGST Rules') provides claiming of refund of tax paid either by recipient of deemed export supplies or supplier of deemed export supplies subject to production of certain documentary evidences and declarations.

Hence, on a combined reading of the Section 147, Notification No 48/2017 and Rule 89 of CGST Rules, it is evident that deemed exports would attract tax at first instance and then law allows to claim refund of such tax payment either by recipient or supplier of deemed exports.

In this article, we tried to dwell on issue that the above modus operandi is applicable only for registered persons who are units in Domestic Tariff Area (herein after referred as DTA units) and not units in Special Economic Zone (for brevity 'SEZ units'). In other words, that payment of tax on deemed exports is applicable only for certain registered persons who are DTA units and does not apply to units in Special Economic Zone. The reasoning as to why the payment of tax and consequent refund is applicable only for DTA units and not units in SEZ is for various reasons as discussed hereunder.

For the SEZ units, the provisions of Special Economic Zone Act, 2005 read with relevant rules would guide them predominantly. Hence, while SEZ units are clearing the goods from their unit which is in Special Economic Zone must comply with provisions of Section 30 of Special Economic Zone Act, 2005 (herein after referred as SEZ Act) which deals with 'Domestic Clearances by Units'. Section 30 of SEZ Act states that any goods removed from a Special Economic Zone to the Domestic Tariff Area ***shall be chargeable to duties of customs including anti-dumping, countervailing and safeguard duties under Customs Tariff Act, 1975 where applicable, as leviable on such goods when imported and*** *rate of duty and tariff valuation, if any applicable to goods removed from a Special Economic Zone shall be at the rate and tariff valuation in force as on the date of such removal, and where such date is not ascertainable, on the date of payment of duty.*

Rule 48 of Special Economic Zone Rules, 2006 (herein after referred as SEZ Rules) deals with procedures pertaining to sale in DTA. As per the said rule, the unit in DTA which intends to purchase from unit in Special Economic Zone shall file a bill of entry for home consumption giving therein complete description of goods, their make and model number and serial number and specification along with invoice and packing list with the Authorised Officers.

Hence, on a combined reading of Section 30 of SEZ Act read with Rule 48 SEZ Rules, it is evident that when a unit located in Special Economic Zone intends to clear its goods to unit in DTA, then the said transaction is treated as import and accordingly the importer (unit located in DTA) is required to file bill of entry and pay customs duties and other applicable duties at the time of removal of goods from unit located in Special Economic Zone. The phrase 'domestic tariff area' has been defined vide Section 2(i) of SEZ Act, 2005 to mean *'the whole of India (including the territorial waters and continental shelf) but does not include the areas of Special Economic Zones'.*

Hence, from the definition of 'domestic tariff area', it is evident that except the areas of Special Economic Zones, all other area is covered under the ambit of DTA. Therefore, the applicant submits that an Export Oriented Unit is also covered under the definition of 'domestic tariff area' and accordingly, the entire provisions of Section 30 of SEZ Act read with Rule 48 of SEZ Rules shall equally applicable when goods removed by unit in Special Economic Zone to EOU.

Accordingly, the supplies made by unit in Special Economic Zone to EOU has also be treated on par with supplies made to unit in DTA despite of the fact that supplies made by registered person to EOU are treated as 'deemed exports' in terms of Section 147 read with Notification No 48/2017. Considering the above provisions of Section 30 of SEZ Act and Rule 48 of SEZ Rules, the supplies made by unit in Special Economic Zone to EOU shall be exempted from payment of tax under the CGST Act or IGST Act and accordingly, SEZ Unit is not required to pay tax on supplies made by them to EOU and then claim refund of such tax paid.

Further, from the instructions mentioned in Form GSTR-1 and other forms, we can garner support for the view that supplies by SEZ units to DTA units would not attract tax in the hands of unit located in SEZ. Section 37 of CGST Act read with Rule 59 of CGST Rules specifies that every registered person must file a monthly return of outward supplies in Form GSTR-1 electronically through the common portal. Vide Instruction 9 to the Form GSTR-1, it was stated as under:

9. Any supply made by SEZ to DTA, without the cover of a bill of entry is required to be reported by SEZ Unit in GSTR-1. ***The supplies made by SEZ on cover of bill of entry shall be reported by DTA unit in its GSTR-2 as imports in GSTR-2.***

From the above, it is evident that supplies made by SEZ on cover of bill of entry shall be reported by DTA unit in its GSTR-2 as imports and accordingly SEZ units need not show such details in its GSTR-1. Since DTA covers the EOU as detailed earlier, it can be concluded that supplies made by them to EOU need no requirement to disclose in the GSTR-1 as they shall be stated as imports and applicable duty is payable by EOU at the time of clearance of such goods from SEZ units.

Also that EOU's when they import goods are exempted from payment of customs and other applicable duties by virtue of Notification No 52/2003- Cus dated 31.03.2003 (last amended vide Notification No 09/2019 – Cus dated 25.03.2019). The said exemption notification also exempts integrated tax and compensation cess leviable under Section 3(7) and Section 3(9) of Customs Tariff Act.

Juxtaposing Notification No 52/2003 – Cus with Section 30 of SEZ Act and Rule 48 of SEZ Rules, it can be inferred that EOU procuring goods from SEZ units has to file bill of entry and accordingly pay applicable customs duties along with other taxes. However, in light of Notification No 52/2003 – Cus, EOU is exempted from payment of such customs duty and other duties. Hence, EOUs are claiming exemption from payment of customs duty and Integrated tax and compensation cess leviable under Section 3(7) and Section 3(9) of Customs Tariff Act.

Hence, unless a clarity is provided by Central Board of Indirect Taxes & Customs (for brevity CBIC), it creates a cash flow burden and administrative burden on SEZ units to pay tax and claim the same as refund. Further, the SEZ units would not have any input tax credit since all vendors would be supplying services or goods under the cover of Letter of Undertaking, hence it is not possible for paying such tax on deemed exports using credit to avoid cash flow effect. Further, the SEZ units would be guided by SEZ Act and rules instead of goods & services tax laws and in case of inconsistency among them, the SEZ Act would prevail. Hence, SEZ units might take a resort that provisions of SEZ Act would apply and they need not pay tax under goods & services tax laws despite of the fact that such supplies are not outrightly exempted. Hence, a clarification is expected to make it clear that the provisions of refund under Rule 89 of CGST Rules as far as deemed exports are concerned, applies to DTA units and not SEZ units to avoid litigation and for ease of doing business.

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FEMA

FEMA COMPLIANCES_STATUTORY AUDIT PERSPECTIVE

Contributed by CA Murali Krishna G & CA Bharani

Audit time has come, and most of the members from Chartered Accountant fraternity would have their detailed and updated audit programs ready for the season. An auditor's responsibility is to express an opinion on the financial statements of an entity based on audit and such an audit involves performing procedures to obtain evidence about the amounts and disclosures made in the financial statements. It may be relevant to note that as per the Companies Act, the Auditors need to express their opinion on "True and Fair View" of the disclosures made therein. The scope of such procedures is increasing day by day with number of developments happening in finance world and regulatory regime and thereby impacting corporate world. Accordingly, audit programs get updated with procedures to be adopted based on changes to various applicable laws that govern the entity being audited. The Foreign Exchange Management Act, 1999 (FEMA) is one such law which constantly undergoes changes in line with macro-economic situations and international conditions/laws.Unlike other laws where everything is permitted unless specifically prohibited, under FEMA everything is prohibited unless specifically permitted. Hence, the tenor and tone of the Act is very drastic.

