KATALYST ADVISOR

Katalyst Kaleidoscope

December 2023: Tax and Regulatory Insights

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A. Income tax highlights

1. Supreme Court[1]: 'Market value' for the purpose of deduction under Section 80-IA

In this case, the Assessee (engaged in eligible business), set up its own captive power plants and supplied electricity to its manufacturing units (intra-company) at the rate of Rs 3.72 per unit [profits on such transfer by eligible business, qualified for deduction under section 80-IA of the Income-tax Act, 1961 ('IT Act')]; however surplus power was supplied to the State Electricity Board at the rate of Rs 2.32 per unit.

For the purpose of claiming deduction under section 80-IA of the Act, profits and gains are to be computed as if the transfer has been made at 'market value' (price of such services would ordinarily fetch in open market) of goods on that date, which, in the view of the Assessing Officer ('AO') was Rs 2.32 per unit and not Rs 3.72 (considered by the Assessee, and also the rate charged by the State Electricity Board from industrial consumers); and hence the AO restricted the excess claim of deduction of the Assessee of Rs 1.4 per unit, under section 80-IA of the Act.

The Supreme Court held that market value should not be compared with the rate of power when sold by the Assessee to the State Electricity Board as this was not the rate at which an industrial consumer could have purchased power in the open market, thus concluded the market value as Rs 3.72 per unit.

Katalyst comments:

This is an important reiteration of the concept of the basis of a claim of tax holiday, where intra-company transfer is involved.

2. Delhi HC[2]: Stay of demand over 20% of demand adjusted against outstanding demand

In this case, a demand was raised on the Assessee in the Assessment Order for AY 2017-18, on account of several additions made by the AO, which was challenged by the Assessee before the CIT(A). Thereafter, the demand for the said AY was fully adjusted against an income-tax refund due to the Assessee for another AY.

Against this adjustment, the Assessee filed a writ petition with the HC, contending that the Revenue could not have adjusted the entire demand; the Assessee relied on guidelines prescribed in the Office Memorandums ('OMs'), issued by the Central Board of Direct Taxes ('CBDT'), which mentions that, in case where the outstanding demand is disputed before

[1] Jindal Steel & Power Ltd (SC) (CIVIL APPEAL NO. 13771 OF 2015), December 6, 2023

[2] FIS Payment Solutions & Services India Private Limited (Delhi HC) [WP(C) 2162/2020], November 24, 2023

CIT(A), the AO shall grant stay of demand till disposal of first appeal in payment of 15% of the disputed demand (revised to 20% vide OM dated July 31, 2017).

The HC, also relying on the OMs, confirmed the view of the Assessee, and directed the AO stay the demand raised for AY 2017-18, and release the income-tax refund which is in excess of 20% of the disputed demand.

Katalyst comments:

The decision safeguards the interest of Assessee's who would be facing liquidity issues, on account of huge disputed demands entirely being adjusted against income-tax refunds due to them.

3. Delhi HC[3]: Reaffirms overriding effect of IBC on Revenue's claims raised after resolution plan's approval

In this case, the Revenue issued notices and orders to 2 Assessee companies, pertaining to income-tax claims, which pertained to the period much prior to the date of approval of the Resolution Plan under IBC. Accordingly, the 2 Assessee companies filed writ petition with the HC, contending that it is not open for Revenue to reopen its stale claims which stood settled under IBC.

The HC, considering the Assessee's contention and the decision of the SC in case of Ghanshyam Mishra (Civil Appeal No 8129 of 2019), held as follows:

- The Revenue arbitrarily issued the impugned notices and orders, ignoring the fact that resolution plans with respect to the Assessees were duly approved by the NCLT and that all the tax claims accruing before the approval of resolution plan stand extinguished upon approval of the said resolution plans under IBC;

- The Revenue (being State exchequer) would also be bound by the Resolution process provisions under IBC.

