

Katalyst Kaleidoscope

October 2018: Tax and Regulatory Highlights

A. Income-tax Highlights

1. Do company's Investment activities constitute business activities?

The Hyderabad ITAT¹, in the case of GVK Airport Developers Limited, recently held that since the assessee had advanced funds only for the purposes of investment in the SPVs, the same cannot be considered as business activity so as to allow the deduction u/s 36(1)(iii) of the Income-tax Act, 1961("ITA"), read with section 14A. ITAT noted that the company had carried out only investment activities and had no business of construction or development of domestic or international airports done by itself, as provided in main objects of the Company; therefore, the activity of investing cannot be equated with carrying on business activities.

ITAT further distinguished Delhi HC ruling in Dalmia Cement (Bharat) Ltd., where interest was allowed as deduction for companies which were engaged in the core businesses of the assessee company and had also advanced funds to its sister concern as a part of its business activities.

Katalyst Comments:

Pursuant to the above case, investment itself cannot be considered as 'for the purpose of business' activity unless its main objects are to carry out investment per se. Further, in industries like real estate or infrastructure, wherein a holding company structure is followed, the impact of this ruling needs to be evaluated in detail.

2. Long-term/ Short-term Capital Gain split between Land and Building:

The Chandigarh ITAT² observed that assessee had received undivided compensation against land & building compulsorily acquired by the government. under a compulsory acquisition scheme. It was held by ITAT that when there is a transfer of entire undertaking as a whole and land & building both form part of the undertaking, the compensation received has to be bifurcated between the land & building. The building is a depreciable asset and hence, the compensation received on account of building is to be treated as short-term within the meaning of section 45, read with section 50 of ITA. On the other hand, land is a non-depreciable asset and therefore, capital gain earned on account of transfer is treated as long term.

Consequently, deduction under section 54 of the ITA was allowed to the extent of long-term capital gain assessed.

Katalyst Comments:

There are several judgments of ITAT where land is considered as a separate capital asset, even if a building is constructed thereon. Accordingly, where land has been held as a capital asset for more than 24 months (pursuant to the Finance Act, 2018), the gains arising from the sale of the land should be considered as long-term capital gain.

3. Option to adopt between provisions of ITA and treaty for each separate source

¹ ITO v. GVK Airport Developers Ltd [2018] 96 taxmann.com 236 (Hyderabad -Trib.)

² ITO v. Het Ram Sharma [2018] 97 taxmann.com 75 (Chandigarh -Trib.)

Katalyst Kaleidoscope

October 2018: Tax and Regulatory Highlights

The Mumbai ITAT³ has recently held that in case of multiple sources of income, the tax payer is permitted to adopt the provisions of the ITA for one source while applying the beneficial DTAA provisions for the other source of income.

The assessee (Singapore Co.) earned gross receipts from two distinct sources of income i.e. management fee and service fee. The assessee adopted the service fee received to be taxable as 'fees for technical services' as per section 115A(1)(b) of the ITA and as regard to the management fees, the assessee claimed the benefit of DTAA since that was more beneficial as compared to the provisions of ITA. However, the A.O. contented that assessee has service PE in India as per Article 5(6)(b) and accordingly, attributed both receipts to activities in India and sought to tax as business profits as per the Article 7 of the DTAA.

The ITAT (after considering the views of the ITAT Bangalore in the case of IBM World Trade Corporation) held that the assessee is entitled to adopt the provisions of the ITA for one source while applying the provisions of the DTAA for another.

Katalyst Comments:

Where tax payer has different sources of income, this ruling provides flexibility to compare and adopt the provision that is more beneficial.

4. CBDT notification – transactions exempted from payment of STT

On 1st October, 2018⁴, CBDT has issued the final notification (similar to the draft notification) providing the class of transactions entered on or after 1st October, 2004, to which benefit of concessional 10% rate of LTCG tax shall be available, even if STT was not paid on acquisition of shares of a listed company pursuant to such transactions. Kindly refer May, 2018 - Katalyst Kaleidoscope (<http://katalystadvisors.in/pdf/katalyst-kaleidoscope-may-2018.pdf>) for complete list of such transactions.

B. Foreign Exchange Regulations

1. RBI launches a new scheme “Voluntary Retention Route” for investment by Foreign Portfolio Investors (FPIs)

The Reserve Bank of India (RBI) proposed new norms⁵ for FPIs to attract stable FPI investments into debt markets through a special Route called 'Voluntary Retention Route' (VRR), while allowing them more operational flexibility in terms of instrument choices, as well as exemptions from regulatory provisions, such as the cap on short-term investments at 20% of portfolio size and concentration limits.