The focus on FEMA compliances as part of statutory audit has been seen to be limited. This may probably be because of ignorance of relevant provisions or no specific requirement under CARO (or any other annexure to statutory audit report) to report any non-compliances under FEMA. Offences or irregularities under FEMA are civil in nature and can be compounded by making a suitable application to RBI. But when such offences are coupled with any serious issue involving money laundering or likes, it goes beyond the scope of RBI and falls before Directorate of Enforcement (DoE) making them criminal in nature. Be it ignorance or wilful negligence, statutory auditor becomes primarily responsible in such case and stands alongside the promoters or management of the auditee. FEMA, beside the main Act, has 6 sets of rules by central government and 26 sets of regulations, around 1500+ circulars / notifications, 15 Master Directions, DIPP Press Notes (for FDI), FAQs and Special Permissions by RBI under it. Hence, it is not a minor law to be ignored.

This article is as an attempt to provide glimpses to those performing statutory audit to keep a note of important provisions of FEMA. Considering the vast nature of provisions, this article is limited to provisions as applicable to corporates only (excluding those in financial services sector).

Below are major areas under FEMA which are commonly seen as applicable to Indian corporates.

1. Foreign Direct Investment in India (FDI)
2. Overseas Direct Investment by Indian Parties (ODI)
3. Export of Goods and Services
4. Import of Goods and Services
5. Branch Office outside India
6. Branch Office/ Liaison Office/ Project Office in India
7. External Commercial Borrowings and Trade Credit

Before getting in to specific regulations, it should be noted that all the transactions under FEMA are to be routed through Authorized Persons only. Accordingly, if an auditor finds any sort of adjustment (journal) entry in the books involving cross border transactions / adjustments, he should be more cautious and suggest necessary remedies / corrective actions. Impact of costs associated with such transactions, in the form of compounding fee, late submission fees or penalty, should appropriately be considered in financial statements.

1. Foreign Direct Investment in India (FDI):

FEM (Transfer or Issue of security by a person resident outside India) Regulations, 2017, as amended from time ("FDI Regulations") and Master Direction No. 11/2017-18 ("MD on FDI"), deals with investments in capital instruments by Non-Residents (NRs). Capital Instruments means equity shares, compulsorily convertible debentures, compulsorily convertible preference shares and share warrants, of Indian companies. If the entity being audited has foreign investment in to it, the auditor may adopt suitable procedures to review the compliances of FDI Regulations, some of which are listed as under:

a. Check, as one-time activity, the completeness and accuracy of data filled in Entity Master Form (EMF) on FIRMS portal with reference to total foreign investment till the date of introduction of EMF (i.e., June 28, 2018).
b. The status of forms submitted on erstwhile physical documents submission and ebiz portal may be checked, and cross check with the actions taken by the entity in resolving pending cases, if any.
c. In case of fresh foreign investments during the year (until August2018), check if form ARF is filed within 30 days from the date of inward remittance. [Reg. 13.1(1)]
d. The auditor may check if the capital instruments were allotted against the above-mentioned inward remittances within statutory period of 60 days from the date of receipt of funds. [Para 2.3 of MD on FDI]
e. Check if form FC-GPR is filed by the entity within 30 days from the date of allotment of capital instruments.[Reg. 13.1(2)]
f. In case of transfer of capital instruments between a resident and non-resident, check if the transfer is recorded by the entity only after submission of form FC-TRS by the resident transferor or transferee, as applicable.[Reg. 13.1 (4)]
g. If an entity having foreign investment, invests in another Indian entity, such investment is treated as indirect foreign investment or downstream investment. If the entity being audited has such downstream investment, check if the same is notified to DIPP through FIFP portal, and whether Form DI is filed with RBI within 30 days of such investment. [Reg 14 and 13.1(11)]
h. Check such downstream investment is not made from funds borrowed in the domestic markets but is made only out of internal accruals or out of foreign funds. [Reg. 14(5)(b)]
i. Ensure the compliance of regulations relating to downstream investments are mentioned in the Directors report of the company. Also, the auditor shall issue a certificate on annual basis towards downstream investment regulations compliance. [Reg. 14(5)(d)]
j. Check if the foreign investment has not resulted in to round-tripping of funds in to India (i.e., nexus between FDI and ODI transactions of the entity).If noted, ensure post facto approval of RBI is sought for.
k. Check if Annual Return on Financial Liabilities and Assets (FLA) is filed by July 15for preceding financial year. [Reg. 13.1 (3)]

2. Overseas Direct Investment by Indian Parties (ODI):

FEM (Transfer or issue of any foreign security) Regulations, 2004, as amended from time to time, ("ODI Regulations") deal with investments by persons resident in India. Under these regulations, an Indian Party (IP) means a company incorporated in India or a body created under an Act of Parliament, registered partnership firm or a limited liability partnership making investment in a joint venture (JV) or wholly owned subsidiary (WOS).

Financial Commitment (FC) means the amount of direct investment by way of contribution to equity, loan and 100% of the amount involved in guarantees and 50% of the performance guarantees issued by an IP to or on behalf of its overseas JV or WOS. Under ODI Regulations, Compulsorily Convertible Preference Shares shall be treated at par with equity for FC calculation. As long as the investments are in line with the regulations, they are under automatic route. Otherwise prior approval of RBI is to be taken (approval route). Below are few important regulations which are to be looked in to for compliance.

If the entity being audited has made overseas investment, the auditor may adopt suitable procedures to review the compliances of FDI Regulations, as under:

a. Check if all the remittances made abroad (including guarantees issued to overseas JV / WOS) are accompanied by Form ODI-Part I. The form can be submitted up front along with remittance request or within 30 days from the date of such remittance. [Reg. 6(2)(iv)]
b. Check to ensure that all the ODI transactions are routed through AD Bank only, and that a specific branch of AD Bank is designated for ODI transactions [Reg. 6(2)(v)]
c. If overseas investment is made in the form of capitalization of amounts due to the entity towards export proceeds, fee, royalty or other eligible amounts, check if Form ODI is submitted for such transactions. Also check if RBI approval is in place, if such capitalization is of receivables outstanding for more than nine months / period specified by RBI. [Reg. 11]
d. In case the entity is on RBI's exporters caution list or list of defaulters, or under investigation by CBI / ED etc, check if the fact is appropriately reported in Form ODI.[Reg 6(2)(iii)]
e. Check whether Unique Identification Number (UIN) allotted by RBI against first ODI transaction is quoted on second and all subsequent ODI transactions. That is, second ODI transaction should not be undertaken till UIN is allotted by RBI.[Reg. 10]
f. Where the entity has diversified its activities or set up step down subsidiary or alter the shareholding pattern in overseas entity, check if the same is reported to RBI within 30 days from the date of approval of decisions for such activities. [Reg. 13]
g. Check if the entity has submitted copy of share certificates or any other proof of investment in overseas entity, within 6 months from the date of remittance / capitalization.[Reg. 15 (i)]
h. Check if the entity has repatriated to India all the dues receivable from overseas entity like dividend, royalty, etc within 60 days of its falling due. [Reg. 15(ii)]
i. Check if the entity has filed Annual Performance Report (APR) in form ODI – Part II on or before the due date (currently December 31) in respect of each JV / WOS abroad, which shall be based on audited annual accounts of JV / WOS for the preceding year. [Reg. 15(iii)]
j. APR under form ODI – Part II shall be certified by statutory auditor as per regulations. In case, the overseas JV / WOS is not mandatorily required under law of host country to get their accounts audited, the auditor shall certify in the APR that the figures in the APR are based on unaudited accounts of JV / WOS and that they have been adopted and ratified by the Board of the entity.[Reg.15(v)]

k. Check if the overseas investment has not resulted in to round-tripping of funds in to India (i.e., nexus between FDI and ODI transactions of the entity).If noted, ensure post facto approval of RBI is sought for. [Bona fide activity under Reg. 6(2)(ii)].The scope of word bona fideused in the regulation is very vast and the auditor should be extra scepticbased on factual case to case scenario.

l. Check if Annual Return on Financial Liabilities and Assets (FLA) is filed by July 15 for preceding financial year.

