Katalyst Kaleidoscope

March 2018: Tax and Regulatory Highlights

A. Income-tax Highlights

1. Supreme Court upholds disallowance of interest vis-à-vis investment in shares held as strategic investment / stock-in-trade:

Supreme Court of India ("SC") in the case of Maxopp Investments Ltd[1] held that disallowance under Section 14A of the Income-tax Act, 1961 ("IT Act") is applicable to expenditure relating to exempt income from strategic investment / stock-in-trade, and uphold disallowance of interest paid on borrowings used to acquire such strategic investment / stock-in-trade.

While construing the scope of the phrase "in relation to" employed u/s 14A, SC held that the dominant purpose for which the investment in shares is made by the Taxpayer is not relevant and the provisions of Section 14A would apply regardless of the intention/ motive behind making the investment. Even though the investment was made for acquiring controlling interest or to earn profit from trading in shares and earning of dividend income was merely incidental, it will not preclude from the applicability of Section 14A since the fact remains that dividend income is exempt from tax, and thus expenditure attributable to such dividend income has to be disallowed.

Katalyst comments:

- *Considering above SC ruling, while computing taxable income, it is advisable to consider 14A disallowance even though shares are held as strategic investment / stock-in-trade, in order to avoid levy of any interest and penalty during the course of assessment proceedings.*
- *As such, while dividend is technically exempt, it is economically taxed in the hands of the company distributing the dividend in the form of Dividend Distribution Tax (as pointed out in the Easwar Committee report dt. January,2016).It is hoped that the Government will recognize this aspect of economic taxation and amend the law to reflect this reality.*

2. Share-sale to second step down 100% subsidiary is not "transfer" u/s. 47(iv):

The Kolkata ITAT in the case of Emami Infrastructure Ltd[2] held that a second step down 100% subsidiary is also covered by the provision of Section 47(iv) of the IT Act and transfer to such step-down subsidiary cannot be regarded as "transfer" for capital gains purposes. Tribunal relied on the Bombay High Court ruling in the case of Petrosil Oil Co[3] wherein it was held that since the term "subsidiary company" has not been defined under the IT Act, one can draw reference from the Companies Act, 1956 where step down 100% subsidiary company is also considered a subsidiary.

3. Termination of call option is subject to tax net within the ambit of capital gains:

The Ahmedabad ITAT in the case of Vodafone India Services[4] held that termination of call option to buy shares in an Indian company is liable to capital gains. In the given case, the assessee had a right to either exercise the call option or right to nominate the person who could acquire the shares of an Indian company. The assessee did not exercise the call option but exercised the right to

[1] Maxopp Investments Ltd. [TS-115-SC-2018]
[2] Emami Infrastructure Ltd. [TS-101-ITAT-2018(Kol)]
[3] Petrosil Oil Co. v CIT [2000] 111 Taxman 261 (Bombay)
[4] Vodafone India Services (P.) Ltd. v. DCIT [2018] 89 taxmann.com 299 (Ahmedabad - Trib.)

nominate the person in favor of its associated enterprise. Tribunal held that such right to nominate qualifies as a capital asset and upon exercise, such right comes to an end resulting in a taxable transfer covered within the capital gains ambit.

4. **Tribunal allowed set-off of losses despite shareholding change, 51% voting power beneficially held by the same Individuals:**

   Mumbai ITAT in the case of Wadhwa & Associates Realtors Pvt Ltd[5] allowed set-off of losses by holding that Section 79 of the IT Act laid emphasis on beneficial "voting power" rather than "percentage shareholding" as on the last day of the previous year when the loss was incurred and on the last day of the previous year when the set off was claimed. Relying on the Karnataka HC decision in the case of Amco Power Systems Ltd, the Tribunal considered beneficial ownership over voting power for determining the eligibility to set-off losses from the current year's income. Tribunal also noted that even though the shareholding in percentage terms had changed, in substance the effective interest was held by the same Individuals.