4. ITAT Delhi[4]: Factual dimensions critical in context of valuation; matter remanded back for re-determination of issue afresh

The Assessee issued 4.9 lakh equity shares of Rs 10 each at a premium of Rs 92 per share in AY 2016-17 (valuation report, per DCF method determined the value as Rs 102 per share). The

[3] TUF Metallurgical Pvt. Ltd (Delhi HC) [WP(C)10528/2022], Delhi Baroda Road Carrier Private Limited [WP(C) 0628/2022], December 12, 2023
[4] Sharp Eye Broadcasting Pvt.Ltd. (Delhi ITAT) (ITA No 1105/Delhi/2020), November 20, 2023

AO, during Assessment proceedings, was of the view that the that the valuation report did not assume correct parameters (the FMV was determined based on the projected cash flow which was highly exaggerated and divorced of ground realities), and that in actual fact, the Assessee company did not even achieve 1% of the projections assumed in the valuation report. Accordingly, the AO carried out an addition of the excess premium charged over the fair valuation of Rs 17.18 (determined per Net Asset Value method), in the taxable income of the Assessee company, under Section 56(2)(viib) of IT Act.

However, the CIT(A) reversed the addition made by the AO; mainly on the basis that (i) AO cannot impose valuation method of its own choice [as option to choose method is provided to Assessee under Rule 11UA(2) of Income-tax Rules 1962 ('Rules')], and (ii) DCF method is essentially based on projections only, and hence, these projections cannot be compared to actuals to expect the same figures.

The ITAT held that the CIT(A) did not deal with the factual objections of the AO, and simply proceeded its findings on an abstract law; hence remanded the matter back to CIT(A) for re-determination of the issue afresh.

5. ITAT Kolkata[5]: No addition of outstanding unsecured loan (not trading liability) to income, only interest on such loan (claimed as expenditure) to be added to income

The Assessee, in this case, obtained loan from a Company (struck off at a later stage), which remained outstanding for several years in the balance sheet only, and was never claimed as a trading liability; only the interest on such sum was claimed as an expenditure. The AO added the entire loan and interest amount to the income of the Assessee, invoking the provisions under section 41(1) of the IT Act.

The ITAT concluded that only the interest expenditure claimed by the Assessee needs to be added back to the income of the Assessee; the outstanding loan concerned is not in the nature of trading liability and thus cannot be added in the income of the Assessee.

Katalyst comments:

Section 28(iv) of the IT Act covers within its ambit the value of any benefit or perquisite, whether convertible into money or not, arising from business or the exercise of profession as being taxable.

The Supreme Court ('SC') in the case of Mahindra and Mahindra Ltd Civil Appeal No. 6949 – 6950 of 2004 held that in order to invoke the provisions of section 28(iv), the benefit which is

[5] Shimmer Textiles (P.) Ltd (Kolkata ITAT) (ITA No 773/Kol/2023), September 22, 2023

received has to be in some other form rather than in the shape of money. As waiver of loan is a cash receipt, Section 28(iv) does not come into picture.

However, with effect from April 1, 2024 (applicable from AY 2024-25), section 28(iv) of the IT Act has been amended to include those benefit or perquisite arising from business or exercise of profession, which are ***received in cash or partly in cash and partly in kind****. In view of this, the waiver of outstanding loans could be roped in the taxability under section 28(iv) of the IT Act.*

B. Corporate Law Highlights

1. SC[6]: Validity of 'Group of Companies' doctrine

In this case, Cox and Kings Ltd ('C&K') entered into an agreement with SAP India Pvt. Ltd ('SAP India'), for installing a new software which ran into several difficulties. Accordingly, C&K reached out to SAP SE, based in Germany, for their assistance, whereby SAP SE took over the project. However, the project failed, leading to termination of contract by C&K, and led to C&K demanding a refund of the payments made to SAP.

In response, arbitration proceedings were initiated by SAP India; the arbitration proceedings were adjourned in November 2019 by the NCLT as C&K were facing insolvency proceedings. Despite looming bankruptcy, C&K initiated fresh arbitration, and included SAP SE as a party to the arbitration even though SAP SE was not a signatory to any of the agreements, and claimed that SAP SE could be included as a party to the arbitration, as SAP SE took full responsibility of the project and gave their implied consent as the parent company of SAP India (this principle of including a non-signatory as a party to an arbitration agreement is known as the 'Group of Companies Doctrine'.)

