Katalyst Kaleidoscope

July 2018: Tax and Regulatory Highlights

A. Income-tax Highlights

1. Demerger – No taxability trigger, absent consideration to demerged company[1]

- Datex Ohmeda (India) Private Limited ("Datex"), a wholly owned subsidiary of GE Healthcare OY, Finland ("GE"), was engaged in trading and servicing of medical equipments, which included Trading & Distribution ("T&D") division. During FY 2008-09, Datex transferred the T&D division to Wipro GE Healthcare Private Limited ("Wipro- GE") with effect from April 1, 2008 through a High Court approved Scheme of Arrangement ("Scheme").

- In the Scheme, since unsecured loan from holding company amounting to INR 50.62 Crores was not transferred, the AO regarded the demerger as a taxable "transfer" in the hands of the demerged company which was not eligible for claim of exemption u/s 47(vib) of the ITA and computed capital gains accordingly considering the said transfer as a "slump sale".

- The CIT(A) deleted the addition by the AO after taking into consideration various aspects including the argument canvassed by the assessee that the T&D division was transferred by the assessee company as a going concern by way of demerger for which shares were issued by Wirpo-GE to its shareholders and therefore, there was no monetary consideration which accrued to the demerged company.

  On appeal by the Revenue, while affirming that the demerger did not indeed satisfy the tax neutrality conditions u/s 2(19AA), the ITAT, nonetheless, accepted that the demerged company had not received any monetary consideration and therefore, should not be taxable as "slump sale" placing reliance on various judicial precedents[2].

Katalyst Comments:

Tax neutrality of demerger is unfortunately riddled with too many conditionalities, some of which do not seem to be logical at all; for example, the need to transfer the assets at book value and which actually has no prejudicial income tax implications. In this context, this very welcome decision which takes the argument to a much higher level, which is that demergers of such nature should not be liable to tax at all. This also brings out an important dimension: the existence of an

[1] Datex Ohmeda (India) Pvt Ltd [TS-320-ITAT-2018 (Kol)]

[2] Bombay High Court in case of CIT vs Bharat Bijlee Ltd [2014] 46 taxmann.com 257, Mumbai ITAT in case of Bennett Coleman & Co. Ltd vs ACIT [2018] 89 taxmann.com 415 and Hyderabad bench of ITAT in case of Zinger Investments Pvt Ltd [2013] 38 taxmann.com 388

exemption does not mean that the potential transaction or restructuring is taxable in the first place.

2. **Allowability of loss on off-market sale of shares to group company rejecting revenue's claim of colourable device**[3]

- Kolkata ITAT was dealing with a situation of long term capital loss on off-market sale of shares by assessee to its group company, it allowed the loss, rejecting revenue's stand that the off-market transaction with a group company, was a colourable device only to claim loss and reduce the tax burden.

- The ITAT observed as under:

  - Sale of shares was duly supported by documentary evidence;
  - Delivery instructions were issued to the depository participants for actual delivery of shares;
  - Value of shares were same as quoted on the stock exchange and due compliance with SEBI regulations was done;
  - Reliance was placed on CBDT circular no. 704 of 1995, Punjab & Haryana HC ruling in Pivet Finance Limited[4] and SC ruling in Azadi Bachao Andolan[5].

Katalyst Comments:

This decision highlights the dimension that an attempt by the revenue to attack a transaction can be countered appropriately if the transaction has substance, supported by appropriate documentation and tax payer is able to establish that the transaction is at arm's length and commercially justifiable.

3. **Non - applicability of provisions of Section 56(2)(viia) of the ITA on buy back of shares**[6]

- The Mumbai ITAT was dealing with the provisions of Section 56(2)(viia) of the ITA vis – a – vis a closely held company buying back its own shares. The ITAT clarifies that own shares cannot become property of the recipient company, and only shares of another company can become property of the company. Accordingly, provisions of section 56(2)(viia) of the ITA would have no applicability in case of buy back of shares.