5. **AAR denied India-Mauritius Tax treaty benefits based on the substance over form:**

   AAR in the case of AB Mauritius[6], based on the facts and circumstances of the case denied the India-Mauritius treaty benefit and held that the Applicant was not acting as an independent company to take decisions on its own and could not be treated as the beneficial owner of shares. AAR perused various documents such as Share Purchase Agreement (SPA), minutes of meeting of board of directors, etc to reach the above conclusion. AAR specifically observed that Holding company had signed collusive agreements of the subsidiary (i.e. AB Mauritius) on its behalf and paid the consideration for the same, the subsidiary could not be considered as an owner of the shares. AAR also opined that Tax Residency Certificate is merely a presumptive evidence of beneficial ownership and not conclusive presumption. In addition to this, by lifting the corporate veil, AAR taxed such capital gains in the hands of Holding Company based out of USA and held taxability in India as per the provisions of the India US Tax treaty.

   Katalyst comment: The ruling of the Authority, although divergent, have been based on the specific fact pattern. This ruling is unfortunate, since the situation has generally been that a Tax Residency Certificate(TRC) is sufficient to claim the benefit of the tax treaty.

B. Amendments to the Finance Bill, 2018 – Key Highlights

Taxation of Long term capital gains:

The Finance Bill, 2018 has been passed in Lok Sabha on 14 March 2018 with certain amendments.

With regard to long term capital gains taxation, the Finance Bill, 2018 had provided for computation of the "fair market value" in case of shares listed on 31 January 2018. Among others, amendments as on 14 March 2018 now seeks to provide for the determination of "fair market value" in the following cases also:

- shares unlisted as on 31 January 2018, but listed subsequently;

[5] Wadhwa & Associates Realtors Private Limited [TS-82-ITAT-2018(Mum)]
[6] AB Mauritius [TS-635-AAR-2017]

- shares which became property of the taxpayer in consideration of share which is not listed as on 31 January 2018 by way of transactions not regarded as transfer u/s 47 of the IT Act.

It is provided that in above cases, the taxpayer is required to consider the indexed cost of acquisition of such unlisted equity shares for the purpose of computing capital gains.

Katalyst comment: Basis this amendment, for companies getting listed after 31 January 2018, the long term capital gains in the hands of Promoters upon sale in future (after 01 April 2018) will be computed considering indexed cost of acquisition of unlisted shares (which is likely to be lesser as compared to fair market value as on 31 January 2018) as cost basis.

C. Corporate Law Highlights

1. **MCA relaxes the provisions with respect to registration of companies:** In the light of "ease of doing business" initiative, the Ministry of Corporate Affairs has brought into force the Companies (Incorporation) Amendment Rules, 2018 w.e.f. from 26 January 2018.The highlights of these rules are as follows:
   - Companies with an authorized share capital of upto INR 10 Lakhs can be incorporated with zero incorporation fees.
   - Name of proposed company can be reserved without obtaining DIN and digital signature.
   - Time limit for reservation of name has been reduced from 60 days to 20 days.
   - Requirement of affidavit with declaration from the proposed directors and promoters has now been removed.
   - Process of allotment of DIN has been redesigned by allotting it at the time of individual's appointment as director.

2. **Insolvency and Bankruptcy Code – Resolution of stressed assets:** The Reserve Bank of India had (*vide its notification* dated 12 February 2018) released a revised framework on the "Resolution of Stressed Assets". The key features of this amendment are as follows:

   - **Discontinuance of the existing schemes:** Existing schemes such as Scheme for Sustainable Structuring of Stressed Assets (S4A), Strategic Debt Restructuring (SDR), Corporate Debt Restructuring (CDR) and the Joint Lenders Forum (JLF) have been done away with.

   - **Classification as special mention accounts:** Lenders will have to identify stressed loan accounts immediately on default and classify them as special mention accounts (SMA). Lenders will need to report the SMA for all borrowers having aggregate exposure of INR 50 million to the credit database of the RBI on a weekly basis and initiate the resolution.

