KATALYST
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Katalyst Kaleidoscope

August 2021: Tax and Regulatory Insights

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A. Income Tax highlights

1. Government withdraws the retrospective amendment to 'indirect transfers' made applicable prospectively for indirect transfers undertaken post May 28, 2012

Government vide the Taxation Laws (Amendment) Act, 2021[1] (received Presidential asset on August 13, 2021) withdrew the retrospectivity of the 'indirect transfers' as introduced by the Finance Act 2012, which sought to "clarify" that gains arising from sale of shares of a foreign company were always taxable in India if such shares, directly or indirectly, derive its value substantially from assets located in India.

The new law proposes to place an embargo on future tax demands arising out of any indirect transfer of Indian assets undertaken before May 28, 2012. It also proposes to nullify tax demands already raised for indirect transfers made before May 28, 2012 subject to fulfilment of following conditions by the person in whose case such demand has been raised:

(i) Withdrawal or an undertaking for withdrawal of appeal filed before an appellate forum or a writ petition filed before a High Court or the Supreme Court of India;
(ii) Withdrawal or an undertaking for withdrawal of any proceedings for arbitration, conciliation or mediation initiated by such person such as under a bilateral investment treaty; and
(iii) Furnishing of an undertaking waiving their rights to seek or pursue any remedy or any claim in relation to such income whether in India or outside India.

Further, it has been proposed to refund the demand collected /refund adjusted in these cases, however, without any interest under section 244A of the Income-tax Act, 1961 ("IT Act").

Katalyst Comments:

The insertion of retrospective tax provisions has been one of the extremely controversial amendments to the domestic tax law, which has not only caused loss of potentially significant investment opportunities for foreign investment into India, but also has had a huge impact on the credibility of the Indian Government amongst foreign investors.

The retrospective amendment also triggered investment treaty arbitration cases against India, wherein the arbitral tribunals ruled in favour of foreign investors (such as Vodafone and Cairn UK). This had not only been a major setback for the Government, but has also caused enormous time and resources spent on litigation.

[1] The Taxation Laws (Amendment) Act, 2021 No. 34 of 2021 published in Official Gazette on August 13, 2021

From the assessee's perspective, no interest payment on tax collected and rupee depreciation (at the time tax collection vs at time of refund) over period of time will be a critical consideration in deciding regarding availing a settlement.

2. SC: Issuance of debentures in lieu of outstanding interest liability amounts to "actual payment" of interest, eligible for deduction under section 43B[2] of the IT Act

Section 43B(d) of the IT Act provides that any sum payable by the assessee as interest on any loan or borrowing from any specified lender is allowed as a deduction only on actual payment basis.

Since the assessee was not in position to pay the interest and liquidated damages, it approached the lead Financial Institutions which approved a Rehabilitation Plan wherein it was agreed that the assesses would issue convertible debentures in lieu of outstanding interest and other charges. As a result of issue of debentures in favour of the financial institutions, outstanding interest was contended to be effectively paid to the financial institutions and was claimed as a deduction under section 43B(d) of the IT Act. However, the AO did not agree with the view of the assessee and disallowed the deduction claimed in the income-tax return.

The matter went up to the SC which observed that, as per the Rehabilitation Plan the debentures were accepted by the financial institution in discharge of the debt on account of outstanding interest.

Further, the SC also held that introduction of Explanation 3C to Section 43B with retrospective effect from April 1, 1989 is not applicable in the present case since Explanation 3C, which was introduced for the 'removal of doubts', only made it clear that interest that remained unpaid and has been converted into a loan or borrowing shall not be deemed to have been actually paid. In the present case, issue of debentures by the taxpayer was, under a rehabilitation plan, to extinguish the liability of interest altogether. Thus, the SC held that the Delhi High Court ("HC") had erroneously concluded that 'interest', on facts of instant case had been converted into a 'loan' and allowed the assesses contentions.

Katalyst Comments:

Whilst the SC placed reliance on the terms as agreed between the borrower and the lender under the Rehabilitation Plan, by upholding the conversion of the outstanding interest liability into fully paid debentures as a permissible deduction under section 43B, the SC has acknowledged the concept of "constructive payment" or "constructive discharge" of the interest liability, which amounts to actual payment.

[2] M.M. Aqua Technologies Ltd vs CIT (Delhi) [Civil Appeal No. 4742-4743 of 2021]

3. Mumbai ITAT: India Mauritius Tax Treaty benefits allowed to off-shore entities upon re-domiciliation from British Virgin Island to Mauritius[3]

In the given case, the Assessee-Company was an entity originally registered in the British Virgin Island ("BVI") as an international business company. Subsequently, it was redomiciled to Mauritius and its registration was cancelled by Registrar of Company in BVI. Parallelly, the Mauritian Revenue Authorities also issued a tax residency certificate ("TRC") to the assessee company. The assessee submitted that even though initially incorporated in BVI, it was registered in Mauritius and hence it is entitled to claim India – Mauritius Tax Treaty benefits.

Whilst the Revenue did not challenge the TRC issued by the Mauritian Government, it contended that the assessee, originally being a BVI company, was not entitled to treaty benefits under the India-Mauritius DTAA. Accordingly, a question arose whether re-domiciliation affects the treaty entitlement benefits to off-shore entities.