[3] UMIL Share & Stock Broking Services Limited [TS-349-ITAT-2018(Kol)]
[4] CIT vs Pivet Finance Limited [192 Taxman 21 (P&H HC)]
[5] Union of India vs Azadi Bachao Andolan [263 ITR 706 (SC)]
[6] Vora Financial Services Private Limited [TS-346-ITAT-2018(Mum)]

Katalyst Comments:

Section 56(2)(viia) of the ITA has now been replaced by Section 56(2)(x) of the ITA w.e.f. April 1, 2017, the language of which is similar in the relevant context. This decision distinguishes between buyback of shares and receipt of shares of another company. Accordingly, applicability of Rules 11U and 11UA of the Income-tax Rules, 1962, for valuation of shares, would be restricted to transfer of 'shares of another company' and not applicable on buyback of shares.

4. **Authority for Advance Ruling ("AAR"): Payment received from India based group company under non-exclusive reseller agreement for sale of content delivery solution not FTS/ Royalty**[7]

- The applicant filed the application for advance ruling to determine whether payments received by the applicant under non-exclusive reseller services agreement to provide a global, secure and outsourced infrastructure facility using reseller's network and technology to customers be regarded as in the nature of FTS or Royalty under the Income-tax Act, 1961 or under India-US DTAA and whether withholding of tax under the provisions of ITA be required.

- It was held by the AAR that reseller agreement neither entails any grant or a transfer of rights in 'process' nor entails any use of 'process'. Also, solutions provided were in the nature of a 'standard facility' and did not cater to individual requirement of customers and there is absence of human intervention.

- The AAR distinguished revenue's reliance on ABB FZ[8] ruling which was rendered in the context of use/sharing of specialized knowledge, expertise, etc. by assessee through its employees, and observed in present case that there is no use/sharing of knowledge, information, etc. by the applicant with the reseller or the end user.

- The AAR has accordingly ruled that when payment received by the US holding company under reseller agreement for content delivery solutions is not towards any IPR / Trademarks, it cannot be covered within the definition of FTS/Royalty. Accordingly, in the absence of any PE in India, same would not be taxable in India and no requirement of withholding of tax arises u/s 195 of the ITA.

[7] Advance Ruling in case of Akamai Technologies Inc., – [2018] 93 taxmann.com 471 (AAR - New Delhi)
[8] ABB FZ-LLC vs DCIT [[2017] 83 taxmann.com 86 (Bengaluru Tribunal)]

5. CBDT: Revision of monetary limits for filing of appeal by Tax department[9]

- CBDT has enhanced the monetary limits and conditions for the tax department to file an appeal before the Tribunals, High Courts and SLP before the Supreme Court.

- Further, it prescribes that all the existing departmental appeals having tax effect below the prescribed monetary limits shall be pursued for dismissal as withdrawn / not passed.

- Prescribed enhancement in monetary limits are as under:

Appeal with respect to income tax matters before	Revised Monetary Limit	Existing Monetary Limit
Tribunal	INR 20,00,000	INR 10,00,000
High Court	INR 50,00,000	INR 20,00,000
Supreme Court	INR 1,00,00,000	INR 25,00,000

- Also, it has been clarified that an appeal should not be filed merely because the tax effect in a case exceeds the monetary limit as prescribed above. Filing of appeal in such cases is to be decided on merits of the case.

- The impact of new limits would be withdrawal of cases filed by the department in ITAT by 34%, in case of High Courts by 48% and in case of Supreme Court by 54%. Total percentage of reduction of litigation from revenue authority side would be reduced by 41%.

Katalyst Comments:
This initiative by CBDT, is a welcome move providing much needed relief to tax payers especially where small amounts are involved in the appeal.

6. CBDT seeks to address 'high pitched' tax demands

- A High-Pitched Scrutiny Assessment Committee ("Local Committee") was set up vide instruction no. 17/2015 dated November 9, 2015 in every tax region. However, it has apparently been a non-starter and CBDT Chairman Mr. Sushil Chandra has written a letter dated July 4, 2018 to the Principal Commissioners in all jurisdictions, the essence of which letter is to address and deal with High-pitched assessments.