3. Export of Goods and Services:

FEM (Export of Goods and Services) Regulations, 2015 ("Export Regulations") and Master Direction No. 16/2015-16 on Export of Goods and Services("MD on Exports") provide detailed guidelines on export transactions. The auditor should specifically focus on realization and repatriation aspects as part of review of export transactions. Below are few important points in this regard:

a. Check if the full value of export proceeds is realized and repatriated to India within 9 months from the date of export for all exporters. [Reg. 9(1)]

b. In case of goods exported to warehouse established outside India, the proceeds shall be realized within 15 months from the date of shipment of goods. [Reg. 9(1)(a)]

c. AD Banks are authorized to provide extension for realizing the export proceeds beyond the periods mentioned above for a period of 6 months at a time. Check if such approval is available in case of delayed realization of export proceeds In case, AD Bank has provided extension beyond one year, the total outstanding of the exporter shall not exceed USD 1 Mn or 10% of average import remittances during the preceding 2 financials years whichever is higher. [Para C.20 of MD on Exports]

d. In case export proceeds are realized from a third party based on business requirements, the auditor should check if the same is approved by AD Banker, and relevant conditions attached to such arrangements are followed.[Para A.3.v of MD on Exports]

e. Where an entity receives advance payment towards exports, it shall be under obligation to ensure that the shipment of goods is made within one year from the date of receipt of advance payment (rate of interest, if any, shall not exceed LIBOR+100 basis points). [Reg. 15(1)]

f. If there are sale proceeds arising during an international exhibition outside India, the entity can open a temporary foreign currency account abroad for this purpose, and the entity shall repatriate such proceeds to India within a period of one month from the date of closure of exhibition.[Para A.4 of MD on Exports]

g. If the entity is holding any EEFC account, the total of the accruals during a calendar month should be converted in to rupees on or before the last day of the succeeding calendar month after adjusting for utilization of the balances for approved purposes or forward commitments.[Para A.6.iv of MD on Exports]

h. In case of project exports (i.e., export of engineering goods and execution of turnkey projects and civil construction projects abroad), the entity shall obtain prior approval of AD Bank before undertaking execution of such contracts. (Reg. 17)

i. Where goods, being machinery, equipment etc, are exported on lease / hire basis with ultimate re-import, the entity shall take prior approval of RBI through AD Bank. Similarly exports on elongated credit terms also shall have prior approval of RBI.[Para A.15 and A.16 of MD on Exports]

j. Exporters would be caution listed if any shipping bill is not realized for more than 2 years provided no extension is granted by AD Bank / RBI. Auditor should consider this fact in analysing its impact on other FEMA compliances, as caution listing will may end eligibility to utilise automatic route and leading to additional compliances. [Para C.28 of MD on Exports]

k. If there are any book adjustment entries reflecting setting off / netting off of export receivables with import payables in respect of any overseas buyer / seller, the auditor should check if appropriate approval of AD Bank is obtained by the entity.[Para C.26 and C.27 of MD on Exports]

l. In case, export proceeds are not able to be realized in full and thereby the entity has written off in books, the auditor should check if such write off is within the limits allowed (self-write off up to 5% and AD approval write off up to 10% of total export proceeds realized during the previous calendar year). Auditor should cross check such write offs with CA certificate submitted this regard. Any write off beyond the above limits should have RBI approval. Proportionate export benefits already availed should also be surrendered. [Para C.23 of MD on Exports]

m. In case there are any overdue receivables as on the last date of fiscal year, the entity needs to report to AD Bank, on or before 30th April of following year.

4. Import of Goods and Services:

Master Direction No. 17/2016-17 Dated 1.1.2016 on Import of Goods and Services ("MD on Imports") provide detailed guidelines on compliances regarding import transactions. Below are few important points in this regard:

a. Check if the import payables are paid within a period of 6 months from date of shipment.[Para B.5.1 of MD on Imports]

b. In case there are outstanding payables beyond the above-mentioned period, the auditor should ensure to check if AD Banker's approval is sought for extension of time for settling such import dues.AD Banks are authorized to provide extension for a period of 6 months at a time, and not exceeding 3 years in total. In case, AD Bank has provided extension beyond one year, the total outstanding of the importer shall not exceed USD 1 Mn or 10% of average import remittances during the preceding 2 financials years whichever is lower. [Para B.5.4 of MD on Imports]

c. If no such AD Bank approval is available, Auditor should check if the entity has obtained RBI's approval for deferred payment arrangements in the form of Trade Credit [Also refer Trade Credit compliances provided under ECB head in this article]

d. If any payment towards import liability is made to a third party, the auditor should check if AD Bank approval is available for such payment to third party.[Para B.7 of MD on Imports]

e. In case advance remittances are made towards imports, generally the physical imports should be made within 6 months (3 years in case of capital goods) from the date of remittance, or as per the terms of the contract, and the entity should submit documentary evidence of import within 15 days thereof. Also, to ensure that wherever advances are paid beyond specified threshold limit, the Indian Company need to obtain Advance Bank Guarantee (ABG) from the supplier.

5. Branch Office outside India:

Para C.6 of Master Direction on Export of Goods and Services ("MD on Exports") provides guidelines on setting up of branch office of Indian entity outside India. The auditor may check the below in this regard:

a. In case a foreign currency account is opened with a bank outside India, the auditor should check if the same is informed to AD Bank or not. [Para C.6.iii of MD on Exports]
b. Amounts remitted to overseas branch / office shall not exceed 15% of average annual sales / turnover in the last 2 financial years or up to 25% of net worth whichever is higher, in case of initial expenses on setting up. And in case of recurring expenses, the same shall be limited to 10% of average annual sales / turnover of last 2 financial years. [Para C.6.i and ii of MD on Exports]
c. The overseas office / branch / representative should not create any financial liability (contingent or otherwise) for the head office in India.[Para C.6.ii.c of MD on Exports]
d. An audited yearly statement of receipts, expenses and repatriation from overseas office / branch shall be submitted to AD Bank.[Para C.6.vii of MD on Exports]

6. Branch Office (BO) / Liaison Office (LO) / Project Office (PO) in India

FEM (Establishment in India of BO or LO or PO or any other place of business) Regulations, 2016 ("BO/LO/PO Regulations") and Master Direction no. 10/2015-16 ("MD") on this subject matter provide detailed guidelines in this regard. The auditor may check the below points :

a. Check the validity period of permission granted (at a time for maximum of 3 years) to concerned LO with reference to UIN and approval letter issued by RBI or extension letter issued by AD Bank. [Reg. 4(d)]
b. In case of LO, the auditor may check the approval of RBI in case such LO is having more than one bank account in India at any point of time. [Para 3 of MD]
c. The auditor may check the submission of Annual Activity Certificate within 6 months of completion of financial year by BO / LO to the AD Bank and Director General of Income Tax - International Taxation (Only to AD Bank in case of PO). [Reg. 4(l)]
d. In case of transfer of assets of BO/LO/PO, while issuing a certificate in this regard, the auditor should check for dates of acquisition, original price, depreciation till date, present book value and sale consideration. The sale consideration should not be more than the book value in each case. In case of transfer of assets to JV / WOS, it can be done only if such BO/LO/PO is intended to be closed. [Reg. 4(k) of BO/LO/PO Regulations and Para 11 of MD]
e. In case BO/LO/PO is in the process of closure as at year end, the auditor may check the documents submitted to AD Bank in this regard, and accordingly report the same in his audit report.
f. In case of change in top management or CEO/MD/CMD of BO/LO, such change should be intimated to AD Bank [Para 12(xi) of MD]

7. External Commercial Borrowings (ECB) and Trade Credit (TC):

FEM (Borrowing or Lending in Foreign Currency) Regulations, 2000 ("ECB and TC Regulations") and Master Direction No. 5/2015-16("MD on ECB & TC) on the subject matter provide guidelines on ECB and TC matters. It may please be noted that RBI vide Notification FEMA 3(R)/2018-RB, dated 17.12.2018 notified FEM (Borrowing and Lending) Regulations, 2018 which superseded earlier regulations on ECB and TC ("New ECB and TC Regulations").

