

Katalyst Kaleidoscope

September 2018: Tax and Regulatory Highlights

A. Income-tax Highlights

1. Rules for determination of fair market value of inventory converted into/ treated as capital asset notified¹:

The Finance Act, 2018 had inserted clause (via) under section 28 of the Income Tax Act, 1961 ('IT Act') to levy tax on conversion into/ treatment as capital asset (on the fair market value of inventory) as profits and gains from business or profession. CBDT has notified Rule 11UAB under the Income Tax Rules, 1962 ('IT Rules') for determining the fair market value ('FMV') of inventory on conversion into capital asset:

- i) For immovable property (being land or building or both), FMV shall be the value assessed or assessable for the purpose of payment of stamp duty;
- ii) For jewellery, archaeological collections, drawings, paintings, sculptures, any work of art, FMV shall be as determined as per Rule 11UA(1) of the IT Rules
- iii) For shares or securities, FMV shall be as determined as per Rule 11UA(1) of the IT Rules
- iv) For any other property, FMV shall be the price that such property would fetch on sale in the open market.

In the said notification, CBDT has also amended the definition of 'balance-sheet' for the purpose of determination of FMV (other than for the purposes of sub-rule (2) of rule 11UA) and separately defining it for Indian companies and foreign companies.

The above Rule shall come into force from 1st April, 2019 and shall be applicable from AY 2019-2020 and subsequent years.

Katalyst comments: The rules for determining the FMV on conversion/ treatment of inventory as capital asset are in line with the FMV rules prescribed under the IT Act and thereby provides the much-required clarity.

2. Demerger vis-à-vis maintenance of separate books of account to avail benefit of carry forward of losses u/s 72A(4) – whether mandatory?

The Gujarat High Court² held that there is no requirement to maintain separate books of account in order to avail the benefit of carry forward and set off of accumulated loss and unabsorbed depreciation as per clause (a) of section 72A(4) of the IT Act. The Gujarat High Court upheld the Tribunal's view that there was no statutory provision to command maintenance of separate books of account and that the Tribunal was correct in remanding the issue back to the Assessing Officer. Accordingly, the Gujarat High Court dismissed the appeal on absence of question of law.

¹ Notification No 42/ 2018, dated 30th August, 2018

² PCIT v. Adani Retail Ltd [2018] 95 taxmann.com 153

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3. **Bombay High Court admits³ revenue's appeal in the case of Sudhir Menon HUF on applicability of provisions of section 56(2)(vii)(c) of the IT Act on 'rights issue' of shares:**

The Bombay High Court admitted the revenue's appeal on two substantial questions of law: a) on applicability of provisions of section 56(2)(vii)(c) of the IT Act on allotment of shares below fair market value, and b) method of computation of fair market value of shares allotted below FMV.

Katalyst Comments: Earlier, the Mumbai ITAT, in the above case, had held that proportionate (pro-rata) 'rights issue' of shares will not trigger the rigors of section 56(2)(vii)(c). It would be interesting to note the outcome of this position at the High Court level.

4. **ITAT Jaipur - Assessing Officer ('AO') is not permitted to interfere in the valuation done in accordance with the method prescribed under Rule 11UA(2):**

The ITAT⁴ recently held that, in case of shares issued at premium, the assessee company has an option to choose the method of valuation as per the prescribed rules (Rule 11UA (2) of the IT Rules) and the AO cannot change the method or adopt a different method. The ITAT further held that the AO can only scrutinize the valuation report for any arithmetical inaccuracy or make modifications to the extent any assumption or workings of the valuer is erroneous or contradictory. The ITAT also observed that revising the DCF valuation with actual numbers will be principally in contemplation of Rule 11UA(2)(b), which provides for valuation as per DCF method i.e. based on mere projections and not actuals as against NAV method prescribed under Rule 11UA(2)(a) of the IT Rules.

Katalyst Comments: This is a welcome judgement since the judgement seeks to put fetters on the arbitrariness of the Assessing Officer while adjudicating on the valuation under Rule 11UA in relation to issuances of shares at a premium.