[9] Circular no. 3/2018 dated July 11, 2018

- Here are some key highlights of the letter:
  - In cases where, Local Committee takes a view that addition made in the assessment order is high-pitched, an explanation of the AO would invariably be called for;
  - In case of relevant high-pitched assessments are found to be inappropriate, disciplinary actions would be taken against such AO;
  - Also, no coercive action should be taken by AO for recovery of demand in cases which have been identified as high-pitched by the Local Committee.

Katalyst Comments:

This initiative is an additional step towards transparency and reduction in tax terrorism.

B. Competition Commission of India

1. Online Guidance System for determination of notification requirement to the Competition Commission of India (CCI) in case of Mergers/ Acquisitions India

- Supplementing the Government of India's vision for e-Governance and Digital India Programme, the Competition Commission of India (CCI) has launched an Online Guidance System for determining notifiability of merger & acquisitions (combinations) in terms of the Competition Act, 2002. The Guidance System has been named as "Do It Yourself (DIY): A notifiability check for mergers & acquisitions under the Competition Act, 2002"

- The online guidance system has been launched as part of CCI's outreach initiatives and measures to simplify compliance requirements regarding combinations. The interactive online application has been developed based on relevant provisions of the Competition Act, 2002, relevant regulations issued thereunder and exemption notifications issued by the Ministry of Corporate Affairs.

- DIY toolkit is accessible at https://efilingcci.gov.in/DIY/#/

Katalyst Comments:

This is a very useful initiative by the CCI to simplify compliance requirements regarding combinations. This application envisages a staged process to guide the stakeholders in determining whether a merger/acquisition is notifiable to CCI.

C. Securities and Exchange Board of India

1. Enhancement of limits for overseas investment by AIFs and VCFs

- In terms of SEBI (Alternative Investment Funds) Regulations, 2012 ("AIF Regulations"), SEBI vide circular no. CIR/IMD/DF/7/2015 dated October 01, 2015 had allowed overseas investment by AIFs and VCFs to the extent of USD 500 million.

- SEBI has issued a circular[10] with effect from July 2, 2018, key highlights of which are as under:

  - It is now been decided to enhance the limit for overseas investment by AIFs and VCFs to USD 750 million.
  - Requirement for disclosure for utilization of the overseas limits has been mandated to be reported by AIFs and VCFs within 5 working days of utilization on SEBI intermediary portal at https://siportal.sebi.gov.in.

2. Acquisition of control on execution of call option agreement, triggers Open offer requirement: NDTV case – SEBI Order dated June 27, 2018

- In FY 2009-10, Vishvapradhan Commercial Private Limited ("VCPL") along with its associates entered into three agreements with promoters of NDTV, viz. Mr. Prannoy Roy ("PR"), Mrs. Radhika Roy ("RR") and RRPR Holdings Private Limited ("RRPR"), an entity wholly owned by Mr. PR and Mrs. RR.

- Under these agreements, VCPL granted a zero-interest unsecured loan for financing repayment of another loan taken by RRPR from bank, which in turn was taken to fund an open offer made by promoters in 2008.

- Agreements provided rights to VCPL as under:
  - To acquire 99.99% shares of RRPR conferred through issue of warrants any time (even after repayment of loan);
  - Veto rights in key management decision of NDTV and RRPR;
  - Rights to purchase upto 26% shares of NDTV at a price at premium of 51%.

- Observations made by SEBI are as under:
  - Tenure of warrants and option agreements was independent of the loan repayment as the agreements allowed exercise of options even after the loan was repaid in full;
  - Under 'Rights of First Refusal' clause in the agreement, promoters were restricted from transferring their shareholding in NDTV without the consent

[10] SEBI Circular : SEBI/HO/IMD/DF1/CIR/P/2018/103/2018 dated July 3, 2018

of VCPL and from engaging in other activity which was similar to the then broadcasting activities of NDTV without consent of VCPL;
- On exercise of rights under these agreements, VCPL will exercise 52% voting rights over shareholding of NDTV
- VCPL, being a small company (revenue of upto INR 60,000) had given advances of INR 400 Crs which was obtained from subsidiary of Reliance Industries Limited.

