# Katalyst Kaleidoscope

June 2019: Tax and Regulatory Insights

## A. Income-tax Highlights

### 1. Issue of preference shares at a premium attracts provisions of section 56(2)(viib) of the ITA

Jaipur Income-tax Appellate Tribunal ("ITAT"), in the case of Ginni Global Pvt Ltd[1], has held that section 56(2)(viib) of the ITA does not distinguish between equity and preference shares and therefore, issue of preference shares at a premium will be covered under the provisions of section 56(2)(viib) and the valuation should be determined under Rule 11UA(1)(c) (which provides that the fair market value shall be the estimated price such shares would fetch if the same were sold in the open market) and not Rule 11UA(2) (which only refers to "equity shares").

Further, the ITAT also observed that for the purposes of determining the valuation, the valuation date should be the date of issuance of preference shares and not the last balance sheet date, as was adopted by the assessee. Further, where the Net Asset Value determined as per the valuation report obtained by the assessee is arrived at by dividing the difference between assets and liabilities by total paid up capital, the paid-up capital should include both, equity as well as preference share capital. The ITAT, thus, remanded the matter back to the Assessing Officer to determine the value based on the above discussions.

***Katalyst Comments:*** *While the main issue of considering share premium as income continues to be unaddressed, this case is an instance of unwarranted and undue litigation arising on account of outlier legislation.*

### 2. Bombay High Court ("HC") affirms the principle that amendments in the Income-tax Act ("ITA") would not override provisions of a Double Taxation Avoidance Agreement ("DTAA")

In the case of Reliance Infocomm Ltd.[2], the taxpayer did not withhold taxes on amounts paid to a Dutch company, but the Revenue contented that such payments were taxable as "royalty" and hence, subject to withholding tax. The Bombay HC relied on the decision of the Delhi HC in the case of New Skies Satellite BV[3] and reiterated the observation that amendment made to domestic law cannot be considered to be reflected in the provisions of the DTAA unless a specific amendment is made in the DTAA itself.

### 3. India ratifies Multilateral Instrument

As a very important step towards implementing BEPS measures, the Indian Government has ratified the Multilateral Convention (MLI) on 27 May 2019[4]. India had signed the MLI on 7 June 2017, becoming one of the 88 countries that had done so.

[1] ITA No. 1009/JP/2018
[2] ITA No. 1395/ 2016
[3] 382 ITR 114
[4] Press release dated 12 June 2019

India will now have to submit the ratified copy of the MLI with the OECD, along with the final list of the Covered Tax Agreements ("CTA") (tax treaties that India wishes to be modified by MLI) and its final position on MLI Articles. While the press release mentions that India has finalised its position on the MLI Articles, the details are not yet available in the public domain.

***Katalyst Comments:*** *This step reinforces India's commitment to embracing the BEPS recommendations or curbing revenue loss through treaty abuse. While the MLI will become effective once the CTA partner ratifies the MLI and notifies the OECD (if not already done so), it would become imperative for cross-border transactions to be examined in view of the anti-avoidance positions that would be introduced by the MLI.*

**4. Extension granted to Task Force for submitting report on New Direct Tax Law ("DTL")**

After being granted an extension of 3 months upto 31 May 2019 from the original release date of 29 February 2019, the Task Force constituted for submitting its report in relation to the New DTL has been given further extension of 2 months i.e. the report is to be submitted by 31 July 2019. Major structural changes (as opposed to incremental amendments) are expected from the New DTL.

## B. Corporate Law Highlights and Schemes

**1. Ministry of Corporate Affairs ('MCA') notifies procedure for conducting meetings of the National Financial Reporting Authority ('NFRA')**

In November 2018, the MCA had notified the NFRA Rules, 2018 to lay down the powers, jurisdiction, roles, and duties of the NFRA (an independent regulator for the auditing profession). With an aim to streamlining the procedures and facilitating effective operation of the NFRA, the MCA has now notified[5] the procedure for conducting meetings of the NFRA.