The Mumbai Income Tax Appellate Tribunal ("ITAT") observed that corporate re-domiciliation is a process by which a company moves its 'domicile' from one jurisdiction to another by changing the country under whose laws it is registered, whilst maintaining the same legal identity. It is a dynamic and constantly evolving process since the offshore entities face a situation where the rules and regulations then prevailing in the current 'domicile' remain no longer fit for the company's purpose, or the prevailing rules and regulations restrict business prospects which triggers transfer of the domicile by way of continuation from one place to another.

Hence, the ITAT held that re-domiciliation of the company by itself cannot lead to denial of treaty entitlements of the jurisdiction in which the company is re-domiciled.

Katalyst Comments:

Due to recent changes in India's tax treaties, several MNCs and institutional investors have dismantled old structures and undertaken restructuring of their investment into India. The decision of the Tribunal is consistent with global understanding of the concept of re-domiciliation which enjoys multiple advantages and administrative ease of implementation over incorporating a new entity in another country and then transferring assets/business.

4. Mumbai ITAT: Long term capital loss on sale of shares acquired at a substantially high price, on facts, is not artificial loss[4]

Swiss Reinsurance Company Ltd, a Swiss company and a tax-resident of Switzerland had acquired 26% shareholding in TTK Healthcare Services Pvt. Ltd. ("TTK") between 2007-2010 under the FDI route, at a premium ranging from INR 35 to INR 5,140 per share. After ~ 5-7

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[3] Asia Today Limited [2021] 129 taxmann.com 35 (Mumbai - Trib.)
[4] Swiss Reinsurance Company Ltd [TS-588-ITAT-2021(Mum)]

years, during AY 2014-15, the assessee sold all its shares in TTK to Vidal Healthcare Services Pvt. Ltd. ("VHS") at an agreed price of INR 5 per share and incurred a long-term capital loss of ~ INR 50 Cr, which was carried forward as per return of income.

The Revenue authorities contended that the transaction was a sham using colourable device to create artificial loss since the assessee had purchased the shares at huge premium and the assessee subsequently sold the shares at below par value.

However, the Mumbai ITAT observed that no doubts were raised by the Revenue authorities in the preceding years wherein the assessee had purchased the shares. It further noted that investment made by assessee at a high premium was a commercial decision and did not violate any rules or regulations. It further noted that that the explanation of the assessee that even after infusion of such capital, the revenue of TTK continued to decline, necessitating Assessee's decision to dispose of its shareholding, has not been countered with strong and valid reasoning by the Revenue Department. Accordingly, the ITAT held the transaction to be genuine and allowed carry forward and setoff of long-term capital loss to the assessee.

Katalyst Comments:

With the ITAT adjudicating the appeal in favor of the assessee by categorically emphasizing that where a particular transaction has been carried out within the legal framework of regulators like IRDAI, RBI, etc. and is commercially justifiable, then the same cannot be considered to be arranged for creating artificial loss or for taking undue benefits, provides relief to genuine investments made in India by foreign investors.

B. Corporate Law Highlights

1. MCA clarifies that spending CSR funds on COVID-19 vaccination for persons other than employees is CSR activity[5]

MCA had earlier clarified[6] that spending of CSR Funds for COVID-19 is an eligible CSR activity. MCA has now further clarified that spending of CSR funds for COVID-19 vaccination of persons other than the employees and their families, is an eligible CSR activity under item no. (i) of Schedule VII of the Companies Act, 2013 relating to promotion of health care including preventive health care and item no. (xii) relating to disaster management.

[5] MCA General Circular No.13/2021 dt. July 30,2021
[6] MCA General Circular No. 10/2020 dt. March 23, 2020

2. MCA amends the requirement to pass the online proficiency assessment test for appointment as Independent Directors – Government Officials, CA / certain other professionals excluded from online test conditions

Rule 6 of Companies (Appointment and Qualification of Directors) Rules, 2014 lays down the compliances required by a person eligible and willing to be appointed as an independent director. One of the requirements was to pass an online proficiency self-assessment test conducted by the institute[7] within a period of two years from the date of inclusion of individuals name in the independent director's data bank.

MCA has now notified Companies (Appointment and Qualification of Directors) Amendment Rules, 2021[8], to inter alia amend proviso to Rule 6 to state that an individual is not required to pass the online proficiency self-assessment test when he has served for a total period of not less than 3 years as on the date of inclusion of his name in the Independent Director data bank, in the pay scale of Director or equivalent or above in any Ministry or Department, of the Central or any State Government, and having experience in handling the following:

(i) Matters relating to commerce, corporate affairs, finance, industry or public enterprises; or
(ii) Affairs related to Govt. companies or statutory corporations set up under an Act of Parliament or any State Act and carrying on commercial activities;

Further, the amendment also provides that individuals who are or have been, Advocates of a Court, in practice as a Chartered Accountant or Cost Accountant or Company Secretary, for at least 10 years, shall not be required to pass the online proficiency self-assessment test.

Katalyst Comments:

The online test requirements for experienced individuals have been very onerous, and often needless; in this context, the relaxation is welcome.