- SEBI has directed VCPL to make open offer to acquire shares of NDTV in accordance with SEBI (Substantial Acquisition of Shares and Takeovers) Regulations 1997 within period of 45 days and pay interest of 10% p.a. from the date of violation.

3. **Approval of SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018 ("ICDR Regulations 2018") to replace SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 ("ICDR Regulations 2009")**

- SEBI after considering the recommendations of the Primary Market Advisory Committee and public comments on consultation paper, has approved ICDR Regulations 2018.

- Some of the key proposals as approved are as follows:

Sr. No.	Particulars	Key Proposals	Existing provisions under ICDR Regulations 2009
1	Time period for announcement of price band	2 working days prior to opening of issue	5 working days prior to opening of issue
2	Financial disclosure for public / rights issue	3 years preceding data of restated and audited financials	5 years preceding data of restated and audited financials
3	Threshold for submission of draft letter of offer for rights issue to SEBI	INR 10 crs	INR 50 lakhs
4	Minimum anchor investors size in SME IPO	INR 2 crs	INR 10 crs
5	Threshold for identifying promoter group shareholding	20%	10%

- In addition to the above, following proposals are also approved:

  - Shortfall of up to 10% of minimum promoter's contribution can be met by institutional investors such as by foreign venture capital investors, scheduled commercial banks, public financial institutions and insurance companies registered with Insurance Regulatory and Development Authority of India, in addition to Alternative Investment Funds, without being identified as promoters;
  - For a company to be eligible to make fast track rights issue, it should not have any audit qualifications or adverse opinion.
  - Definition of Group companies is widened and shall include such companies (other than promoter and subsidiaries) with which there were related party transactions in past 3 years.

D. Corporate Law Highlights

1. **Chennai NCLT ("the NCLT"): Indian Limited Liability Partnership ("LLP") allowed to be merged with Indian Private Limited Company ("Company") under a scheme of amalgamation ("Scheme") filed before the NCLT**

- Scheme was filed before the NCLT for approval of merger of Real Image LLP ("Transferor LLP") with Qube Cinema Technologies Private Limited ("Transferee Company"). Under the above Scheme, NCLT dealt with question of whether an LLP can be allowed to be merged with Company under the Scheme of Amalgamation filed before NCLT.

- The NCLT noted as under:
  - The legislative intent behind the enacting the LLP Act, 2008 and the Companies Act, 2013 (collectively referred to as "Acts") is to facilitate the ease of doing business and to create a desirable business atmosphere for companies and LLPs;
  - Both the Acts provide for merger of two or more LLPs and Companies respectively;
  - The erstwhile Companies Act, 1956 permitted merger of an unincorporated partnership firm and a body corporate into a company. Further, Section 234 of the Companies Act 2013 also permits foreign body corporate into an Indian company.

- Therefore, in absence of a legal bar u/s 232 of the Companies Act, 2013 to permit merger of a LLP with another company, NCLT permitted merger of a LLP into a company notwithstanding the fact that there was no express provision for the same u/s 232 of the Companies Act, 2013.

Katalyst Comments:

This is a landmark decision providing a much wider scope to consider the merger of a Body Corporate with an Indian Company under the Companies Act, 2013 (since there were various precedents[11] permitting merger of a partnership firm with a company under the Companies Act, 2013). The tax impact of merger of LLP into company would need to be considered from the perspective of the partners of the LLP (who would receive the shares of the transferee company against their interest in the LLP) as well as the LLP itself (which is the transferor entity).

2. Mandatory KYC for all the directors of all companies by August 31, 2018

- Every director who has been allotted DIN on or before March 31, 2018 and whose DIN is in 'Approved' status, would be mandatorily required to file form DIR-3 KYC on or before August 31, 2018. Details such as Unique Personal Mobile Number and Personal Email ID are mandatorily required to be indicated and would be duly verified by One Time Password (OTP).