A three-judge Bench of the SC referred the case to a five-Judge Constitution Bench in relation to the concerns regarding the Doctrine; the five judge Bench addressed the uncertainty surrounding the scope and applicability of the Doctrine in India, by confirming that non-signatory group companies can, in principle, be bound by arbitration agreements under the Doctrine, but only in certain situations, as articulated below:

- The role and relationship of a third-party, as may be specified in the agreement, could be a factor of their consent to be bound by the arbitration agreement;

- During the referral stage under the Arbitration Act, the HC / SC must defer to the arbitral tribunal to determine the binding nature of non-signatories to the arbitration agreement;

[6] Cox and Kings Ltd. vs. SAP India Pvt. Ltd. & Anr (SC) (Arbitration Petition (Civil) No 38 of 2020), December 6, 2023

- The underlying basis for application of the doctrine rests on maintaining corporate separateness of the group of companies while determining the common intention of the parties to bind the non-signatory to the arbitration agreement;

- The principle of alter ego or piercing the corporate veil cannot be made the basis for the application of the doctrine;

- An arbitration agreement must be written, but it need not be signed.

Katalyst comments:

The SC judgement has led to clarity that mere endorsement of an arbitration agreement does not singularly establish one as a 'party' to that agreement; however, in a case where businesses form part of a larger group and engage in interconnected transactions, such engagements may imply a willingness to be bound by the arbitration agreement.

When corporate groups specifically aim for only the signing company to be obligated by the arbitration agreement, they should precisely structure the transaction accordingly, aligning their actions with this intention. Including explicit language in the contract reflecting this intention is also a prudent consideration.

2. SC[7]: Companies Act does not override or deal with law of succession

In this case, the question revolved around the rights of nominee of shares and whether they enjoy absolute ownership or are subject to the laws of succession, to which the SC held as follows:

- Courts have consistently interpreted that, upon the holder's death, the nominee does not acquire absolute title to the nominated assets [applying this principle to Companies Act, 2013 ('Co Act'), and the Depositories Act, 1996 ('DP Act')];

- The vesting of securities in favour of the nominee under the Co Act, and DP Act, 1996, is for a limited purpose i.e. to preventing confusion pertaining to legal formalities that are to be undertaken upon the death of the holder and to protect the subject matter of nomination from any protracted litigation until the legal representatives of the deceased holder are able to take appropriate steps;

[7] Shakti Yezdani &ANR vs Jayanand Jayant Salgaonkar & ORS (Civil Appeal No 7107 of 2017), (SC), December 14, 2023

- Nomination process under Co Act and DP Act does not supersede succession laws, and there is no third mode of succession intended by these Acts.

C. SEBI/ FEMA/PMLA/OTHER

1. Delhi HC[8]: Eldest female member can also be "Karta" of Hindu Undivided Family ('HUF')

The case involved determining the successor to the Karta position in a HUF, following the passing away of all the sons, wherein the deceased person's granddaughter, asserted her right as the eldest to be the next Karta, facing opposition from male relatives.

In this context, the Delhi HC held that daughters can be "Karta" of HUF and represent the HUF before the competent authorities like tax departments, on the following basis / principles:

- The Hindu Succession (Amendment) Act, 2005, which grants daughter to have the same rights (by birth) in the coparcenary property (ancestral property of the Hindu undivided family) as a son, would include all other rights that a coparcener has, which includes a right to be a Karta;

- The claim that the husband of a female Karta would have an indirect control over the activities of HUF is only a parochial mindset;

- If there arises any skepticism about the skills, efficiency, sincerity or ability of female Coparceners to act as the Karta or being influenced by her in-laws, the other Coparceners have adequate remedies to seek for a partition or impeach any wrongful alienation of property made by the Karta;

- Neither the Legislature nor the traditional Hindu Law limits the right of a woman to be a Karta; also, societal perceptions cannot be a reason to deny the rights expressly conferred by Legislature.