³ Dimension Data Asia Pacific Pte. Ltd. [TS-604-ITAT-2018(Mum)]

⁴ Notification no. 60/2018 dated 1st October 2018

⁵ RBI Statement on Developmental and Regulatory Policies, dated 5th October, 2018

Katalyst Kaleidoscope

October 2018: Tax and Regulatory Highlights

Key features of the discussion paper (was open for comments till 19th October 2018) issued on VRR are as follows:

- Any entity registered as a foreign portfolio investor with SEBI is eligible to participate through VRR.
- Under VRR-Govt, FPIs may invest in any government securities, and under VRR-Corp, corporate debt instruments, including commercial papers.
- FPIs will be eligible to participate in repos for liquidity management, provided that the amount borrowed or lent under repo does not exceed 10% of their investment under VRR.
- The flexibility for lessening investments between 67%-100% of Committed Portfolio Size.
- The total amount that may be invested will be stipulated by RBI from time to time.
- The minimum retention period shall be three years, or as decided by RBI for each auction.

Katalyst Comments:

There have been several measures undertaken in the recent times to facilitate FPI investment in debt. Hopefully, this step shall reduce the volatility in the FPIs debt flows.

C. Corporate Law/ LLP Highlights

1. LLP Second Amendment Rules, 2018 - Incorporation process reengineering

The Limited Liability Partnership (Second Amendment) Rules, 2018⁶ have prescribed revised incorporation related e-form layouts. The said amendment rules contain major changes, as detailed below:

- Introduction of a Web Service titled 'RUN-LLP (Reserve Unique Name – Limited Liability Partnership)' and Introduction of a new integrated Form christened FiLLiP (Form for incorporation of Limited Liability Partnership).
- Few modifications in Form 5 (Notice for name change), Form 17 (Conversion of firm into Company), Form 18 (Conversion of Company into LLP).

Existing Form	New eform	Changes
Form 1 – Application for reservation or name change	LLP RUN Web services	RUN will replace Form 1

⁶ Notification dated 18th September, 2018

Katalyst Kaleidoscope

October 2018: Tax and Regulatory Highlights

Form 2- Incorporation documents & Subscriber statement	FiLLiP Form	FiLLiP will replace Form 2. It offers multiple services viz. allotment of DIN/ Reservation of name and incorporation of LLP
--	-------------	---

- Due to replacement and modification in Forms, a significant process flow change has been proposed to enable the LLP incorporation process re-engineering.

Katalyst Comments:

MCA has initiated Ease of doing business reforms by introducing simplified procedures and forms; LLPs have become a relatively popular form of housing a business, and the said simplification should help.

2. Scheme of Arrangement – fold up of holding company into its subsidiary operating company- rejected

On 7th of September 2018, the NCLT Mumbai bench⁷, rejected the Scheme of Amalgamation and Arrangement (“Scheme”) between Gabs Investments Pvt. Ltd. (Gabs) – the Transferor Company (holding approximately 9% of Ajanta Pharma) and Ajanta Pharma Ltd (Ajanta) – the Transferee Company and their respective shareholders on the grounds of that the said scheme was conceived to avoid taxes (thereby, indirectly, invoking the provisions of General Anti Avoidance Rules i.e. GAAR) and also to circumvent the provisions of SEBI Takeover Code.

The tax authorities raised objections before the NCLT that pursuant to the Scheme, the shareholding of Ajanta held by Gabs would directly be vested with the individual shareholders. Therefore, this would tantamount to distribution of assets which would be subject to dividend distribution tax. Further, if Gabs were to sell the shares of Ajanta, the same would be either taxed as business profits or alternatively, be subject to Minimum Alternate Tax u/s 115JB, which would not be applicable if the shareholding were to directly be vested with the individual shareholders. Therefore, this would be an Impermissible Avoidance Agreement, as provided for under the provisions of GAAR. While rejecting the Scheme, NCLT upheld the contentions of the tax authorities and further observed that this Scheme circumvented the provisions of SEBI Takeover Code since the shareholding of Gabs in a listed company was sought to be transferred to and vested upon its shareholders which would otherwise require trigger of open offer under the provisions of SEBI Takeover Code.