5. **Amendment to CBDT's Circular No. 3 of 2018 (Revision of monetary limits of filing of appeal by the Income Tax Department)⁵:**

Earlier, the CBDT had issued a circular⁶ enhancing the monetary limits and conditions for the tax department to file an appeal before the Tribunals, High Courts and SLP before the Supreme Court. CBDT has now amended para 10 (issues to be contested on merits, irrespective of monetary limits) of the above circular to clarify that, the following issues will also be contested on merits, irrespective of the monetary limits:

- a) Addition in relation to undisclosed foreign income/ undisclosed foreign assets/ (including financial assets) undisclosed foreign bank account;
- b) Addition based on information received from external sources in the nature of law enforcement agencies;

³ Income Tax Appeal No 712 of 2015, dated 5th September, 2018

⁴ Rameshwaram Strong Glass (P) Ltd vs ITO [2018] 96 taxmann.com 542

⁵ F No 279/ Misc. 142/ 2007-ITJ, dated 20th August, 2018

⁶ Circular 3 of 2018, dated 11 July 2018

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- c) Cases where prosecution has been filed by the Income Tax Department and is pending with the Court.

6. Proposed amendments relating to Permanent Account Number ('PAN') Application:

CBDT has issued draft notification⁷, proposing certain changes in Rule 114 of the IT Rules and PAN Application Forms (Form 49A and Form 49AA) such as, in cases where mother is a single parent, mentioning of father's name is optional and mother's name is mandatory, timeline for application of PAN for certain persons and empowering Principal Director General/ Director General of Income Tax (Systems) for specifying the manner in which PAN shall be issued.

7. Proposed amendments relating to application seeking grant of certificate for lower withholding of tax:

CBDT has issued a draft notification⁸, proposing multiple changes in the IT Rules (Rule 28, 28A, 28AB, 37G and 37H) and Application Form (Form 13) relating to application seeking grant of certificate for lower withholding. A key change is that the application will be required to be made electronically.

Katalyst Comments: The draft notification reflects the clear intention of CBDT of rationalizing the process (to some extent) for obtaining the above certificate and making the entire process easier through electronic mode.

8. Introduction of exceptions to mandatory e-assessments:

CBDT has issued an instruction⁹ providing seven exceptions to e-assessments which were made mandatory vide its instruction¹⁰ issued earlier by the CBDT. Further, for certain situations, the above instruction also provides for an opportunity of personal hearing/ attendance.

Katalyst Comments: The instruction highlights the CBDT's intention of reducing the time and efforts of the taxpayers while interacting with the Income Tax Department and making the entire assessment process more taxpayer-friendly.

9. Exemption to interest income on specified off-shore Rupee Denominated Bonds:

CBDT has issued a press release¹¹, exempting interest income and withholding obligation u/s 194LC of the IT Act, on the interest payable by an Indian company or a business trust to a non-resident, including a foreign company, in respect of rupee denominated bond issued outside India during the period from 17th September, 2018 to 31st March, 2019.

⁷ F. No 371042/40/2016-TPL (Part-I), dated 31st August, 2018

⁸ F. No 371042/10/2018-TPL, dated 17th August, 2018

⁹ Instruction No 3/ 2018, dated 20th August, 2018

¹⁰ Instruction No 1/ 2018, dated 12th February, 2018

¹¹ Press Release, dated 17th September, 2018

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B. Corporate Highlights

1. **Central Government notifies Common Application Form ('CAF') for Foreign Portfolio Investors ('FPIs'):**

The Central Government (Ministry of Finance – Department of Economic Affairs) recently notified¹² CAF for the purpose of registration, opening of bank and demat accounts and application for PAN by FPIs in India.

Katalyst Comments: This is a welcome step and shows the Government's commitment towards ease of doing business in India by providing a single window clearance for FPIs.

2. **MCA amends Companies (Prospectus and Allotment of Securities) Rules, 2014¹³:**

MCA has inserted Rule 9A to provide that all unlisted companies shall, with effect from 2nd October, 2018, issue securities (including buyback) or transfer of securities, in dematerialized form only.

Katalyst Comments: This is a welcome step for improving the corporate governance and increasing transparency in dealings of securities of unlisted public companies.

3. **MCA amends Companies (Appointment and Qualification of Directors) Rules, 2014 ("Appointment and Qualification of Directors Rules")¹⁴:**

MCA has amended the proviso to Rule 12A ('Directors KYC') for directors holding a Director Identification Number ('DIN') as on 31st March, 2018, by extending the time limit of filing e-form DIR-3 KYC from 31st August, 2018 to 15th September, 2018.

Katalyst Comments: MCA had inserted Rule 12A by amending the Companies (Appointment and Qualification of Directors) Fourth Amendment Rules, 2018, with effect from 10th July 2018. The above amendment gives some breather to the directors (holding DIN as on 31st March, 2018), to fulfil the compliance requirement.