- The form would need to be filed by every director using his own digital signature ("DSC") and should be duly certified by a practicing professional (CA/CS/CMA). Filing of DIR-3 KYC would be mandatory for 'Disqualified Directors' also.

- After expiry of the due date by which the KYC form is to be filed, the MCA21 system will mark all approved DINs (allotted on or before March 31, 2018) against which DIR-3 KYC form has not been filed as 'Deactivated' with reason as 'Non-filing of DIR-3 KYC'. After the due date of filing of DIR-3, KYC in respect of such deactivated DINs shall be allowed upon payment of a specified fee only, without prejudice to any other action that may be taken.

Katalyst Comments:

This initiative for mandatory filing of DIR-3 would enable cancellation of all the duplicate / dormant DINs with MCA, which, in turn, would help in identifying Shell companies.

[11] Ahmedabad NCLT in case of Kedia Ceramics dated September 27, 2017 and Mumbai High Court in case of Kirtilal Kalidas Diamonds Exports Pvt Ltd [148 CompCase 607]

E. Reserve bank of India

1. **Modifications under Liberalized Remittance Scheme ("LRS") - Vide circular RBI/2017-18/204. A.P. (DIR Series) Circular No.32 dated June 19, 2018**

- Currently, under the LRS, resident individuals are allowed to remit upto US$ 2,50,000 per financial year for any permitted current or capital account transaction or a combination of both.

- Key amendments introduced vide the above circular are as under:

  - The definition of 'relative' under the master direction has been aligned with the Companies Act 2013. Prior to this circular, definition of 'relative' was aligned to the Companies Act, 1956 which was broader and included many second-degree relations;

  - Disclosure of PAN has been made mandatory for all remittances under the LRS. Prior to this circular, PAN was mandatory for making remittances under the LRS only for capital account transactions and permissible current account transactions above US$25,000.

F. Indirect Taxes

1. **Key GST Amendments**

- It is clarified by circular no. 49/23/2018-GST dated June 21, 2018 that where a conveyance (vehicle, aircraft, vessel) carrying various consignments is intercepted and documents (e-way bill and other documents) relating to some of the consignments are provided by person-in-charge, in that case, only such consignments with respect to which violation under the GST law is established should be confiscated/detained and not the all consignments of a conveyance.

- The GST Council has released a set of draft amendments in the CGST Act, IGST Act and GST (Compensation to the States) Act for public comments, which was requested to be submitted by July 15, 2018. The significant amendments proposed and their impact are mentioned below:

Sr no.	Section	Proposed amendments	Katalyst Comments
1	Schedule I, entry no. 4 – Supply liable for GST even	The entry is proposed to be amended to include Import of service from a related person or from any of his	Import of service even by non-taxable person (no outward GST liability) from a related

Sr no.	Section	Proposed amendments	Katalyst Comments
	if made without consideration	other establishments outside India without consideration even by a **non-taxable person** in course of business as 'supply without consideration'	person in course of business without consideration is liable to GST
2	Schedule III – Activities to be treated as neither supply of goods nor supply of service	Following activities are proposed to be added to the list of activities which do not amount to supply of goods or services: • Supply of goods from a place in non-taxable territory to another place in non-taxable territory without entry in taxable territory • Supply of warehoused goods to any person before clearance for home consumption • Supply of goods by endorsement of documents of title before clearance from home consumption	Government intends to resolve the ambiguity in treatment of high sea sale transactions, merchant trade transactions and transactions relating to sale of goods stored in customs bonded warehouse.
3	16(2)-Credit eligibility and conditions for taking input credit	It is proposed that in case of reversal of credit due to non-payment of consideration to a supplier within 180 days from the date of invoice, no interest will be payable	Welcome change
4	34(1) and 34(3) – Credit note and debit note	It is proposed to allow issuance of credit /debit note against multiple invoices	Welcome change especially for Pharma, FMCG sector

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