Katalyst Comments:

This NCLT decision has created significant concern; the GAAR aspect appears to be far-fetched since there is no evidence that the shares are being sold and there is a clear rationale for structure simplification and there could be other important non-tax reasons for such a fold up. It is hoped that this decision will be reversed by the NCLAT which is the forum it is now lying at. Further, R. 10(1)(d)(ii) of SEBI Takeover Code specifically excludes applicability of open offer requirements for any scheme of arrangement directly involving a listed company (which was so in the present case) as the transferor or

⁷ Gabs Investments Pvt. Limited and Ajanta Pharma Limited, CSP No. 995 of 2017 and CSP No. 996 of 2017, dated 5th September, 2018, NCLT, Mumbai Bench

Katalyst Kaleidoscope

October 2018: Tax and Regulatory Highlights

the transferee company. Therefore, the rationale of the observations of the NCLT in the context of circumvention of SEBI Takeover Code is unclear.

3. Financial statement format for NBFCs for complying with Ind AS

The MCA has issued⁸ a circular specifying the format in relation to the Financial Statements for a Non-Banking Financial Company (NBFC) whose financial statements are drawn up in compliance of the Companies (Indian Accounting Standards) Rules, 2015. The said circular also provides general instructions for preparation of financial statements for NBFCs to whom Indian Accounting Standards (Ind AS) apply.

4. New Constitution of the National Financial Reporting Authority (NFRA)

MCA has issued a notification⁹ to constitute the National Financial Reporting Authority (NFRA) to establish independent regulators for enforcement of auditing standards and to strengthen the independence of audit firms. Thus, NFRA will have power to review, inspect, probe, oversee the quality of service of Chartered Accountants.

MCA has sent the books of IL&FS to the National Financial Reporting Authority (NFRA), as its first case.

D. Securities' Laws Highlights:

1. SEBI's Board Meeting - Press Release:

SEBI in its board meeting¹⁰ has proposed to amend important provisions relating to FPI's, Promoters, Corporates:

i. Eligibility conditions for FPIs:

SEBI has issued circular¹¹ allowing NRIs, OCIs (Overseas Citizens of India) and RIs (Resident Indians) to be allowed to hold non-controlling stake in FPIs and no restriction on them to manage non-investing FPIs or registered offshore funds. In simpler words, FPI can now have 100% NRI investors for 2 years and can also be controlled by NRIs and RIs without any condition. However, there will not be any restrictions even beyond 2 years if FPI invests only in Indian Mutual Funds.

ii. Beneficial owner identification and KYC requirement for FPIs:

This move is aimed at checking possible re-routing of funds of Indians and NRIs through overseas locations.

iii. Total Expense Ratio ('TER') of Mutual Fund Schemes:

⁸ Notification dated 11th October, 2018

⁹ Notification no. S.O. 5098 (E) dated 1st October, 2018

¹⁰ Press Release dated 18th September, 2018

¹¹ CIR/IMD/FPIC/CIR/P/2018/132 dated 21st September 2018

Katalyst Kaleidoscope

October 2018: Tax and Regulatory Highlights

TER is a measure of total cost of managing mutual funds that investors pay for availing of the services. SEBI has lowered the TER of Mutual Funds, which is intended to improve returns for investors.

iv. Reducing the time period for listing of issues:

In the public issue process, SEBI has intended to introduced a new payment mechanism Unified Payment Interface, which will give issuers faster access to capital raised.

v. Re-classification of promoter/public:

SEBI has proposed to made changes in the existing framework by introducing a mechanism for persons, who may have been promoters but are no longer in the day-to-day control and management and have a low shareholding, to have the option to be reclassified.

vi. Amendments to SEBI (Delisting of Equity Shares) Regulations, 2009:

In case of voluntary delisting, promoters will be allowed to give a counter offer for the price, which should be accepted by 90% public shareholders. It has been also decided to amend the regulations to provide that promoters will have to give the exit to public shareholders within 3 months of delisting from recognized stock exchange.

vii. Approved the framing of the SEBI (Settlement Proceedings) Regulations, 2018

SEBI approved the said Regulations seek to revamp SEBI' settlement mechanism based on the recommendations of a SEBI High-Level Committee chaired by Justice AR Dave, a former judge of the Supreme Court of India. The erstwhile regulations were restrictive in the sense that they only sought to settle certain issues which were in relation to violation of specific securities' law only. The new Regulations have expanded the scope of the laws on which the violations by listed companies could be settled. Further, under the said Regulations, the defaults which will have market-wide impact or has caused loss to many investors or has affected the integrity of the market, will not be settled.

Katalyst Comments:

The said Regulations, being principle-based regulations, while providing discretion to SEBI to settle certain defaults, has also provided flexibility to make the settlement mechanism more robust.

2. Key recent amendments and changes in SEBI Regulations are:

- **Securities and Exchange Board of India (Depositories and Participants) Regulations, 2018**¹² - SEBI has notified the Securities and Exchange Board of India (Depositories and Participants) Regulations, 2018¹² ("New Regulation") on 3rd October, 2018. All the amendments are in the direction of Depositories to have systems or producers to coordinate with issuer or its' agents or participant for reconciling the records of ownership of securities so that interests of the beneficial owners against risks are to be protected by the depositories.