C. Securities' Law Highlights

1. SEBI relaxes Takeover Code compliances:

SEBI has amended SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011[9] which would be applicable from April 1, 2022 to provide as under:

[7] "institute" means the "Indian Institute of Corporate Affairs at Manesar" notified as an institute for the creation and maintenance of data bank of Independent Directors
[8] Notification No. G.S.R 579 (E) published in Official Gazette on August 19, 2021
[9] Notification No. SEBI/LAD-NRO/GN/2021/46 published in Official Gazette on August 13, 2021

(i) Removal of certain disclosure obligations for the acquirers / promoters, pertaining to ***acquisition or disposal of shares*** (i.e., initial disclosure of acquisition of 5% and subsequent change of 2%), annual shareholding disclosures and creation / invocation / release of encumbrance registered in depository systems under Takeover Regulations. These relaxations have been done on account of implementation of the System Driven Disclosures ("SDD")[10].

(ii) Removal of obligation for physical disclosures.

Katalyst Comments:

The requirement to remove the obligation for physical disclosures under the Takeover Code is a respite for Listed Companies which are overburdened with too much of compliance.

2. SEBI amends the lock-in period for minimum promoters' contribution and disclosure requirements for IPOs

SEBI has notified SEBI (Issue of Capital and Disclosure Requirements) (Third Amendment) Regulations, 2021[11] to reduce post Initial Public Offer ("IPO") / Follow on Public Offer ("FPO") lock-in period for minimum promoter's contribution (i.e., 20% of post issue capital) as under:

(i) **Relaxation in Post IPO / FPO Lock in Period**:

Sr no.	Category	Existing Lock In	Revised Lock In	Conditions
1.	Promoters / Promoter Group (up to minimum promoters' contribution	3 years	18 months	a) Object of the issue is only Offer for Sale ("OFS"). b) The IPO does not contemplate more than 50% of the primary raise proceeds being deployed for capital expenditure on a project.
2.	Promoters / Promoter Group (excess of minimum promoter's contribution)	1 year	6 months	
3.	Pre- IPO securities held by persons other than Promoters / Promoter Group	1 year	6 months	No conditions

[10] Under SDD, relevant disclosures are disseminated by the stock exchanges based on aggregation of data from the depositories without human intervention. The SDD for the aforesaid disclosures is already in place and runs parallel with the submission of physical disclosures under the Takeover Code

[11] Notification No. SEBI/LAD-NRO/GN/2021-45 dt. August 13, 2021

Further, no post-IPO lock-in for Venture Capital Funds ("VCFs"), Alternate Investment Funds ("AIFs") and Foreign Venture Capital Investor ("FVCIs") to continue, except that in order to be eligible for the exemption, they must have held the equity securities for at least 6 months prior to the IPO (instead of the existing 1 year).

(ii) **Relaxation in disclosure requirements at the time of IPO:**

- ***Rationalization of definition of promoter group***: The definition of promoter group shall be rationalized, in case where the promoter of the issuer company is corporate body, to exclude companies having common financial investors.

- ***Top 5 Group Companies:*** The disclosure requirements in the offer documents, in respect of Group Companies of the issuer company, shall be rationalized to, inter-alia, exclude disclosure of financials of top 5 listed / unlisted group companies. These disclosures will continue to be made available on the website of the group companies.

Katalyst Comments:

Shorter lock-in period is welcome move from the perspective of financial investors – it will increase market liquidity and facilitate better price discovery. Additionally, rationalizing promoter group definition will provide great relief to financial investors (private equity and institutional investors) whose other portfolio companies shall not be treated as part of the issuer's promoter group in IPO documentation.

3. SEBI amends LODR regulations to strengthen the independence of Independent Directors

SEBI has notified the Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) (Third Amendment) Regulations, 2021[12] wherein provision related to independent directors are amended in order to further strengthen the independence of Independent Directors ("IDs"). The key amendments include:

(i) ID not to have a pecuniary relationship with the listed entity, holding, subsidiary, associates, promoters or directors ("Listed Company Group") during three immediately preceding financial years.

(ii) Several restrictions on the relatives of the ID as under:
- To not hold any securities of Listed Company Group in excess of INR 50 Lacs or 2% of paid-up share capital during the specified period;
- Not be indebted to the Listed Company Group;

[12] Notification No. SEBI/LAD-NRO/GN/2021/35. dt. August 3, 2021

- No giving guarantee or provide security in relation to indebtedness of third person to the Listed Company Group;
- No pecuniary transaction or relationship with Listed Company Group amounting to 2% or more of its gross turnover or total income

(iii) The appointment, re-appointment or removal of an ID of a listed entity shall be subject to approval of the shareholders by way of a special resolution in the next general meeting or within a period of three months from the date of appointment;

(iv) At the time of appointment / re-appointment of a director, following additional information to be provided to the shareholders:
- Name of listed entities from which such person has resigned in the past three years;
- In case of an ID, the skills and capabilities required for the role and the manner in which the proposed person meets such requirements.