Katalyst comments:

The judgement serves as a precedent for recognizing and upholding women's rights in HUFs, reinforcing the idea that statutory provisions take precedence over outdated societal norms. It marks a step towards dismantling gender based barriers within family structures and aligns with broader efforts to promote equality and justice.

[8] Manu Gupta vs Sujata Sharma & ORS (Delhi HC) (RFA(OS) 13/2016 & CM APPL. 6041/2016), (SC), December 4, 2023

2. SC[9]: Unstamped Arbitration Agreement not void in law

In this case, the SC (7 judge bench) overruled the judgement in case of NN Global Mercantile v Indo Unique Flame (2023), rendered in April, 2023 (5 judge bench - SC), which held that unstamped arbitration agreements are not enforceable; the SC held that arbitration clauses in unstamped or inadequately stamped agreements are enforceable, and concluded the following:

- Non-stamping or inadequate stamping is a curable defect;
- Insufficiency in stamping does not make the agreement void or unforceable, but renders it inadmissable in evidence;
- Objections regarding stamping fall within the jurisdiction of arbitral tribunal, and not the Courts.

Katalyst comments:

While this judgement will minimize court supervision and reduce delays in arbitration, the significance of proper stamping in agreements remains unchanged; it is vital to note that agreements without adequate stamping are still inadmissable in evidence.

3. Securities Appellate Tribunal[10]: Persons acting in concert

The facts of the case were linked to a company called Abhishek Infraventures Ltd. ("the company"); certain complaints were received in relation to the company which led to an investigation by SEBI and based on the investigation, a show cause notice was issued by SEBI under the Takeover code.

The crux of the show cause notice was that the company had made a preferential allotment to 11 allottees, out of which 2 were promoter entities and 9 were non promoter entities. However, it was found that these 9 promoter entities including the appellants were connected to one another and 7 of them had received funds in their accounts for subscribing to the preferential allotment from entities connected with the company and the promoters.

[9] Curative Petition (C) No. 44 of 2023 in Review Petition (C) No. 704 of 2021 in Civil Appeal No. 1599 of 2020, SC, December 13, 2023

[10] Omprakash Kovuri & Others vs SEBI dated August 29, 2023

In the above context, SEBI's Whole Time Member ('WTM') found that the appellants were connected to one another and had acted in concert and therefore, the shareholding as a group which was only 24% prior to preferential allotment increased to 88% post preferential allotment. Accordingly, a fine for failure to furnish information was imposed in addition to other consequences.

The SAT held, under the circumstances, that the parties were acting in concert.

Katalyst comments:

As with the general trend of legislation, substance over form is becoming the core test of interpretation. At the same time, it is important to recognise that transfer of shares between promoters does not trigger the take over offer ; in this context, please see the Supreme Court judgement in the case of Virendra Kumar Singh versus SEBI dated January 19, 2023 – please refer link of Katalyst Kaleidoscope March 2023.

4. SEBI[11]: Circular: Simplification of requirements for grant of accreditation to investors

SEBI has issued a Circular, simplifying the grant of certification to Accredited investors (such investors are identified based on net worth or income, and can invest in securities that may not be available to retail investors).

Under the framework, accreditation agencies, which are also KYC Registration Agencies (KRAs), can access Know Your Customer (KYC) documents of applicants available with them in the capacity of KRA and can also access the same from the database of other KRAs; and grant accreditation. Further, it is vital to note that the accreditation certificate will include the following disclaimer:

"The assessment of the applicant for accreditation is solely based on the applicant's KYC and financial information and does not in any manner exempt market intermediaries and pooled investment vehicles from carrying out necessary due diligence of the "accredited investors" at the time of onboarding them as their clients".

The validity period of the certificate has also been revised in the Circular.

[11] SEBI/HO/AFD/PoD1/CIR/2023/189 dated December 18, 2023

D. Goods and Service Tax highlights

1. Gujarat AAR[12]: Supply of aircraft along with provision of service is composite supply and GST rate of 5% is applicable.