¹² Notification no. SEBI/LAD-NRO/GN/2018/40

Katalyst Kaleidoscope

October 2018: Tax and Regulatory Highlights

- **SEBI (Issue and Listing of Debt Securities) Regulations, 2008** – SEBI by its notification¹³ dated 9th October 2018, has omitted rule 19B of the regulation i.e. requirement of keeping security deposit with stock exchanges before opening of subscription list while listing debt securities.

E. GST Highlights

1. Rejection of writ petition in the matter of classification of imported goods

Madras High Court¹⁴ dismisses writ petition filed by the assessee in the matter of classification of imported goods under Schedule II of IGST notification no. 1/2017-IGST (Rate) dated 28th June, 2017 and held that classification issue cannot be adjudicated in a writ petition. Also, the HC directed revenue to issue show cause notice in the matter and pass the speaking order.

2. Notice to Revenue in the matter of restriction of rebate of IGST to certain class of assesseees

Bombay High Court¹⁵ (Goa Bench) issues notice to Revenue in writ petition challenging Rule 96(10) of CGST Rules, 2017 which restricts rebate of IGST to EOUs, Advance authorisation holders and similar assesseees.

3. Advance Rulings

The Maharashtra AAR¹⁶ has held that ITC for various 'Mechanical' and 'Electrical' Works relating to Internal and Domestic Water Distribution system, gardening water supply system, Internal Fire Hydrant System is not available to the manufacturer of medical equipment.

Madhya Pradesh AAR¹⁷ has held that food, soft drinks and snacks supplied in Snack Bar and Food Court at Mall/Multiplex shall be classifiable @ 5% as per Notification 11/2017-CGST(Rate) dated June 28, 2017.

Madhya Pradesh AAR¹⁸ has held that construction of electricity distribution lines, sub-stations and other infrastructure for sale of electricity by a wholly owned subsidiary of M.P. Management Co. Ltd., is liable to GST @ 18% and concessional rate of 12% as per Notification no. 24/2017-CGST(Rate) dated September 21, 2017 is not applicable.

Odisha AAR¹⁹ has held that ITC of inputs and input services relating to repairs and maintenance work of township and hospitals used by employees and guest houses used by employees and others is not available as these inputs and input services have no nexus with the manufacturing activities and are covered under the blocked credit u/s 17(5) of the CGST Act.

¹³ Notification no. SEBI/LAD-NRO/GN/2018/42

¹⁴ Erbis Engineering Co. Ltd. vs. The Commissioner of Customs [TS-568-HC-2018(MAD)-NT]

¹⁵ Watson Pharma Pvt. Ltd. vs. Union of India & Ors.

¹⁶ Nipro India Corporation Pvt. Ltd. [TS-552-AAR-2018-NT]

¹⁷ Jabalpur Entertainment Complexes P. Ltd. [TS-493-AAR-2018-NT]

¹⁸ Madhya Pradesh Paschim Kshetra Vidhyut Vitran Co. Ltd. [TS-494-AAR-2018-NT]

¹⁹ National Aluminium Company Ltd. (NALCO) [TS-557-AAR-2018-NT]

Katalyst Kaleidoscope

October 2018: Tax and Regulatory Highlights

4. Notifications regarding constitution of AAR and AAAR in Union Territories:

The Central Government has notified²⁰ the constitution of the Authority of Advance Ruling and Appellate Authority for Advance Ruling in the Union Territories.

5. Circular on applicability of GST on residential programme or camps for advancement of religion, spirituality or yoga

The Government has by way of a circular²¹ clarified that the residential programmes or camps where the fee charged includes cost of lodging and boarding shall be exempt as long as the primary and predominant activity, objective and purpose of such residential programmes or camps is advancement of religion, spirituality or yoga.

Do feel free to reach out to us for a detailed discussion on ketan.dalal@katalystadvisors.in

Our Offices:

Mumbai

Forbes Building, 3rd Floor,
Charanjit Rai Marg, Fort,
Mumbai – 400001
Tel: +91 22 4917 1616

Pune

#402, Lunkad Sky Vista
New Airport Road,
Viman Nagar,
Pune- 411014
Tel: +91 20 6749 7700

²⁰ Notification no.14/2018-UTGST dated October 8, 2018 and notification no. 15/2018-UTGST dated October 8, 2018

²¹ Circular no. 66/40/2018-GST dated September 26, 2018