Operational instructions for implementation of new ECB regulations were issued by RBI on ECB matters vide AP (DIR Series) Circular No. 17, dated 16.01.2019 and on Trade Credit matters vide AP (DIR Series) Circular No. 23, dated 13.03.2019. Similarly, RBI issued Master Direction No. 5/2018-19 dated 26.03.2019 on ECB and TC matters, which superseded previous Master Direction on subject matter. Accordingly, the auditor should check compliances by keeping both the regulations in mind as applicable for relevant period. The auditor may check below important points.

Regulation references provided pertain to previous ECB Regulations and corresponding Master Direction unless specifically mentioned, because they are applicable for majority period of previous financial year.

a. Where an entity has borrowings in foreign currency or in Indian rupees from overseas lenders, the auditor may check or review Form ECB / Form 83 submitted to RBI / AD Bank for their approval. [Para 2.11 of MD on ECB & TC]
b. Check if any draw-down in respect of ECB as well as payment of any fees / charges for raising ECB is made only after obtaining Loan Registration Number (LRN) from RBI.[Para 2.12.1 of MD on ECB & TC]
c. Review revised Form 83 submitted to AD Bank where there are any changes to terms and conditions of ECB as compared to original approval. [Para 2.12.2 of MD on ECB & TC]
d. Review monthly Form ECB-2 submitted to AD Bank towards actual ECB transactions of the month, the due date for which is 7 working days from the close of month to which it relates. [Para 2.12.3 of MD on ECB & TC]
e. Where there is any conversion of ECB in to equity (in part or in full), the auditor may check for compliance in the form of submitting Form FC-GPR towards equity (converted portion) under FDI Regulations including other compliances mentioned thereunder and Form ECB 2 towards ECB (unconverted portion) under ECB regulations. [Para 2.12.4 of MD on ECB & TC]
f. Where any ECB matured is found to be unpaid, the auditor may check if the same is reported and approved by AD Bank.[Para 2.16(xiv) of MD on ECB & TC]
g. In case of deferred payment arrangements for import transactions, the auditor may check Trade Credit approval (Minimum maturity period of 5 years for capital goods and 1 year or operating cycle whichever is less for non-capital goods under ECB Regulations) in the form of Trade Credit Registration Number sought from AD Bank. (Limited to 3 years for capital goods under New ECB Regulations). [Reg 6(3) read with Schedule III of ECB Regulations]
h. Also check that wherever the company is under obligation to hedge the ECB and TC amount, whether Derivative Regulations are complied with

Conclusion:

Also, RBI vide Circular no. RBI/2018-19/83, dated 29/11/2018, has issued a Road Map for covering all the companies under Legal Entity Identifier (LEI) Regime in phases for the companies dealing in non-derivative transactions (OTC contracts). Hence apart from the above compliances the auditor may also check that whether required LEI number is obtained by the company.

FEMA is an ocean by itself and requires specialization in the subject to have a comprehensive check on compliances. The compliance requirements mentioned in this article are those which are most commonly found in practice and provides a reasonable comfort as to coverage of FEMA provisions. However, the auditor may have to go extra mile based on facts of the case to get a better comfort in FEMA compliances.

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GST

CHANGES TO REAL ESTATE SECTOR

Contributed by CA Sri Harsha & CA Manindar

Background:

1. The Central Government has issued various notifications dated 29th March 19 to bring out the changes to the tax rates applicable for real estate sector. In this note, we have made an attempt to understand the impact of such notifications and the way forward for the promoters. Without any further delay, let us proceed to understand the notifications.

Snapshot of Changes:

2. Essentially, the notification dealing with rate of tax has categorised, the projects as under:

Projects						
Fresh/Ongoing					Ongoing	
RREP			REP		PMAY & Likes	Res & Commerical
Affordable	Other than Affordable	Commercial Portion in RREP	Affordable	Other than Affordable	(ie)	(if)
(I)	(ia)	(ib)	(ic)	(id)	8%	12%
1%	5%	5%	1%	5%	ITC Allowed	ITC Allowed
No ITC	No ITC	No ITC	No ITC	No ITC		

Option of Old Rate - Only for Ongoing Projects:

3. The promoter has been given a onetime option for ongoing projects to choose whether the rate of tax for his services would be new rate (5%)[1] or old rate (12%)[2]. Such option has to be frozen by 10th May 2019. If not selected by such date, the notification deems that promoter has opted for new rate and accordingly the balance credit shall lapse.

4. It is important to note that projects which commences on or after 01st April 19 does not have an option to choose 5% or 12%. They have to mandatorily collect and pay tax at 5%.

The option for choosing 5% or 12% is only for ongoing projects and not applicable for fresh projects which commence on or after 01st April 19.

Hence, promoter should satisfy as to whether his project falls under the definition of 'ongoing project'.

[1] In case of affordable, the new rate is 1%
[2] In case of PMAY and likes, the old rate is 8%

Conditions for Opting New Rate:

5. The difference between the old rate and new rate is detailed as under. **If a promoter wishes to choose the new rate that is 5% for the ongoing projects, he has to satisfy all the following conditions:**
   a. No input tax credit except in certain circumstances
   b. Reversal of credit[3] pertaining to credit attributable to project, where time of supply is after 1st April 19
   c. Developer pays tax on services provided to land owner for construction of land owner share
   d. Land owner shall avail credit of tax paid to builder and pays tax[4] on services provided to his customers
   e. 80%of value of input and input services[5] should be received from registered supplier
   f. Where in a financial year, such 80% threshold is not met, tax has to be paid by builder on shortfall @ 18%
   g. Cement purchased from unregistered supplier, the builder shall be liable to pay tax at applicable rates
   h. Promoter shall maintain project wise accounts for arriving 80% threshold and
   i. Pay tax on shortfall by end 30th June of succeeding financial year
   j. Tax on cement purchases from unregistered supplier has to be paid in month in which cement is received
   k. Input tax credit received shall be reported as ineligible in returns.

The option of 5% comes with many conditions to be satisfied. The promoter has to carefully examine, whether he will be in a position to satisfy all such conditions before making a final call in choosing the rate. Once chosen, there is no roll back option and he has to continue for the entire project.

On selecting, the 5% rate:

- the balance in credit ledger which pertains to construction happening post 01st April 19 shall lapse.
- 80% purchases should be from Registered Suppliers qua FY. Shortfall attracts tax at 18% under RCM.
- Land owner should be registered and required to pay tax on his share. Such tax shall not be less than what builder charges land owner. If land owner deferred his capital gains tax vide Section 45(5A) of Income Tax Act, the same has to be revisited.
- Cement purchased from unregistered supplier shall attract tax at applicable rates. The payment of tax on cement will be counted to arrive at threshold (look illustration 3 of 03/19)

[3]In absence of credit, payment has to be made in cash
[4]Such tax should not be less than tax paid by land owner to the builder
[5]Excluding Development Rights/FSI/Premium, Electricity, HSD, MS and Natural Gas

Fresh vs Ongoing Projects:

6. From the above, it is important to understand the difference between fresh project and ongoing projects. The definition of 'projects which commences on or after 01st April 19'has been defined in the notification to mean a project other than an 'ongoing project'.