   - **Initiative:** The resolution plan has to be initiated by lenders once there is a default and may involve restructuring, change in ownership, regularization of the account by payment of all the overdues by the borrower, sale of the exposures to other entities/investors.

   - **Monetary Cap:** Such resolution plans involving restructuring/change in ownership in respect of 'large' accounts (i.e. INR 1 billion and above). RBI to also come up with a timeline for accounts with exposure ranging in between INR 1 Billion to 20 Billion. The former to require an Independent Credit Evaluation Report (ICE) for the residual debts from an RBI authorized

credit rating agency (CRA). In case on an exposure of INR 5 Crs or more, 2 such ICEs to be required.

- **Introduction of timelines:** The RBI has now put a timeline within which the resolution to be implemented. For accounts having an exposure of INR 20 Mn and above, lenders which have to ensure that the implementation plan within 180 days or 31 March 2018. If it exceeds such a limit, then it has to be referred under the Insolvency and Bankruptcy Code, 2016 within 15 days.

D. Securities' Laws Highlights:

The SEBI issued a circular on 22 February 2018 listing down following further methods by which a listed entity can achieve the required minimum public shareholding:

- Open market sale: Sale of shares held by the promoters/promoter group up to 2% of the total paid-up equity share capital of the listed entity in the open market, subject to five times' average monthly trading volume of the shares of the listed entity;

- Qualified Institution Placement: Allotment of eligible securities through Qualified Institutions Placement in terms of Chapter VIII of the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009.

E. Other Highlights

Indian e-FRRO (Foreign Regional Registration Offices) services launched: With the intent to ease out immigration compliances, the Indian Bureau of Immigration has introduced "e-FRRO" services for implementing the Indian in-country immigration compliances such as a Residential Permit/Registration Certificate. The objective is to introduce a hassle free process with the FRRO. The fees if any, is required to be paid online. This service is being rolled across major cities (FRRO offices), starting with Bangalore, Chennai, Delhi and Mumbai. The benefits of the online process can be listed as follows:

- The mandatory visit to the FRRO Office has been done away with.
- The stay visa and other documents to be sent to the registered Indian Address of the foreigner and a soft copy of the same to be sent to the email ID.

F. Indirect Taxation

The Government has vide circular no. 33/07/2018-GST dated 23 February 2018 clarified the following:

- Non-utilization of Disputed Credit Carried Forward:
  The Government has clarified that any transitional CENVAT credit carried forward under the GST regime, against which an adjudication order or order-in-appeal declaring it as inadmissible existed on 01 July 2017, then such CENVAT credit should not be utilised to discharge the tax liability under GST.

- Non-transition of Blocked Credit:
  If any inadmissible CENVAT credit is carried forward and utilized to discharge any GST liability, the same will be recovered from the taxpayer along with interest and penalty.

- Submission of Undertaking:
  Further, it has been provided that where the amount of disputed or blocked credit is greater than INR 10 lakhs, the taxpayer will have to submit an undertaking to the jurisdictional central tax officer stating that such credit will not be utilised or has not be availed as transitional credit, as the case may be.

- The Government has vide circular no. 35/09/2018-GST dated 05 March 2018 clarified that taxable service provided by members of Joint Venture (JV) to the JV or to other members of the JV or by JV to the members is taxable under GST.

- The 26th GST Council meeting was held in New Delhi on 10 March 2018 and key decisions taken are summarized below:

  - The reverse charge mechanism on supply from unregistered dealers has been further deferred until 30 June 2018 (which was earlier suspended until 31 March 2018).

  - The implementation of provisions in respect of 'tax deduction at source' and 'tax collection at source' has also been postponed until 30 June 2018.

  - The nationwide e-Way Bill for inter-state movement of goods will be implemented from 01 April 2018. Further, for intra-state movement, the E-Way Bill will be rolled out in a phased manner starting from 15 April 2018 and it will cover all states by 01 June 2018.

  Tax exemptions available to exporters on imported goods extended for a further period of 6 months beyond 31 March 2018.

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