4. **The Insolvency and Bankruptcy Code (Second Amendment) Act, 2018¹⁵:**

Key amendments of the Insolvency and Bankruptcy Code (Second Amendment) Act, 2018 ('IBC Amendment Act') are:

- The definition of 'financial creditor' is now enlarged by amending the definition of 'financial debt' (by way of an explanation), to include home buyers
- It is now permissible to withdraw the application (even after admission) subject to consent of 90% of the committee of creditors
- Voting threshold for certain decisions has been reduced from 75% to 51% and for certain key decisions it has been reduced to 66%

¹² F. No. 4/15/2016-ECB, dated 21st August, 2018

¹³ Notification dated 10th September, 2018

¹⁴ Notification dated 21st August, 2018

¹⁵ Received assent of the President on 17th August, 2018

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- Provisions of Limitation Act, 1963 are now applicable to insolvency proceedings
- Importantly, the IBC Amendment Act is applicable prospectively from 6th June, 2018.

C. Securities' Law Highlights

1. SEBI introduces revised Buy-back Regulations, 2018¹⁶:

SEBI has introduced Securities and Exchange Board of India (Buy-back of Securities) Regulations, 2018 and the erstwhile regulation relating to buy-back i.e. Securities and Exchange Board of India (Buy-Back of Securities) Regulations, 1998 are repealed from the date of notification of the above regulations.

Katalyst Comments: The revised regulations are more aligned with the requirements of Companies Act, 2013

2. SEBI introduces revised ICDR Regulations, 2018¹⁷:

SEBI has introduced Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2018 and the erstwhile regulation i.e. Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009 are repealed from the date of notification of the above regulations.

Katalyst Comments: The purpose of introduction of new ICDR regulations was to simplify the language, include more disclosures in the prospectus at the time of public offering of its shares by a company, align the regulations in line with various informal guidance, circulars, FAQs and interpretive letters issued by SEBI, identify policy changes in line with the market environment, etc.

3. SEBI amends SEBI (Substantial Acquisition of Shares and Takeovers) Regulation (SEBI (SAST) Regulations), 2011¹⁸:

SEBI introduced Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) (Second Amendment Regulations), 2018 thereby amending the SEBI (SAST) Regulations.

One of the important amendments, inter-alia, includes clarification of the meaning of 'company' to include a body corporate (whether Indian or foreign) specifically for Regulation 10(1)(a)(iii) which provides for exemption from an making open offer in case of transfer of shares of a listed company between a company, its holding company, subsidiaries and group companies (subject to certain conditions).

¹⁶ Notification dated 11th September, 2018

¹⁷ Notification dated 11th September, 2018

¹⁸ Notification dated 11th September, 2018

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4. SEBI exempts family trust, linked to FDC Limited, under Regulation 11 of the SEBI (SAST) Regulations¹⁹ from making open offer:

SEBI has allowed the application seeking exemption from making open offer under SEBI (SAST) Regulations in the case of proposed transaction of acquisition (by way of gift) of 21.63% equity shares of FDC Limited by the family trust (with individual family members as trustees and beneficiaries) from the existing promoters.

Katalyst Comments: The above application was made post SEBI Circular dated 22nd December, 2017, which sought to standardize the format of application under Regulation 11 of the SEBI (SAST) Regulation. Taking cognizance of the above fact, it seems that SEBI has streamlined the processing of such applications (presumably, applications in conformity with the above circular) as is evident from the fact that the exemption order was passed within 4 months from the date of application.

5. SEBI exempts Diageo Group from making fresh open offer to United Spirits' shareholders under SEBI (SAST) Regulations, 2011²⁰ from making open offer:

United Spirits Limited ('USL') was controlled by two promoter groups, i.e. UB Group and Diageo Group. In 2013, Diageo Group made a voluntary open offer under the SEBI (SAST) Regulations, 2011 wherein the shareholding of Diageo Group came to 54.78% and UB Groups shareholding was ~4%. Diageo Group and UB Group were disclosed as promoter in the filings made by the USL with SEBI.

Pursuant to a shareholders' agreement (SHA) between the Diageo Group and the UB Group, UB Group was required to vote in accordance with Diageo Group's instruction, and in November 2015, the former failed to accord the SHA and voted against Diageo Group's instructions.

In light of the above, SEBI issued a show cause notice, alleging shift of control from joint control (by Diageo Group and UB Group) to sole control (Diageo Group), thereby failing to comply with open offer requirement under the SEBI (SAST) Regulations, 2011.

SEBI taking the above facts into account, relied on the erstwhile text of SEBI (SAST) Regulations, 1997 and concluded when there are two or more promoters in control and one promoter renounces his control and the entire control vests with the other promoter, it cannot be said that there is change in control as public shareholders are familiar with both the promoters. Further, the control was already shifted at the time of open offer as only rights, being protective in nature (arising out of SHA) is not sufficient enough to give control to the UB Group.