7. A project shall be 'ongoing project' as defined in notification, when it meets all the following conditions, namely:
   - ***commencement certificate***(CC) in respect of project, where required to be issued by competent authority has been issued prior to 31st March 19 and it is certified by architect/engineer/surveryor that ***construction of project*** has started on or before 31st March 19:
   - where commencement certificate is not required to be issued by competent authority, it is certified by architect/chartered engineer/licensed surveryor that construction of project has started on or before 31st March 19
   - A completion certificate has not been issued or first occupation has not taken place before 31st March 19

- Apartments being constructed under the project have been, partly or wholly, booked on or before 31st March 19

8. For the purposes of the above, the phrases 'commencement certificate', 'construction of project', 'an apartment booked on or before 31st March 19' has been laid out as under:

   commencement certificate:

   means the commencement certificate or the building permit or the construction permit, by whatever name called issued by the competent authority to allow or permit the promoter to begin development works on an immovable property, as per the sanctioned plan.

   construction of project:

   construction of a project shall be considered to have started on or before the 31st March 19, if the earthwork for site preparation for the project has been completed and excavation for foundation has started on or before 31st March 19.

Apartment booked on or before 31st March 19:

shall mean an apartment which meets all the following conditions:

- part of supply of construction of which has time of supply on or before 31st March 19
- at least one of instalments has been credited to bank account of promoter on or before 31st March 19
- Allotment/AoS/similar instrument has been issued on or before 31st March 19

To call a project as 'ongoing project', it has to satisfy all the below conditions on or before 31st March 19:

- CC has been received from competent authority and same is certified by Architect/Engineer/Surveyor that construction has started
- In case no CC is required to be obtained, then certificate from Architect/Engineer/Licensed Surveyor that construction has started
- Completion Certificate has not been issued
- Bookings for partly/wholly of project should be there

In case project does not satisfy all the conditions, then such project shall be classified as fresh project and new rate of tax shall be applicable with all the conditions detailed vide 'Conditions for opting New Rate'.

RREP vs Commercial:

9. The term 'real estate project' (REP) has been defined to mean as defined in Section 2(zn) of Real Estate (Regulation & Development) Act, 2016 (for brevity 'RERA laws'). However, the term 'Residential Real Estate Project' (RREP) shall mean a REP in which the carpet area of commercial apartments is not more than 15% of the total carpet area of all the apartments in REP.

10. It is important to note that the phrase 'carpet area' has been defined to means as defined in Section 2(k) of RERA laws. The definition of 'carpet area' under RERA laws specifically exclude the area covered by external walls, areas under service shifts, exclusive balcony or verandah area and exclusive open terrace area, but includes the area covered by internal partition walls of the apartment.

11. Hence, care has to be taken while calculating the area of 15% to decide whether a project is a residential or commercial. This is important because, the commercial space is allowed to be taxed at 5% only if it forms part of RREP. In situation, where it does not form part of RREP, the said commercial space would attract 12% rate of tax. The definition of 'commercial apartment' is defined to mean an apartment other than 'residential apartment'. The definition of 'residential apartment' shall mean an apartment intended for residential use as declared to RERA or to competent authority.

- RREP is a REP in which commercial apartments is not more than 15% of total carpet area of all apartments in REP.
- If area of commercial apartments is less than 15% of total carpet area in REP, the rate of tax applicable is 5%. Otherwise it would be 18%.
- Determination of 15% is based on carpet area as defined in RERA laws. Care should be taken to arrive appropriate carpet area to reckon whether it is less than 15% or not.

- Determination of 'Carpet Area' under RERA laws is complicated.
- In this connection, MahaRERA has issued a clarification as to how carpet area has to be arrived. The said circular can be referred at https://maharera.mahaonline.gov.in/Upload/PDF/Clarification_on_Calculation_of_Carpet_Area.pdf

Affordable vs Other than Affordable:

12. The notification has defined 'affordable residential apartment' under two limbs. The first limb deals with fresh and ongoing projects, if the promoter has not chosen the old rate and opted for new rate. The second limb deals with constructions in the ongoing projects under specific schemes, where the promoter has not opted to pay tax at old rate.

First Limb:

13. The first limb of definition states that, an apartment shall be affordable residential apartment if such apartments having carpet area not exceeding 60 square meter in metropolitan cities[6] and not exceeding 90 square meters in cities or towns other than metropolitan cities **and for which gross amount charged is not more than 45 Lakh rupees.**

14. For arriving 45 Lakh rupees, the consideration charged by builder for services provided, the value charged for transfer of land or undivided share of land including lease or sub-lease and any other amount charged by promoter from buyer including preferential location charges, development charges, parking charges, common facility charges shall be added.

15. If both the above conditions based on square meters and gross amount charged are satisfied, such apartments are called as 'affordable residential apartments', where effective rate of tax is 1%. All conditions as mentioned in 'Conditions for Opting New Rate' shall be applicable and observed by Promoters.

[6]Bangalore, Chennai, Delhi NCR (specific areas), Hyderabad, Kolkata and Mumbai (whole of MMR)

Second Limb:

16. The second limb deals with constructions as per specified schemes with respect to ongoing projects. Vide second limb the constructions under specified scheme shall be called as 'affordable residential apartments' even though they do not satisfy the area requirement (60 or 90 square meter) or 45 lakh rupees. However, the promoter should not opt for payment of tax at old rates. The specified schemes are as under:

    - A civil structure or any other original works pertaining to In-situ redevelopment of existing slums using land as a resource, under Housing for All (Urban) Mission/PMAY (Urban) – Entry 3(iv)(c)
    - A civil structure or any other original works pertaining to the 'Beneficiary led individual house construction / enhancement' under the Housing for All (Urban) Mission/PMAY – Entry 3(iv)(d)
    - A civil structure or any other original works pertaining to the 'Economically Weaker Section (EWS) houses' constructed under the Affordable Housing in partnership by State or Union territory or local authority or urban development authority under the Housing for All (Urban) Mission/ PMAY (Urban) – Entry 3(iv)(da)
    - A civil structure or any other original works pertaining to the 'houses constructed or acquired under the Credit Linked Subsidy Scheme for Economically Weaker Section (EWS)/ Lower Income Group (LIG)/ Middle Income Group-1 (MIG-1)/ Middle Income Group-2 (MIG-2)' under the Housing for All (Urban) Mission/ PMAY (Urban) – Entry 3(iv)(db)
    - a single residential unit otherwise than as a part of a residential complex – Entry 3(v)(b)
    - low-cost houses up to a carpet area of 60 square metres per house in a housing project approved by competent authority empowered under the 'Scheme of Affordable Housing in Partnership' framed by the Ministry of Housing and Urban Poverty Alleviation, Government of India – Entry 3(v)(c)
    - low cost houses up to a carpet area of 60 square metres per house in a housing project approved by the competent authority under 'affordable housing in partnership' component of Housing for All (Urban) mission or PMAY or any other housing scheme of State Government – Entry 3(v)(d)
    - low-cost houses up to a carpet area of 60 square metres per house in an affordable housing project which has been given infrastructure status vide notification of Government of India, in Ministry of Finance, Department of Economic Affairs vide F. No. 13/6/2009-INF, dated the 30th March,2017 – Entry 3(v)(da)
    - a residential complex predominantly meant for self-use or the use of their employees or other persons specified in paragraph 3 of the Schedule III of Act – Entry 3(vi)(c).