Gujarat AAR holds that Tata's (Applicant/service provider) supply of aircraft and provision of support services are naturally bundled and supplied in conjunction with each other. Also, in ordinary course of business, supply of support services i.e., maintenance etc., is possible only when goods/aircrafts are supplied. Hence, supply of aircraft with support services is a composite supply and GST rate of principal supply i.e., aircraft which is 5%, is applicable. Further, the AAR also clarified that transaction value to be adopted for the purpose of payment of GST shall include the supply made free of cost by Airbus (service recipient) to Tata (service provider).

2. Chennai CESTAT Bench[13] - Split ruling on applicability of service tax on portion of salary and other allowances paid to secondees in Indian rupees

The Chennai bench of CESTAT has issued a split ruling in the matter of applicability of service tax on salary and other allowances paid directly in Indian currency by the taxpayer/Indian entity to secondees; the issue dealt with by the CESTAT was limited to the question of valuation and arriving at the taxable value and not the taxability of the transaction.

In this matter, the judicial member has held that Indian salary and other allowances paid directly by the taxpayer to secondees are not includible in the taxable value and the technical member has held that such payments are includible in the taxable value. Further, given the conflicting views of the technical and judicial members, the final outcome in this matter is keenly awaited

Katalyst Comments:

Post this ruling, the CBIC has issued the instructions[14] to field formations in pursuance of the judgment of the Supreme Court in the case of Northern Operating Systems Private Limited (NOS ruling) on applicability of service tax on secondment of employees. The instructions provide that with multiple types of secondment arrangements, the NOS ruling should not be applied mechanically in all cases and an investigation (by GST authority) is required with

[12] In the matter of Tata Advanced Systems Ltd. [TS-623-AAR(GUJ)-2023-GST]
[13] Service Tax Appeal No. 41909 to 41911 of 2017 (Interim Order Nos. 40016-40018/2023 dated 11 December 2023)
[14] Instruction No. 05/2023-GST dated December 13, 2023

careful consideration of the complete factual matrix. As the CBIC has issued instructions to field formations, taxpayers may re-evaluate and revisit their litigation strategy on the secondment issue both under the pre-GST as well as the GST regime.

3. West Bengal AAR[15]: GST is applicable on amount collected towards corpus fund, common area electricity charges from members

The West Bengal AAR has held that GST is applicable on the amount collected by the Applicant (Association of Apartment owners) from its members for setting up a sinking fund to meet future contingencies/major CAPEX and common area electricity charges; such receipt is an advance payment towards future supply of services and hence, it should be taxed. Due to this reason, such contribution cannot qualify as a "deposit."

Katalyst Comments:

This decision seems to be highly debatable, and is likely to be challenged.

4. Patna High Court[16]: Pre-deposit for maintaining appeal can be made through Electronic Cash Ledger('ECL') and not through Electronic Credit Ledger ('ECRL')

The Patna High court has held that the pre-deposit (10 %) for maintaining appeal can be done by utilizing amounts in the ECL only as per the provisions contained in Section 49(3) of the CGST/BGST Act read with Rule 85 (4) of the CGST/BGST Rules and not through ECRL. Further, the HC clarified that 'pre-deposit' is not any output tax under the GST Law and the balance in ECRL, however, is a self- assessed input tax credit of the registered person and it is subject to an assessment proceeding to determine the amount of credit eligible for being utilized by the registered person and hence, the ECRL should not be used to make pre-deposit for maintaining appeal.

Katalyst comments:

*In the instant case, Hon'ble Patna High has held that ECRL can't be used for making payment of pre-deposit for filing an appeal. However, in case of M**/s. Kiran Motors v. Addl. Commissioner of CT & GST [W.P (C) No.22817 of 2023, dated August 10, 2023],** the Hon'ble Orissa High Court concluded that a pre-deposit for GST can be accomplished using the ECRL. Also, Hon'ble Madras High court has also allowed pre-deposit through ECRL in case of **Larsen & Toubro Ltd. vs. The Joint Commissioner (ST) & Anr. [TS-435-HC(MAD)-2023-GST].***

[15] In the matter of Prinsep Association of Apartment Owners [TS-622-AAR(WB)-2023-GST]
[16] Flipkart Internet Pvt. Ltd vs The State of Bihar [TS-611-HC(PAT)-2023-GST]

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