(v) All related party transactions shall be approved by only IDs who are the members of the audit committee;

(vi) Cooling off period of one year from date of resignation for re-appointment of ID as an executive / WTD on the board of any Listed Group Entity or on the board of a company belonging to its promoter group

(vii) Vacancy created by ID on resignation or removal to be filled within 3 months;

(viii) At least 2/3rd of the directors in the nomination and remuneration committee shall be IDs;

(ix) W.e.f 1 January 2022, top 1000 listed entities by market capitalization calculated as on March 31 of the preceding FY, shall undertake Directors and Officers insurance for all the IDs of such quantum and for such risks as may be determined by its BOD.

Katalyst Comments:

While these amendments seek to bring more transparency in the selection, appointment and resignation of independent directors at a holistic level, there is a tendency to over legislate and some of that may not be practical or would have unintended adverse approval consequences; for example, the condition regarding approval of shareholders by Special Resolution (as opposed to ordinary resolution today) could result in the resolution being defeated just because public shareholders may not be aware of the value that a particular independent director may bring. This can cause a lot of disruption and embarrassment and may not be to the benefit of the company.

4. SEBI notifies new norms for issuance and listing of non-convertible securities under SEBI (Issue and Listing of Non- Convertible Securities) Regulation, 2012[13]

On August 9, 2021, SEBI notifies the SEBI (Issue and Listing of Non-Convertible Securities) Regulations which consolidates erstwhile SEBI (Issue and Listing of Debt Securities) Regulations, 2008 and SEBI (Issue and Listing of Non-Convertible Redeemable Preference Shares) Regulations, 2013 into SEBI (Issue and Listing of Non-Convertible Securities) Regulations, 2021 which are effective from August 16, 2021. The key aspects of the Regulations are as under:

(i) **Applicability of the Regulations**:

- Issuance and listing of debt securities (such as debentures, bonds) and non-convertible redeemable preference shares ("NCRPS") by an issuer by way of public and private issuance and listing;
- Issuance and listing of non-convertible securities (such as Perpetual non-cumulative preference shares, perpetual debt instruments) by an issuer issued on private placement basis which are proposed to be listed; and
- Listing of commercial paper issued by an issuer in compliance with the guidelines framed by the RBI.

(ii) **Definition of Issuer:** Means a company or a body corporate / statutory corporation / multilateral institution or a trust registered as a Real Estate Investment Trust or an Infrastructure Investment Trust, authorized to issue non-convertible securities and / or commercial paper and is seeking to list its non-convertible securities, with any recognized stock exchange.

(iii) **Conditions to access the bond market:** Issuers other than unlisted REITs and InvITs who are in existence for less than 3 years, have been facilitated to tap the bond market, provided:

- Issuance of their debt securities is made only on a private placement basis;
- The issue is made on the Electronic Book Mechanism ("EBP") platform irrespective of the issue size; and
- The issue is open for subscription only to QIBs.

(iv) **Prospectus:** To enable issuers to raise funds quickly without filing a separate prospectus each time, the restriction of not more than 4 issuances of debt securities in a year through a single shelf prospectus has been done away with.

[13] SEBI (Issue and Listing of Non-Convertible Securities) Regulations, 2021 vide Notification No. SEBI/AD-NRO/GN/2021/39 dt. August 9, 2021

(v) **Call & Put option:** The option for call and put has been introduced in case of debt securities issued on private placement basis. This will provide greater flexibility to the issuers and investors of debt securities and NCRPS as well. Further, the period for exercise of call and put option has been brought down to 12 months from 24 months in order to provide increased flexibility, both to issuers and investors.

(vi) **Minimum issue size:** In order to encourage public issuances of debt securities, the present stipulation that the minimum size of INR 100 crore has been done away with.

Further, pursuant to the above consolidation, SEBI has also notified an operational Circular[14] dated August 10, 2021 which provides for a chapter wise framework for issue and listing of the following securities:

- Non-Convertible Securities ("NCS");
- Securitised Debt Instruments ("SDI");
- Security Receipts ("SR");
- Municipal Debt Securities; and
- Commercial Paper ("CP")

5. SEBI notifies new SEBI (Share Based Employee Benefits and Sweat Equity) Regulations, 2021[15]

SEBI merged two sets of regulations i.e. SEBI (Share Based Employee Benefits) Regulations, 2014 and SEBI (Issue of Sweat Equity) Regulations, 2002 into a single regulation SEBI (Share Based Employee Benefits and Sweat Equity) Regulations, 2021. Key amendments notified are as follows:

(i) The companies will be allowed to provide share-based employee benefits to employees, who are exclusively working for such company or any of its group companies including its subsidiary or its associate.

(ii) The companies will have flexibility in switching the administration of their schemes from the trust route to the direct route and vice versa with the approval of the shareholders, subject to the condition that the switch is not prejudicial to the interest of the employees.

(iii) The time period for appropriating the unappropriated inventory of the trust has been extended from existing 1 year to 2 years subject to the approval of the Compensation / Nomination and Remuneration Committee for such extension.

[14] Operational Circular No. SEBI/HO/DDHS/P/CIR/2021/613 dated August 10, 2021
[15] SEBI (Share Based Employee Benefits and Sweat Equity) Regulations, 2021 vide Notification No. SEBI/AD-NRO/GN/2021/40 dt. August 13, 2021

(iv) Dispensation granted with respect to the minimum vesting period and lock-in period for all share benefit schemes in the event of death or permanent incapacity (as defined by the company) of an employee.