17. If the promoter has not opted to pay tax under old rates and the project is an ongoing and falls under any of the above schemes, the rate of tax applicable is 1%. All conditions as mentioned in 'Conditions for Opting New Rate' shall be applicable and observed by Promoters.

18. If the promoter is engaged in construction of apartments which is not falling under 'Affordable Residential Apartments' and such project being a REP/RREP, then rate of tax applicable is 5%, if the promoter does not opt for old rate.

19. Composite supply of works contract in respect of apartments:
    a. which contains units which fit under 60/90 square meter and gross consideration is less than 45 lakhs (specific units)
    b. and such project is not covered under RREP or REP or
    c. and such project is not a project under specific schemes like PMAY and Others and
    d. promoter has not opted to pay tax at old rates

    then the rate of tax applicable is 12%.

20. The said rate shall be applicable only if the project has carpet area of specific units not less than 50% of the total carpet area of all the apartments in the project. **Further, in a case, where it finally turns out that carpet area of specific units is less than 50% of the total carpet area of apartments, then promoter shall be liable to pay under reverse charge equivalent to difference between the tax payable on service at applicable rate but for rate prescribed herein and the tax actually paid at the rate prescribed. For example, if the rate of tax is 18% and because of this entry, the rate was fixed at 12% and in case, if the carpet area of specific units is less than 50% of total carpet area, then promoter has to pay tax at 6%.**

- Affordable Residential Apartments are of two kinds. One with conditions linked to area and gross amount charged. The other is constructions under specified schemes.

Fresh or Ongoing Project:

- If area of apartment is less than 60/90 square meter and gross amount charged is less than Rs 45 lakhs – then the rate of tax is 1% with all conditions as applicable for option of new rate.

Ongoing Project:

- If project is under specified scheme under PMAY or Others, then rate of tax is 1% with all conditions as applicable for option of new rate.

Other than Affordable Residential Apartments:

- If the project is not an 'affordable residential apartments', and is REP/RREP, then the rate of tax applicable is 5%. The conditions as applicable for option of new rate shall be applicable.

80% Threshold & Consequences:

21. One of the conditions that promoter has to observe by opting for new rate (for fresh or ongoing project) is that he has to purchase 80% of inputs and input services from registered suppliers qua financial year. If in a financial year the promoter obtains completion certificate, then he has to comply with 80% by the time he obtains completion certificate.

Exclusions for 80% threshold:

22. For arriving 80% threshold, the purchase of development rights, FSI, premium, electricity, high speed diesel, motor spirit, natural gas shall be excluded. In other words, the promoter has to purchase 80% of his inputs and input services from registered suppliers by not taking the above purchases into consideration. For example, if 30% of purchases of promoter is diesel, such 30% shall not be taken for arriving the 80% threshold. Hence, out of the 70% expenditure, 80% has to be procured from registered suppliers, since purchase of diesel is not considered for arriving 80% threshold.

Inclusions for 80% threshold:

23. The promoter is allowed to include expenditure on which he is obliged to pay tax under reverse charge under Section 9(3) into the 80% threshold. In other words, the tax paid under reverse charge by promoter is deemed to be purchases from registered suppliers.

24. For example, if promoter has made purchases of 75% from registered suppliers and 25% from unregistered suppliers and out of 25% of purchases, if promoter is obliged to pay tax under reverse charge to the extent of 15% (say lawyer fee, goods transport agency services, sponsorship or import of services), then for calculating 80% threshold, the 15% expenditure shall be included. Hence, in this example, it would be deemed that promoter has purchased 90% (75% + 15%) from registered suppliers.

25. Further, the notification states that if promoter purchases cement from unregistered supplier, the applicable tax on such cement has to be paid under reverse charge under Section 9(4) by the promoter. **It is important to note that the tax shall be paid on cement not @ 18%, but on the rate applicable to cements**.

26. The said payment of tax on cement purchased from the unregistered supplier by promoter shall also be taken for calculating the 80% threshold. For example, if promoter has purchased 50% from registered suppliers, 15% of purchases of cement from unregistered supplier and balance 35% from unregistered supplier, then first tax under reverse charge on cement has to be paid at applicable rates and accordingly the said quantum will be included to arrive at 80%, in the instant case, the purchases from registered suppliers shall be 65% (50% + 15%) and tax @ 18% shall be paid on 15% (80% - 50% - 15%).

Liability to pay tax under reverse charge:

For Cement:

27. The liability to pay tax under reverse charge pertaining to purchases from unregistered suppliers shall be done at the time of receipt of cement.

For Shortfall:

28. The shortfall from the 80% threshold shall be computed on financial year basis and the tax on such shortfall shall be paid by 30th June of succeeding financial year. In other words, for the FY 19-20, the liability to pay tax shall be made not later than 30th June 20.

JDA – Obligations & Reliefs:

For transfer of development rights on or after 01st April 19:

29. Where the land owner has transferred development rights on or after 01st April 2019 the implications are detailed as under.

Exemption of tax on Transfer of Development Rights by Land Owner:

30. The land owner is relieved from payment of tax on transfer of development rights to the builder, wherein the consideration for land owner is agreed to be certain portion of constructed complex. In other words, the transfer of development rights (which attract tax under Notification 4/18) in the hands of land owner are exempted from payment of tax in terms of specific exemption vide Entry 41A to Notification 12/17 – CT (Rate).

31. It is important to note that the exemption is granted only to the extent of development rights pertaining to residential apartments. Hence, if a land owner parts away with development rights in a project where commercial and residential apartments are intended, then exemption shall be only to the extent of tax payable on development rights pertaining to residential apartments.

32. The value of supply of developmental rights parted by land owner which is eligible for exemption is deemed to be equal to the value of similar apartments charged by promoter from the independent buyers nearest to the date on which such developmental rights are transferred by land owner – Para 1A of Notification 12/17 – CT (Rate).

33. For example, if a land owner transfers development rights on 25th April 19, and as per the joint development agreement, the land owner is entitled for 40 flats (assuming entire project is residential), then value of development rights is equal to value of similar flats sold by promoter near to the date of transfer of development rights. That is to say, if promoter enters into an agreement of sale with an independent buyer for Rs 1 Crore on 5th May 19, then value of development rights transferred by land owner is Rs 40 Crores (40 flats * 1 Crore/flat).

34. Assuming, the entire project is 100 flats, out of which 20 are commercial and 80 are residential and land owner is entitled to 30 residential flats and 10 commercial flats, then exemption from transfer of development rights shall only be restricted to Rs 30 Crores pertaining to residential flats and land owner continues to be taxable for the transfer of development rights pertaining to 10 commercial flats.

Conditions for above Exemption:

35. The said exemption is on condition that the promoter will sell all flats of his share prior to the completion certificate. In a situation, where the promoter is unable to sell certain flats prior to completion certificate, then tax is required to be paid by promoter under reverse charge mechanism vide Entry 5B of Notification 13/17 – CT (Rate) on the date of completion certificate.

36. The value of such unsold or un-booked flats at the date of completion certificate, shall be deemed to be equal to value of similar apartments charged by promoter nearest to the date of issuance of completion certificate – Para 1B of Notification 12/17 – CT (Rate).

Rate of Tax & Liability of Tax:

37. The rate of tax in any case shall not exceed 1%[7] /5% of value of residential apartments remaining un-booked on date of issuance of completion certificate. The liability to tax arises on the date of issuance of completion certificate.