Katalyst Comments: The above order highlights an important principle that in cases of joint control by two promoter groups, cessation of control by one promoter will not tantamount to change in control, leading to trigger of open offer. However, the order was passed in a very fact specific case and thus, the above principle may not be applied to all cases.

¹⁹ Order dated 21st August, 2018

²⁰ Order dated 6th September, 2018

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D. GST Highlights

1. The GST Amendment Act, 2018

The President has given his assent to the Central GST (Amendment) Act, 2018, Integrated GST (Amendment) Act, 2018 and Union Territory GST (Amendment) Act, 2018 on August 29, 2018.

2. Appeal before Supreme court: One-time leasehold premium

An appeal against the order of Bombay High Court's ruling which validated the imposition of GST on one-time leasehold premium charged for long term lease payment, has been filed.

3. Appeal before High Court: Transition of eligible duties

The Gujarat High Court²¹ strikes down Section 140(3)(iv) of the CGST Act, 2017 which seeks to restrict transition of eligible duties held in stock of inputs, semi-finished goods or finished goods if invoice or other documents were not issued within 12 months immediately preceding the appointed day (i.e. July 1, 2017).

4. Writ petition: 'place of supply'

A writ petition has been filed before Gujarat HC challenging the constitutional validity of Section 13(8)(b) of the IGST Act, 2017 which deems 'place of supply' for 'intermediary' services to be 'location of supplier'.

5. Appellate authority for Advance Rulings (AAAR)

➤ Maharashtra Appellate Authority for Advance Ruling²² has held that mere removal of registered brand name 'MORE' and logo of 'Aditya Birla Retail' from product packages while keeping the surrounding environment intact to take advantage of said brands, does not render the goods 'unbranded'. Therefore, benefit of GST exemption Notification No. 2/2017-Central Tax (Rate) dated June 28, 2017, is not available to the appellant.

➤ West Bengal Appellate Authority for Advance Ruling (AAAR)²³ dismissed an appeal against order of AAR which held that promotion & marketing of various courses of foreign universities among prospective students in India does not constitute "export of services" u/s 2(6) of IGST Act and hence, is exigible to GST.

6. Advance Rulings

➤ Maharashtra AAR²⁴ has held that no ITC of unutilized Education cess ('EC'), Secondary and higher education cess (SHE cess) and Krishi Kalyan cess ('KKC') is available.

➤ Maharashtra AAR²⁵ had held that public charitable and religious trust engaged in spreading knowledge of Jain religion, spiritual teaching and registered u/s 12AA of Income Tax Act is liable to GST on supply of goods and/or services under CGST Act/

²¹ [TS-446-HC-2018(GUJ)-NT] in the matter of Filco Trade Centre Pvt. Ltd.

²² [TS-394-ACAR-2018-NT] in the matter of Aditya Birla Retail Limited

²³ [TS-388-AAAR-2018-NT] in the matter of Global Reach Education Services Private Limited

²⁴ [TS-403-AAR-2018-NT] in the matter of CMI FPE Limited

²⁵ [TS-402-AAR-2018-NT] in the matter of Shrimad Rajchandra Adyatmik Satsang Sadhana Kendra

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MGST Act as the activities carried out by the trust are not covered under the definition of charitable activities.

- Karnataka AAR²⁶ has held that taxi aggregator is the deemed supplier of passenger transportation service and shall be liable to tax on amounts billed by it on behalf of taxi operators towards passenger transportation services rendered through it.

7. Notifications: Effective date for TDS/ TCS

The Government has notified²⁷ October 1, 2018 as the effective date for applicability of provisions of tax deducted at source ('TDS') and tax collected as source ('TCS') as per section 51 and section 52 respectively of the CGST Act, 2017.

8. Circulars

The Central Government vide a circular²⁸ has clarified that supply or receipt of goods by the agent is necessary to consider the transaction between agent and principal within ambit of Schedule I (supply without consideration) of the CGST Act.

9. Order: Form TRAN-01

The period for submitting the declaration in FORM TRAN-01²⁹ has been extended up to January 31, 2019 for such class of registered persons who could not submit the same by due date on account of technical difficulties on common portal and whose cases have been recommended by the Council.

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²⁶ [TS-367-AAR-2018-NT] in the matter of Opta Cabs Private Limited

²⁷ Notification no. 50/2018-CGST dated 13th September, 2018 and Notification no. 51/2018-CGST dated 13th September, 2018

²⁸ Circular No. 57/31/2018-GST dated 4th September, 2018

²⁹ Order no. 4/2018 17th September, 2018