(v) Maximum yearly limit of sweat equity shares that can be issued by a company listed on the main board has been prescribed at 15% of the existing paid-up equity share capital within the overall limit not exceeding 25% of the paid-up capital at any time. Further, in case of companies listed on the Innovators Growth Platform ("IGP"), the yearly limit will be 15% and overall limit shall be 50% of the paid-up capital at any time. This enhanced overall limit for IGP shall be applicable for 10 years from the date of company's incorporation.

D. Foreign Exchange Management Act, 1999

1. Reserve Bank of India ("RBI") issues draft proposals to liberalize overseas investment regulations

In order to further liberalize the regulatory framework governing overseas investments with a view to promote ease of doing business, the RBI has issued draft Foreign Exchange Management (Non-debt Instruments - Overseas Investment) Rules, 2021 and draft Foreign Exchange Management (Overseas Investment) Regulations, 2021 for public comments.

The key proposals made by RBI in the FEM (Non-debt Instruments – Overseas Investment) Rules, 2021 are as under:

A. New Definitions:

(i) The following activities shall be treated as "**Overseas Direct Investment**" ("ODI") by way of equity capital as under:

- Investment by way of acquisition of equity capital of an unlisted foreign entity or;
- Subscription to the Memorandum of Association of a foreign entity or;
- Investment in 10% more of the paid-up equity capital of a listed foreign entity or;
- When a person resident in India making such investment has or acquires "control", directly or indirectly, in the "foreign entity" or;
- Any sponsor contribution made, directly or indirectly, by an Indian Entity to an Alternative Investment Fund or Investment vehicle set up in an overseas jurisdiction as per the laws of such host jurisdiction or;
- Any acquisition outside India of 'participating interest or right' in the energy sector or;
- Investment outside India in agricultural operations as provided in the aforesaid Rules.

(ii) "**Overseas Portfolio Investment**" ("OPI") means investment, other than ODI, in foreign securities, including units of Exchange-traded Funds and depository receipts, which are listed, unless stated otherwise, on a recognized stock exchange outside India but not in any securities issued by a person resident in India (outside an IFSC).

(iii) The term "**financial commitment**" has been amended to clarify that portfolio investments made overseas shall not be included and all overseas direct investment in equity, debt instruments and non-fund-based facilities shall be considered.

(iv) Other terms such as "control", "divestment", "foreign entity", "listed foreign entity", "step down subsidiaries", "write off" etc. have been specifically defined.

B. Other Key Guidelines:

(v) **Round Tripping**: The draft rules also provide that investment by a resident person in a foreign entity that has invested or invests into India (such as ODI-FDI structures) would be prohibited if the transaction is designed for tax evasion or tax avoidance.

(vi) **Pricing Guidelines**: In case of acquisition or divestment of equity capital of an overseas unlisted company by a person resident in India, the transaction price can be within 5% of the fair value arrived on "arm's length basis" as per any internationally accepted pricing methodology duly certified by a registered valuer under the Companies Act, 2013, or similar valuer registered with the regulatory authority in the host jurisdiction. The valuation certificate should be dated not more than six months before the date of the transaction.

C. Additional reporting requirements:

(i) Form ODI to be replaced by Form FC for making financial commitment or undertaking disinvestment

(ii) Form OPI introduced for making or transferring Overseas Portfolio Investments which is to be submitted within 30 days from the end of the half year in which such investment or transfer is made i.e., September or March

(iii) Form APR to be filed within 6 months from end of the accounting period and is not required to be filed where there is only one Indian resident investor in a foreign entity and such investor neither has control nor holds > 10% equity shares.

Katalyst Comments:

The above draft rules and regulations seek to revamp the existing ODI Regulations and make them more comprehensive and extensive in their application. However, certain provisions such as consideration of the ODI-FDI Structure as a serious contravention are too subjective and could create considerable issues in practice; to elaborate, how would the RBI come to the conclusion regarding tax avoidance or evasion? Also, investing in a company abroad which has miniscule investment in India could needlessly get into a grey area in terms of automatic route due to such amendments.

E. Limited Liability Partnership Act, 2008

1. Government notifies the Limited Liability Partnership (Amendment) Act, 2021 – decriminalization of certain provisions[16]

The Limited Liability Partnership (Amendment) Act, 2021 was published in the Official Gazette on August 13, 2021 seeking to facilitate greater ease of living to law-abiding corporates and to decriminalize certain provisions of the LLP Act. The key changes introduced are as under:

(i) **Introduction of Small LLPs:** The provisions amend the LLP Act to introduce the concept of "Small Limited Liability Partnership" in line with the concept of "Small Company" under the Companies Act, 2013. The salient features of a Small LLP are as under:
- Contribution from partners is up to Rs 25 lakh (may be increased up to INR 5 Cr);
- Turnover for the preceding financial year is up to Rs 40 lakh (may be increased up to INR 50 Cr);
- The Central government may also notify certain LLPs as start-up LLPs (as recognised through notifications);
- Small LLPs to be subject to fewer compliances, reduced fee or additional fee, and smaller penalties in the event of default.