38. Continuing with the above example, if the promoter could not sell 15 flats (assuming the entire project is residential apartments other than affordable) of his share as on the date of issuance of completion certificate. Assuming carpet area un-booked is 10%, then, the liability of promoter is arrived as under:

    [GST Payable on Development Rights in residential apartment but for exemption contained] * [Carpet area of residential apartments in project which remain un-booked as on date of issuance of completion certificate] /[Total carpet area of residential apartments in the project]

39. Hence, the liability on promoter pertaining to un-booked flats shall be value of development rights * percentage of un-booked carpet area that is Rs 40 Crores * 10% which is Rs 4 Crores, on which tax payable will be 18% [8], which is amounting to Rs 0.72 Crore. However, this is not the final liability. Such liability of Rs 0.72 Crore has to be compared with 5% of value of 15 flats which are un-booked as on the date of issuance of completion certificate. Assuming the rate of flats near to the date of issuance of completion certificate is Rs 2 Crores, then value of un-booked 15 flats shall amount to Rs 30 Crores (15 flats * Rs 2 Crore/flat).

40. The liability of 5% on Rs 30 Crores shall be Rs 1.5 Crore and the notification states that liability cannot exceed 5% of value of un-booked flats as on the date of issuance of completion certificate. Hence, liability shall be to the tune of Rs 0.72 Crore. Hence, the notification states that there should be a comparison between 18% of value of carpet area which remains un-booked based on the value near to the transfer of development right with 5% of value of carpet area which remains un-booked based on the value near to the date of issuance of completion certificate. In any case, such tax payable shall not be more than 5% of value of un-booked flats near to the date of issuance of completion certificate.

[7] In case of affordable residential apartments

[8] Since DR attracts 18% rate of tax

- Development Rights (DR) transferred by Land Owner on/after 1st April 19 are exempted subject to a condition that promoter sells the entire share of his flats prior to issuance of completion certificate.

- If there are flats un-booked as on date of issuance of completion certificate, the promoter is required to pay tax under reverse charge.

- The tax is calculated based on value of DR * percentage of carpet area belonging to un-booked flats to the total residential apartments.

- However, the tax will be restricted to 5% of value of un-booked flats as on the date of issuance of completion certificate. 5% has to be replaced with 1% if project is affordable residential apartments,

Valuation:

- The value of DR is deemed to be equivalent to value of similar flats sold by promoter to independent buyer nearest to the date of transfer of DR.

- The value of un-booked flats as on date of issuance of completion certificate is deemed to be equal to the value of similar flats sold by promoter to independent buyer nearest to the date of issuance of completion certificate.

Supply of Construction Services by Promoter to Land Owner:

41. Under the new rate, the promoter shall continue to charge the land owner for the construction services provided by him to the land owner. In the above example, the promoter shall charge tax on value of construction services pertaining to 40 flats to the land owner at 5%.

Obligation of Land Owner on his Supplies:

42. The land owner can avail the credit of taxes paid to the builder for his construction services and utilise the same against his liabilities when he sells his share of flats prior to issuance of completion certificate. However, if land owner fails to sell any of his share of flats prior to date of issuance of completion certificate, the land owner is required to reverse such credit pertaining to unsold flats in his share as on the date of issuance of completion certificate. If he has utilised such credit by that time, then the same has to be paid in cash.

For transfer of development rights before 01st April 19:

43. No change in taxability of the transaction. The old position as in existence in light of Notification 4/18 – CT (Rate) shall be applicable.

- What is conditionally exempted is tax on transfer of DR and not any other leg of the entire JDA transaction.
- Hence, builder continues to charge tax on construction services provided by him to land owner.
- Land owner avails credit of tax paid to builder and uses the same for sale of his share of flats prior to issuance of completion

- The area of concern is what happens to the taxability of DR in a case, where DR is transferred prior to 1st April 19 but the promoter has opted for new rate of tax.
- This is a problem because the exemption is given only for DR transferred post 1st April 19. Further, since the promoter is not eligible for credit of taxes which are attributable to supplies post 1st April 19, the tax paid on DR by promoters becomes big cost.
- It would have been great if exemption is granted to DR also for ongoing projects where promoter has opted for new rate or by excluding such DRs from the ambit of services requiring reversal when dealing with credit attribution for supplies post 1st April 19.

Reversal of Credit attributable for supplies post 01st April 19:

44. One of the conditions for ongoing projects to opt for new rate is that the balance of credit which is attributable to construction of project, where time of supply is post 01st April 19 shall be lapsed. The Notification has laid down a detailed mechanism to arrive at the attribution of credit pertaining to the period post 01st April 19 for REP and RREP. In this note, we have dealt only with attribution pertaining to REP.

45. The notification deals with majorly two instances. One, where percentage of completion as on 31st March 19 is not zero or where there is inventory in stock. Two, where percentage of completion as on 31st March 19 is zero but invoicing has been done having time of supply before 31st March 19 and no input services or inputs have been received as on 31st March 19.

Scenario 1:

Where % of completion is not zero or where there is inventory in stock

46. The entire objective of this exercise is to find out the credit which is attributable to the supplies post 01st April 19. If such amount is found to be positive, then such amount requires reversal. If such amount is negative, then such amount can be carried forward as credit and can be used for payment post 01st April 19. Hence, we have to find such credit of input and input services which has time of supply (ToS) post 01st April 19. The said amount is represented as Tx.

47. This Txcan be arrived by removing the credit of inputs and input services pertaining to residential apartments for which ToS is prior to 31st March 19 (Tr) and removal of credit of input and input services pertaining to commercial apartments (Tc) from the total credit availed by promoter (T).

$$\mathbf{Tx = T - Te} \quad [\text{where } Te = Tc + Tr]$$

48. Here, T denotes total credit availed (whether utilised or not) on inputs and input services from 1st July 17 to 31st March 19 including transitional credit. Te denotes eligible credit attributable to commercial apartments and residential apartments for which ToS is prior to 31st March 19.

49. As stated earlier, if Tx is positive, that is T > Te, then the promoter has to reverse the credit or pay in cash an amount equivalent to T – Te. The logic behind the same is simple, Tx represents the credit pertaining to supplies where ToS is post 1st April 19, which cannot be availed because the promoter has opted for new rate. In other words, Tx is nothing but difference of total credit and credit attributable to residential and commercial apartments where ToS is prior to 31st March 19 and only such credit can be availed. By reversing the Tx, the credit pertaining to supplies where ToS is post 01st April 19 stands lapsed and credit pertaining to commercial apartments is separately availed, thereby the net effect is achieved.

50. If Tx is negative, that is T < Te, then the promoter can avail credit on goods and services received post 01st April 19 to the extent of difference between T and Te and utilise the same for payment of taxes. The logic behind the same is simple, the Te shall be more than T only in cases where promoter supplies for which ToS is before 31st March 19 and credit to such an extent has not flowed to him. Hence, he will be eligible for availing credit pertaining to inputs and input services which he receives post 01st April 19 for which tax has been paid prior to 31st March 19 based on time of supply provisions.