**2. NCLAT sets aside NCLT order which declined sanction to a demerger scheme at the application stage**

NCLAT observed[6] that the Appellant had filed an application before NCLT, praying for dispensation of meetings of their creditors and shareholders by producing requisite consent affidavits in support of the scheme; however, NCLT rejected the proposed scheme in view of pending issues and investigations, without ordering a meeting of members and creditors for considering the scheme.

[5] Notification dated 22 May 2019
[6] MEL Windmills Pvt. Ltd. vs. Mineral Enterprises Ltd. & Anr. [LSI-289-NCLAT-2019(NDEL)]

NCLAT held that the Tribunal had erred in dismissing the application without dispensing with or directing convention of meeting of members/ creditors. NCLAT, thus, held that NCLT's order breached the mandate of law engrafted u/s 230(1) of the Companies Act, 2013 ("Companies Act") as it wasn't required to venture into the merits of the proposed scheme of demerger before obtaining the consent of members/ creditors. NCLAT also observed that pending issues could not be construed as an impediment in sanctioning the proposed scheme and the pending investigations could continue without any impact on the proposed scheme. In view of the above, NCLAT remanded the matter to NCLT for proceeding in view of the observations made by the NCLAT.

**3. NCLT allows petition for selective reduction of share capital u/s 66 of Companies Act**

In the case of U. P. Twiga Fiberglass Ltd[7], the company had filed a petition before the NCLT for reduction of share capital u/s 66 of the Companies Act at fair value to offer an exit opportunity to non-promoter shareholders pursuant to its delisting. Regional Director objected that selective capital reduction is not covered u/s 66.

Based on various judicial precedents, the NCLT Allahabad Bench observed that a company is permitted to reduce its share capital "in any manner" and therefore, selective capital reduction is within the framework of law. NCLT also observed that the NCLT would not be justified in withholding its sanction once it was established that the non-promoter shareholders were being paid a fair value for their shares and a majority of the said non-promoter shareholders had voted in favour of the resolution for capital reduction.

**4. Independent directors may soon have to qualify corporate literacy exam before their appointment in company Board**

The Government has proposed to introduce corporate literacy test for independent directors as a pre-condition to be appointed on company board. The exam will be conducted online covering the basics of Indian company law, ethics, and capital market rules. Experienced directors, who have been on boards for several years, will be exempt from the test but will be required to get registered on a database.

## C. RBI and Foreign Exchange Regulations Highlights

**1. Reserve Bank of India ('RBI') amends Voluntary Retention Route ('VRR') scheme for Investment in Indian debt securities by Foreign Portfolio Investors ('FPIs')**

RBI had released the VRR Scheme in March 2019 (refer March 2019 issue of Katalyst Kaleidoscope for details) for investment by FPIs in debt markets. Pursuant to receiving

[7] U.P.Twiga Fiberglass Ltd., CA No.405/ALD/2018, dated 28.05.2019, NCLT, Allahabad

feedback, RBI has made certain amendments to the scheme vide a circular dated 24 May 2019[8]. The key changes made have been summarised below:

i. A new category of eligible instruments has been introduced i.e. VRR Combined, which allows Investment in government securities as well as corporate debt;
ii. Overall investment limit has been capped at INR 750 billion, which will be allocated among the eligible instruments as may be decided by RBI;
iii. In case an FPI decided to not continue with VRR at the end of the retention period, in addition to the options of liquidating the portfolio and exiting, or shifting the investments to general investment limit, the FPI will now also have the option of holding the investment till maturity or sale, whichever is earlier.

The current investment window for VRR has been opened for allotment since 27 May 2019 and will be open till 31 December 2019, subject to exhaustion of the limits.

**2. RBI issues new resolution norms for stressed assets**

Pursuant to the previous circular[9] mandating lenders to initiate resolution even with 1-day default being held as non-constitutional by the Supreme Court, the RBI has released fresh guidelines for NPA resolution (which will supersede all the previous norms).

Under the new norms, defaults are to be recognised within 30 days and during this review period, lenders may decide on the resolution strategy including the nature of resolution plan and the approach for implementation thereof.

