

## Katalyst Kaleidoscope

### November 2017: Tax and Regulatory Highlights

#### A. Income-tax Highlights

- 1. Transfer of “business leads” not slump sale<sup>1</sup>:** While laying emphasis on the genesis of the transaction i.e. bankruptcy of the JV partner, the Mumbai Tribunal noted that transfer of “customer base and business leads” as a result of inability to continue business in absence of the technical and JV partner would not constitute a “business activity” in itself. It observed that transfer of only “business leads” (as an itemized, individual asset) and no other assets or business liabilities, that may together constitute a business activity, cannot be considered as an “undertaking” either. Ruling in favour of the assessee, the Mumbai Tribunal held that the transfer cannot be characterized as slump sale and was rightly reflected as business income.

*Katalyst comment: Given the spate of demergers, the concept of “undertaking” is very important for demergers to be tax-neutral and such judicial precedents are a good point of reference.*

- 2. Consortium not taxable as AOP considering clear work demarcation<sup>2</sup>:** Where there existed clear demarcation of work and costs between consortium members and each member earned profits and incurred losses based on their respective performance, the Mumbai Tribunal observed that the consortium cannot be considered as an AOP. Placing reliance on the Apex Court decisions in the cases of Ishikawajima Harima Heavy Industries and Hyundai Heavy Industries<sup>3</sup>, the Mumbai Tribunal held that the offshore supplies were not taxable in absence of any business connection in India.

*Katalyst comment: CBDT had issued a circular<sup>4</sup> laying out 4 attributes which, if present in a consortium arrangement for executing EPC/ Turnkey contracts, would render the arrangement not taxable as AOP. Broadly, the attributes are (i) clear demarcation in the work and costs between the consortium members, (ii) each member earns profits/ incurs losses based on its performance, (iii) men and material are under respective member’s risk and control, and (iv) control and management is not unified (may be for administrative convenience only). However, the Mumbai Tribunal has not made reference to this circular in the ruling.*

- 3. Clarification on indirect transfer provisions in case of redemption of share or interest outside India<sup>5</sup>:** CBDT has clarified that the exemption provided in case of multi-tiered investment structures to Category I and II FPIs from indirect transfer provisions [*vide* insertion of a proviso to explanation 5 of section 9(1)(i) of the Income-tax Act] in case of redemption of shares or interests outside India as a result of or arising out of redemption or sale of investment in India which is chargeable to tax in India, shall be extended to Category I and II Alternate Investment Funds and Venture Capital Funds as well.
- 4. Agreement for avoidance of double taxation with Hong Kong Special Administrative Region (HKSAR) of China:** Union Cabinet has accorded approval for an agreement between India and HKSAR of China for avoidance of double taxation and prevention of fiscal evasion.

*Katalyst comment: Currently, the Indo-China Double Taxation Avoidance Agreement does not apply to the HKSAR.*

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<sup>1</sup> L&T Finance Limited (ITA Nos. 2577/Mum/2010 and 5286/Mum/2012) dated 25 October 2017

<sup>2</sup> Vitkovice Machinery A.S. (ITA No. 1673/Mum/2015) dated 27 October 2017

<sup>3</sup> 288 ITR 408 and 291 ITR 482, respectively

<sup>4</sup> Circular No. 7/2016 dated 7 March 2016

<sup>5</sup> Circular No. 28/2017 dated 7 November 2017

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#### B. Corporate Law Highlights

- 1. MCA notifies<sup>6</sup> provisions relating to Registered valuers:** The notification provides for operationalising of section 247 of the Companies Act, 2013 (Valuation by Registered Valuers) and issues the Companies (Registered Valuers and Valuation) Rules, 2017 (Rules). Until this notification, valuations required under the Companies Act, 2013 could have been conducted by any independent valuer (except in a few specified cases). The Rules have introduced the concept of “asset class” for classification of assets into 3 categories: (i) plant and machinery; (ii) land and building; and (iii) securities and financial assets. The educational qualifications are different for being a valuer registered under respective asset class. The Rules also provide valuation mechanism (valuation standards yet to be prescribed) eligibility criteria for registration, designate a registration authority, transition period for existing engagements, etc.
- 2. Insolvency Resolution Professional (“IRP”) directed to take over management of corporate debtor to protect interest of home buyers<sup>7</sup>:** The Supreme Court had (*vide* order dated 4 September 2017) stayed the order passed by the NCLT admitting an application against corporate debtor filed by a financial creditor u/s 7 of the Insolvency and Bankruptcy Code, 2016, thereby resulting in restoration of the corporate debtor’s management and thus, affecting the rights of creditors and consumers. On an application filed by the financial creditor, the Supreme Court modified its order so as to, *inter alia*, direct the IRP to take over the management of the corporate debtor and requiring the IRP to formulate an Interim Resolution Plan containing necessary provisions to protect the interests of the home buyers.
- 3. Involvement of a non-intermediary in front running trade practices is covered by the prohibition under SEBI (Prohibition of Fraudulent and Unfair Trade Practice relating to Securities Market) Regulations, 2003 (“FUTP”)<sup>8</sup>:** The Supreme Court held that where it is established that a person who is under duty to keep non-public information confidential provides a tip to a non-intermediary and despite knowledge of such breach, the non-intermediary gets involved in front running, such non-intermediary front running would be considered as having indulged in a fraudulent or unfair trade practice prohibited under Regulations 3 and 4(1) of FUTP.
- 4. No modification of scheme of amalgamation where minority shareholder appellant failed to show any illegality in valuation<sup>9</sup>:** Where the minority shareholders challenged the valuation alleging that the Valuer and the Merchant Banker worked in tandem and not independently and that certain assets were not considered in the valuation report, the NCLAT, New Delhi held that validity of a report cannot be looked into and interfered with on mere allegation, unless a specific illegality is highlighted.