(ii) **Decriminalisation of certain offences**: A total of 12 offences are to be decriminalized under LLP Act which will get shifted to an Internal Adjudication Mechanism to help unclog criminal courts from routine cases.

[16] The Limited Liability Partnership (Amendment) Act, 2021 No. 31 of 2021

(iii) **Standards of accounting:** In order to align with the Companies (Accounting Standards) Rules, the Act requires the Central Government may prescribe the standards of Accounting and Auditing for a class of LLPs in consultation with the National Financial Reporting Authority.

(iv) **Compounding of offences:** Under the erstwhile LLP Act, the Central Government may compound any offence under the Act which is punishable only with a fine. The new provisions allow the Regional Director or any other officer not below the rank of Regional Director to compound any offence under the LLP Act which is punishable with a fine only.

(v) **Non-compliance of Tribunal orders**: The new provisions remove non-compliance of NCLT order as an offence which was earlier punishable with imprisonment up to six months and a fine up to INR 50,000.

(vi) **Punishment for fraud:** Increases in the maximum term of imprisonment from two years to five years for every person party to it knowingly if an LLP or its partners carry out an activity to defraud their creditors, or for any other fraudulent purpose. A fine between INR 50,000 and INR 5 lakh may also be imposed.

Katalyst Comments:

In the Budget Speech for introduction of Finance Act 2021, the Finance Minister had said that decriminalizing of the procedural and technical compoundable offences under the Companies Act, 2013, is now complete and that she would next take up decriminalization of the LLP Act, 2008. These reforms are in line with the said intention. Since LLP structures are more common among startups and small businesses, the above reforms would boost their ecosystems.

F. Insolvency & Bankruptcy Code, 2016

1. SC: Interest-free loans to finance Corporate Debtor's business operations is 'financial debt'[17]

In the instant case the question before the SC was whether a person who gives a term loan to a corporate person, free of interest, on account of its working capital requirements is a financial creditor, and therefore, is competent to initiate Corporate Resolution Process under section 7 of the Insolvency & Bankruptcy Code, 2016 ("IBC").

The SC observed that the trigger for initiation of the Corporate Insolvency Resolution Process by a financial creditor under section 7 is the occurrence of a 'Default' by the Corporate Debtor. 'Default' means non-payment of debt in whole or part when the debt has become due and payable and debt means a liability or obligation in respect of a claim which is due from any person and includes financial debt and operational debt.

[17] Orator Marketing Pvt. Ltd. vs. Samtex Desinz Pvt. Ltd. [Civil Appeal No. 2232 of 2021] dt. July 26, 2021

- The definition of 'debt' is expansive and the same includes inter alia financial debt.
- The definition of 'Financial Debt' under section 5(8) of the IBC means "a debt along with interest if any which is disbursed against the consideration of the time value of money and includes money borrowed against the payment of interest".

The SC observed that the definition of 'financial debt' does not expressly exclude an interest-free loan and the term would have to be construed to include interest-free loans advanced to finance the business operations of a corporate body.

Katalyst Comments:

This case clears the position of law with regards to interest free loans and classifies them under the purview of financial debt.

G. Other Highlights

1. SC rules in favor of Amazon by holding the Emergency Arbitrators Order restraining the deal between Future Group and Reliance Retail enforceable under Indian Laws

Background:
On October 5, 2020 Amazon.com NV Investment Holdings LLC ("Amazon") had filed an application seeking an Emergency Interim Relief under Singapore International Arbitration Centre Rules ("SIAC") for restraining Future Retail Ltd. ("FRL") from disposing its retail business assets to Reliance Retail Ltd ("Disputed Transaction"). The SIAC appointed an Emergency Arbitrator ("EA") whose order[18] restrained the Disputed Transaction and held that the award granted by the EA was enforceable.

Proceedings were initiated by the Amazon before the Delhi HC under section 17(2) of the Arbitration Act to enforce the award / order of the EA. The Single Judge of Delhi HC and the Division Bench of Delhi HC passed a status-quo order[19] which restrained FRL from undertaking the Disputed Transaction. Detailed findings of the Delhi HC order in this case can be accessed in our April 2021 edition of Katalyst Kaleidoscope here.

Question of Law before the SC:

(i) Whether an "award" delivered by an EA under the SIAC Rules can be said to be an order under section 17(1) of the Arbitration Act; and

[18] Order passed by EA under arbitration proceedings – SIAC Arbitration No. 960 of 2020
[19] Order dated February 2, 2021

(ii) Whether an order passed under section 17(2) of the Arbitration Act in enforcement of the award of an EA by a Single Judge of the High Court is appealable.

Observations of the SC:

(i) SC relied on SIAC Rules which indicates that an award of an EA is included within the ambit of relevant SIAC Rules.

(ii) SC highlighted that even before an Arbitral Tribunal is constituted under the SIAC Rules, urgent interim reliefs can be granted by EA. It further explained that once the Arbitral Tribunal is constituted, the tribunal may reconsider, modify, or vacate any such interim order, and such interim order or award issued by the EA will continue to bind the parties unless it is modified or vacated by the Arbitral Tribunal upon constitution, until the Tribunal makes a final award or until the claim is withdrawn. Accordingly, the SC observed that an emergency award made by EA are enforceable.