**3. RBI issues updated Frequently Asked Questions ("FAQs")**

**(i) <u>External Commercial Borrowings ("ECB") and Trade Credits</u>**

As per the revised ECB framework introduced in December 2018, any entity eligible to receive Foreign Direct Investment ("FDI") was made eligible to raise ECBs. In view of the said definition, and considering the fact that foreign investment in Limited Liability Partnership ("LLP") was permitted under the FEMA (Transfer or Issue of Security by a Person Resident Outside India) Regulations, 2017, albeit under a specific Schedule therein, a view emanated that LLPs could be considered eligible for raising ECBs.

RBI has now clarified[10] its intention regarding the above and updated the FAQs for ECB and Trade Credits, clarifying, *inter alia*, that LLPs are not eligible to raise ECBs.

[8] RBI/2018-19/187 A.P. (DIR Series) Circular No 34
[9] Dated 12 February 2018
[10] Question 5 of FAQs on External Commercial Borrowings and Trade Credits (updated as on May 29, 2019)

**Overseas Direct Investments ("ODI")**

Round-tripping has been a contentious issue in absence of any specific regulations permitting/ prohibiting under the FEMA (Transfer or Issue of Any Foreign Security) Regulations, 2004 ("ODI Regulations"). In that regard, RBI has now clarified[11] that the ODI Regulations do not permit an Indian Party to set up Indian subsidiary(ies) through its foreign Wholly Owned Subsidiary ("WOS") or Joint Venture ("JV") nor do the provisions permit an Indian Party to acquire a WOS or invest in JV that already has direct/ indirect investment in India.

***Katalyst Comments:*** *While the FAQs refer the ODI Regulations, in the absence of specific provisions in the ODI Regulations itself, this clarification may still not preclude a specific approval, for instance, cases where the Indian subsidiary(ies) are proposed to be set up from the funds earned by the foreign WOS/ JV itself and hence, would not result in "round tripping" of funds of the Indian Party.*

## D. Goods and Service Tax Highlights

***Decisions of HC:***

### 1. Admission of writ by Mumbai HC

The Mumbai HC[12] has admitted a writ petition filed by the importers, challenging the levy of IGST on ocean freight vide notification no. 8/2017-IGST(Rate) dated June 28, 2017.

### 2. Interim relief in writ challenging tax payment as pre-condition for return filing

Gujarat HC[13] has allowed the manual filing of GST-3B returns and also held that online system which does not allow filing of returns without payment of tax admitted as per returns, is contrary to the legal provisions.

### 3. ITC of inputs/input services allowed when used for developing shopping mall

Orissa HC[14] has allowed the ITC of inputs and input services used for construction of shopping malls against GST payable on rent receipt from tenants due to letting out of the units and held that provisions of section 17(5)(d) of blocked credit should be applied to a situation where the property is retained for one's own use/ purpose, but not when property is let out.

[11] Question 64 of FAQs on Overseas Direct Investments (updated as on May 29, 2019)
[12] Victory Ventures and Others vs. Union of India
[13] Octagon Communications Pvt. Ltd. Vs. Union of India [TS-399-HC-2019(GUJ)-NT]
[14] Safari Retreats Pvt. Ltd. vs. Chief Commissioner of CGST [TS-350-HC-2019(ORI)-NT]

***Decisions of Authority for Advance Rulings ("AAR"):***

4. **GST applicable on receipts of advisory fees from overseas contributors for management of Alternate Investment Fund ('AIF')**

   Maharashtra AAR[15] has held that advisory and management fees received by the applicant from overseas contributors, in relation to financial services provided to the AIF, is not export of service as AIF being recipient of service is in India and overseas contributors and AIF are separate entities and hence, GST is applicable @ 18%.

5. **No ITC on purchase of motor-vehicle purchase if used for 'rent-a-cab' service**

   West Bengal AAR[16] has held that ITC of GST paid on purchase of motor-vehicle is not admissible in view of the provisions of section 17(5) (b) (i) of the CGST Act, 2017, in case where motor-vehicles are used for providing 'rent-a-cab' service.

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[15] In the matter of Multiples Alternate Asset Management Private Limited [TS-424-AAR-2019-NT]
[16] In the matter of Reesham Associates[TS-404-AAR-2019-NT]