#### C. Securities’ Law Highlights

- 1. SEBI prescribes additional conditions for listing of NCRPS/ NCDs through a scheme of arrangement<sup>10</sup>:** NCRPS/ NCDs issued by any company (listed/ unlisted), being the resulting/ transferee company, pursuant to a Scheme of Arrangement to the holders of specified securities

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<sup>6</sup> Section 247 of Companies Act, 2013 and Companies (Registered Valuers and Valuation) Rules, 2017 notified on 18 October 2017

<sup>7</sup> Chitra Sharma v. Union of India (144 SCL 1) dated 11 September 2017

<sup>8</sup> SEBI v. Kanaiyalal Baldevbhai Patel (144 SCL 5) dated 20 September 2017

<sup>9</sup> Arvind Aggarwal v. Trinetra Cements Ltd (144 SCL 85) dated 12 September 2017

<sup>10</sup> SEBI Circular No.: CIR/IMD/DF/50/2017 dated 26 May 2017

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of a listed company, being demerged/ transferor company, may seek listing of such NCRPS/ NCDs. However, same series of such NCRPS/ NCDs are issued to other investors (other than by way of scheme of arrangement) would not be eligible to be listed. The circular also specifies other requirements such as minimum tenure, valuation report, disclosures, etc. These conditions are in addition to compliance with revised requirements issued in March 2017<sup>11</sup> for listed entities undertaking schemes of arrangement, which did not cover guidance for listing of NCRPS/ NCDs.

- 2. Open offer triggered pursuant to merger of indirect foreign holding company, if not approved by any Court/ Regulatory Body:** Similar to the issue in an interpretive letter in the case of Xchanging Technology Services Private Limited (discussed in Katalyst Kaleidoscope October 2017 issue), SEBI has issued yet another informal guidance in the case of Linde AG/ Linde India Limited, stating that since the laws of Delaware and Germany (i.e. where the transacting entities are based) do not require mergers to be approved by any court or competent authority, the open offer obligation under the takeover code would be triggered in case of merger of foreign indirect holding company (FCo1) of an Indian listed company with another foreign holding company (“FCo2”) resulting in change of ownership/ control of FCo1.

#### D. Recent Schemes of Arrangement

- 1. Divesting assets as a part of Strategic Debt Restructuring (“SDR”) exercise:** SDR rules allow the lenders to convert their debt into equity, thus, obtaining majority control in the borrowing company. Lenders to companies such as Gammon India, VISA Steel Limited, Monnet Ispat Energy Limited have been known to undertake this route. With majority control, the lenders are enabled to undertake corporate restructuring exercise to unlock value of the borrower’s business units by transferring control to credible investors. By divesting a particular division through slump sale/ slump exchange and obtaining fund infusion from credible investors by way of an investment agreement, the borrower is able to address its liquidity issues.

#### E. Other Highlights

- 1. Rationalisation of foreign investment in India<sup>12</sup>:** RBI has issued revised Foreign Exchange Management (Transfer and Issue of Security by a Person Resident Outside India) Regulations, 2017, bringing about a host of revisions and consolidating the Foreign Exchange Management (Investments in Firms or Proprietary concern in India) Regulations, 2000. Key revisions include:
  - Purchase of shares in a listed company on a recognized stock exchange by **any** non-resident can be made up to 10%;
  - Conversion of FDI-funded LLPs into companies and vice-versa permitted;
  - Issuance of convertible notes to foreign investors by startups permitted;
  - Pricing guidelines have now been incorporated – however, the guidelines are not applicable to any transfer by way of sale which is in accordance with SEBI pricing guidelines;
  - Prior approval required for foreign investment in a core investment company;
  - Subject to prescribed conditions, Indian companies can issue **any** capital instrument i.e. equity shares, share warrant, compulsorily convertible debentures and preference shares (formerly, only shares were allowed) pursuant to merger/ demerger/ amalgamation;

<sup>11</sup> SEBI Circular No.: CFD/DIL3/CIR/2017/21 dated 10 March 2017

<sup>12</sup> Notification No. FEMA 20(R)/2017-RB dated 7 November 2017

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- In case of transfer between resident and non-resident, fair price of the capital contribution or profit share in LLP is to be determined by a chartered/ cost accountant or an approved valuer as per internationally accepted valuation norm
  - No RBI approval is required for transfer of capital instruments from a non-resident to another non-resident
2. **National Company Law Tribunal (“NCLT”) order included in Maharashtra stamp duty provisions<sup>13</sup>**: Stamp duty provisions pertaining to orders in respect of amalgamation, merger, demerger, etc. has been aligned to include order made by the NCLT.

*Katalyst comment: The ambiguity arising on whether “order of the High Court” would include order of NCLT qua stamp duty has now been addressed.*

3. **Minimum requirement to maintain Net Owned Funds for Asset Reconstruction Companies<sup>14</sup>**: RBI has specified that the Asset Reconstruction Companies (“ARCs”) should have minimum INR 100 crores as Net Owned Funds (“NOF”) before registration and in case of ARCs already registered, the minimum level of INR 100 crores should be achieved by 31 March 2019.

**Do feel free to reach out to us for a detailed discussion on [ketan.dalal@katalystadvisors.in](mailto:ketan.dalal@katalystadvisors.in)**

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<sup>13</sup> Maharashtra Ordinance No. XXVI of 2017 dated 3 November 2017

<sup>14</sup> Notification DNBR (PD-ARC) No.05/ED(SS)-2017 dated April 28, 2017