Katalyst Comments:

By upholding the enforceability of EAs order in favour of Amazon, the successful consummation of the Disputed Transaction will now lie on the final verdict of the Singapore court. However, considering the deal with Reliance is currently in limbo, the one-time restructuring scheme as approved by lenders of the cash strapped Future Group may be regarded as null and void if it is unable to make their first bullet payment to the lenders by December 2021. In such a scenario, the lenders may consider referring the Future group companies to insolvency proceedings.

2. SC and Karnataka HC reject the appeals filed by Amazon and Flipkart against Competition Commission of India ("CCI") investigation

The SC following the decision of the Division bench of the Karnataka HC[20] dismissed the appeals filed by Amazon and Flipkart challenging an order of a Single Bench of the HC[21] which had allowed CCI to conduct a preliminary investigation into their alleged anti-competitive practices.

The CCI order came on a complaint filed by Delhi Vyapar Mahasangh (an organization of retailers) who alleged that Amazon and Flipkart were involved in alleged anti-competitive

[20] Writ Appeal No. 562/2021 dated July 23, 2021
[21] W.P.No.333/2020 c/w W.P.No.4334/2020 dated June 11, 2021

practices and conduct, such as deep discounting, preferential listing, sale of private label brands through preferential sellers and exclusive tie-ups, alleged to be in violation of Section 3(1) read with Section 3(4) of the Competition Act, 2002.

However, the HC on hearing the arguments by Amazon, Flipkart and CCI dismissed the writ appeal on following key observations:

(i) The order under section 26(1) of the Competition Act can be passed by CCI when there is prima facie material to direct an enquiry. Elaborate reasons are not required to be given by CCI since it is required to express only a tentative view. In case, elaborate reasons are provided in the order passed under Section 26(1), it will certainly prejudice the case of the person against whom a complaint has been made and therefore, the Statute has provided a safeguard for holding an enquiry after an order is passed under Section 26(1) and wherein an opportunity of hearing while holding an enquiry in the matter would be granted.

(ii) If the investigation process is to be restricted it would defeat the very purpose of the Competition Act, which is to prevent practices having appreciable adverse effect on the competition.

(iii) Hence, once CCI, based upon the material has arrived at a conclusion that the matter warrants an investigation, the question of interference by the HC does not arise as the enquiry is yet to take place for determination of the issues involved.

Accordingly, the SC and HC held that the writ appeals filed were devoid of merits and substance, hence, were dismissed.

Katalyst Comments:

The CCI probe order from the court has come at a time when the government has also proposed drastic changes for the ecommerce industry in India. The decision is a setback for both Amazon and Flipkart as the SC appeal was the last legal recourse to block the CCI with its investigation proceedings. Separately, the companies are also grappling with show causes notices issued by the Enforcement Directorate alleging violation under the Foreign Exchange Management Act, 1999 read with the e-commerce regulations as applicable to such foreign owned and controlled e-commerce entities.

3. International Financial Services Centers Authority ("IFSCA") introduces regulations governing issuance, listing of securities by start-ups, SPACs in IFSC

The IFSCA notified that International Financial Services Centers Authority (Issuance and Listing of Securities) Regulations, 2021[22] which will serve as an all-encompassing unified regulatory framework specifying the requirements for issuance and listing of various types of securities, and disclosures. The key aspects are as under:

Sr. No	Particulars	Regulation
1.	**Applicability**	• An initial public offer of specified securities (i.e., equity shares and convertible securities) by an unlisted issuer; • A follow–on public offer of specified securities by a listed issuer; • Listing of specified securities by a start–up company or an SME company; • Secondary listing of specified securities; • An initial public offer of specified securities by a Special Purpose Acquisition Company ("SPAC"); • Rights issue and/or preferential issues by a listed issuer; • Listing of depository receipts; • Listing of debt securities; • Listing of Environment, Social and Governance ("ESG") debt securities; and • Issuance and/or listing of any other securities as may be specified by the Authority from time to time
2.	**General Eligibility Criteria**	• A company incorporated in an IFSC; • A company incorporated in India; and • A company incorporated in a Foreign Jurisdiction.
3.	**Public Offer of Specified Securities**	An issuer shall be eligible to make an initial public offer only if: • It has an operating revenue of at least USD 20 million in the preceding financial year; or • It has an average pre–tax profit, based on consolidated audited accounts, of at least USD 1 million during the preceding three financial years; or • any other eligibility criteria that may be specified by IFSCA.
4.	**Listing of Start-Up and SME Companies**	A start-up company can list its "specified securities" on a recognised stock exchange, with or without making a public offer, if it meets the following criteria:

[22] Notification dated July 16, 2021

Sr. No	Particulars	Regulation
		• The offer document of the company should be filed within a period of ten years from the date of incorporation/ registration; • The annual turnover of the company for any of the financial years since incorporation/ registration should not have exceeded USD twenty million; and • The company is working towards innovation, development or improvement of products or processes or services, or it is a scalable business model with a high potential of employment generation or wealth creation.
5.	**Secondary Listing of Specified Securities**	**I. <u>Listing without Public Offer:</u>** Any company which is having its specified securities listed in India (outside IFSC) or in a Foreign Jurisdiction may list its specified securities on a recognised stock exchange, without public offer, subject to the following conditions: • The company shall file listing application, in the manner specified by the stock exchange(s); and • The company shall comply with the listing requirements of the stock exchange(s) and other conditions as may be specified by IFSCA. **II. <u>Listing with Public Offer:</u>** Any company which is having its specified securities listed in India (outside IFSC) or in a Foreign Jurisdiction may list its specified securities on a recognised stock exchanges by undertaking public offer.
6.	**Listing of SPACs**	SPAC issuer to raise capital through initial public offer of specified securities on the recognised stock exchange, only if: • Target business combination has not been identified prior to the IPO; and • The SPAC has the provisions for redemption and liquidation in line with these Regulations.

<u>Katalyst Comments:</u>

The Regulations in relation to SPACs are similar to the regulatory framework worldwide. Considering the benefits of SPACs in the IFSC, the structure may be a feasible one for Indian start-ups and promoters, giving them opportunities to externalize their structures and raise capital from non-resident investors. However, the success of the SPAC IPO in the IFSC will depend on the marketability of securities on the recognized stock exchange in the IFSC and also the comfort of investors in investing in the IFSC.

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H. Goods and Service Tax Highlights

1. Rajasthan HC: Allowed refund of IGST paid ocean-freight[23]

In case of Mohit Minerals [TS-29-HC-2020(GUJ)-NT], the Gujarat HC had earlier struck down levy of IGST on 'Ocean Freight' on transportation of goods by vessel from a place outside India to a place in India. Further, Gujarat HC in Comsol Energy Private Limited [TS-1241-HC(GUJ)-2020-GST] allowed refund of IGST paid on Ocean Freight under reverse charge mechanism as Entry No. 10 of Notification No.10/2017-Integrated Tax (Rate) which Notification was declared unconstitutional and ultra-virus to IGST Act in Mohit Minerals Case.

2. Rajasthan HC: Rule 89(5) of the CGST Rules, 2017 restricting refund of input services under inverted duty structure challenged

In a writ petition filed by one of the leading newspaper Rajasthan Patrika Pvt. Ltd,24 assailing retrospective amendment to Rule 89 (5) of CGST Rules, 2017 restricting refund of accumulated credit on input services under Inverted duty structure, Rajasthan HC has issued notice to Central and State Government.

Katalyst Comments:

In writ petitions challenging Rule 89(5) of the CGST Rules, Gujarat HC, in case of VKC Footsteps India Pvt. Ltd. [TS-585-HC-2020(GUJ)-NT], and Madras HC decision in Transtonnelstroy Afcons Joint Venture [TS-800-HC-2020(MAD)-NT] both have made contrary pronouncements.

3. Customs, Excise and Service Tax Appellate Tribunal ('CESTAT'): Confirmed service tax demand in the hands of VCFs as it is a service provider to its beneficiaries / investors / contributors

The Bangalore bench of the CESTAT has confirmed the service tax demand in the hand of VCFs as VCFs[25] manage investors' money and such activity is a taxable service like services of banking and financial institutions. The CESTAT confirmed service tax demand on (i) the portion of earnings that are retained by debiting expense from the value of the investments made in the VCFs and (ii) the distribution of carried interest to a specified class of unit holders.

Katalyst comments:

The CESTAT appears to have examined the matter only from the standpoint of Service Tax Law perspective. The matter brings into sharp focus the hitherto widely adopted position of the

[23] Shree Mahesh Oil Products vs. UOI [TS-336-HC(RAJ)-2021-GST]
[24] Rajasthan Patrika Pvt. Ltd. vs. UOI [TS-358-HC(RAJ)-2021-GST]
[25] 2021-TOIL-359-CESTAT-BANG

fund as being only a pooling vehicle. This ruling also exposes fund structures to potential litigation.

4. Reimbursement of post-sale discount by principal to distributor constitutes 'consideration' liable to GST

The Kerala bench of the Appellate Authority for Advance Ruling (AAAR)[26] recently upheld the ruling by the Kerala Authority for Advance Ruling, that post-sale discounts offered by the principal supplier (principal) to its dealers or customers through its authorised distributor (appellant), do not constitute 'discount' as per section 15(3)(b) of the Central Goods and Services Tax Act, 2017 (CGST Act) but it constitutes as 'consideration' liable to be added to the transaction value of supplies made to customers, on which GST is payable. The AAAR has also clarified that the mere mention of the word 'discount' without any parameters or criteria predetermined and mentioned in the agreement, would not fulfil the requirement of section 15(3)(b) of CGST Act, and thus, the amount paid to the dealers or customers of the appellant as 'rate difference' or 'special discount' would not constitute 'discount'.

Katalyst Comments:

Post-sale discounts are common in industry practice. The AAAR has highlighted that if parameters or criteria of discount are not mentioned in the agreements then the taxpayer will not be entitled to claim deduction of the discount amount.

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[26] In the matter of Santhosh Distributors [TS-346-AAAR(KER)-2021-GST]