51. Now, let us proceed to understand how Te is determined. Te is nothing but summation of Tc and Tr. Tc is the credit of input and input services attributable to construction of commercial apartments. Tc can be arrived as under:

$$\textbf{Tc} = \textbf{(T)} * \frac{\text{carpet area of commercial apartments in REP}}{\text{total carpet area of commercial and residential apartments}}$$

52. Now, Tr has to be determined. It is important to note that Tr is nothing but the input tax credit attributable to inputs and input services which are used for construction of residential apartments where time of supply for such construction services is prior to 31st March 19. The notification states that Tr can be arrived as under:

Tr = (T) * F1* F2 * F3 * F4

53. F1 is the quantum of carpet area of residential apartments in the total carpet area of project which contains both residential and commercial. If the project is only residential, then F1 shall be 100%. If project is 50% residential and 50% commercial, then F1 shall be 50%. It is important to find out F1 since, we have to identify the credit pertaining to residential apartments from the total credit. F1 is calculated as under:

$$F1 = \frac{\text{carpet area of residential apartments in REP}}{\text{total carpet area of commercial and residential apartments}}$$

54. F2 deals with quantum of carpet area of residential apartments for which booking were received before 31st March 19. This is important because, we are trying to identify the credit pertaining to supplies where ToS is prior to 31st March 19 from the total credit. F2 gives us the quantum of bookings happened pertaining to residential apartments out of the total carpet area of residential apartments.

$$F2 = \frac{\text{total carpet area of residential apartments booked on or before 31st March 19}}{\text{total carpet area of residential apartment in REP}}$$

55. F3 is arrived by ascribing value to the booking that happened prior to 31st March 19, where ToS is prior to 31st March 19. In other words, the total value of bookings happened prior to 31st March 19 is arrived and from that amount the value pertaining to supplies where ToS is prior to 31st March 19 is identified. For example, 40 flats are booked prior to 31st March 19 and assuming each flat is Rs 0.6 Crore, the value of bookings happened prior to 31st March 19 would be Rs 24 Crores (40 flats * 0.6 Crore/flat). In this the promoter has to identify the percentage of supplies where the ToS is prior to 31st March 19. That is suppose, 20% of the invoices are raised because of ToS has been met, then the value of F3 will be Rs 4.8 Crore (20% of Rs 24 Crore).

56. If it is 60%, then F3 shall be Rs 14.4 Crore (60% of Rs 24 Crore). There is a possibility that percentage of completion might be lower than the percentage of invoices/receipt vouchers[9] of booked residential apartments prior to 31st March 19. In other words, a project may be completed 20% as on 31st March 19, but the invoices/receipt vouchers raised for bookings as on 31st March 19, may be 60%. Hence, F3 is determined as under:

$$F3 = \frac{\text{value of supply of construction of booked apartments for which ToS is prior 31st Mar19}}{\text{Total value of supply of construction of residential apartments booked on or before 31st March 19}}$$

57. F4 is bit tricky. F4 is trying to estimate the total credit that might be available for the promoter based on the percentage of completion of construction as on 31st March 19. In other words, if the total credit available for 20% completion of project is Rs 1 Crore, then F4 estimates that total credit that would be available for 100% completion is Rs 5 Crores (Rs 1 * 100/20). This is done to estimate the total credit that would be available for the promoter when juxtaposed with the invoicing/receipt vouchers. Let us assume, the credit for 20% completion is Rs 1 Crore. If the % of invoicing/receipt vouchers is 60%, then there is a chance that, credit pertaining to 40% (60% - 20%) has not flowed to the promoter. It is important to note that credit flows to promoter based on percentage of completion of project and not just by receipt of advances. However, promoter would have paid tax on receipt of advances. To give the additional credit which has not accrued to the promoter as on 31st March 19, but tax was paid, F4 is being calculated for the entire project and then restricting it to ToS prior to 31st March 19. F4 is calculated as under:

$$F4 = 1/\text{\% of completion as on 31st March 19}$$

58. Once F1, F2, F3 and F4 are arrived, the same shall be multiplied with Total Credit to arrive the credit that is attributable to the supplies where ToS is prior to 31st March 19. This is the methodology to arrive Tr. Once Tr is available, Te can be arrived by adding Tc and Tr. Then, removing Te from T, gives the Tx, which has to be reversed or taken as per the discussion above.

Scenario 2:

Where % of completion is zero, but credit has been availed on goods and services prior to 31st March 19:

59. Where percentage of completion is zero but credit has been availed on goods and services received prior to 31st March 19, credit attributable to construction of residential portion which has ToS on after 1st April 19, shall be calculated and the amount equal to Tx shall be paid or taken credit, by arriving F4 based on the certificate of architect/engineer, which should match with input services received and inputs in stock as on 31st March 19.

[9]The notification uses the word 'invoices'. Normally, the % of completion in any case cannot be lower than % of invoicing. In other words, % of completion matches with % of invoicing. Hence, we have to understand that invoicing used in notification includes receipt vouchers which were raised when collecting advances. Since ToS is being calculated, inclusion of receipt vouchers in the ambit of 'invoicing' sounds better. Otherwise, we do not envisage a situation as mentioned in Illustration 2, where % completion is 20% and % invoicing is 60%.

Scenario 3:

Where % completion as on 31st March 19 is zero but invoicing has been done having ToS before 31st March 19 and no inputs and input services have been received as on 31st March 19:

60. Since invoice/receipt vouchers have been done prior to 31st March 19, the promoter would have paid tax in cash/other credits at old rate. Since he has paid tax at old rate, credit to such an extent should be given to the promoter. Hence, the credit which arrives post 01st April 2019 to 31st March 2020 has to be taken into consideration to arrive such credit which is attributable to the invoicing happened at old rate.

61. The entire methodology as detailed in Scenario 1, shall be applicable with few changes with respect to T and F4. F4 will not be in existence since % completion is zero and one divided by zero would lead to infinity. Hence, F4 is dropped from the formula. Instead of T (total credit), Tn is being considered which is nothing but credit on goods and services availed during the period 19-20. Hence, with the said two changes, Te can be calculated and can be availed. F1, F2 and F3 would remain same and everything else also does not require any change.

Deemed value of Te:

62. The notification states in certain situations, the Te shall be determined by adopting a different mechanism. One of such instances is, where % completion of invoice > % completion of project and the difference is greater than 25% points, the value of % invoicing shall be restricted to % completion of project plus 25% points. In other words, if % completion of invoice is 60% and % completion of project is 20%, then the % completion of invoice shall be taken as 45% instead of actual 60%. This will happen only if the difference between % completion of invoice and % completion of project is greater than 25% points. In the instant case, it is 40% (60 – 20), hence 25% shall be added to % completion of project to arrive at % completion of invoice. **In the above scenario, the % completion of invoice shall be substituted with 45% instead of 60% while arriving F3**.The logic behind this is simple, in absence of such deeming fiction, certain promoters might increase F3 artificially, so that Te becomes negative and thereby avails such amounts as credit for utilisation post 01st April 19. Hence, the deeming substitution of % completion of invoices has been proposed.

63. Further, where value of invoices issued on 31st March 19 exceeds the actual consideration received on or prior to 31st March 19 by more than 25% of consideration actually received, the value of such invoices for the purposes of determination of % invoicing shall be deemed to be actual consideration received plus 25% of actual consideration. **This is also to restrict artificial inflation of F3. There may be certain promoters who would like to raise invoices stating that ToS was on 31st March 19, but consideration might not be received. The law states value of invoices should not exceed by more than 25% of actual consideration.**

64. Let us take an example to understand. Promoter has raised invoices on 31st March 19 stating ToS as said date and value of invoices is Rs 1 Crore and actual consideration received is Rs 70 lakhs. Hence, the invoice value has exceeded actual consideration by more than 25% that is Rs 87.5 lakhs (70 lakhs + 25%), hence the % value of invoices for the purposes of F3 shall be taken as Rs 87.5 lakhs and not Rs 1 Crore.

65. Where value of inputs and input services prior to 1st April 19 exceeds the value of actual consumption of inputs and input services used in % completion of construction as on 31st March 19 by more than 25% of value of actual consumption of inputs and input services, the jurisdictional Commissioner or any other Officer authorised in this regard may fix Te based on actual per unit consumption of inputs and input services based on documents duly certified by Chartered Accountant or Cost Accountant submitted by promoter.

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