

Katalyst Kaleidoscope

February 2024: Tax and Regulatory Insights

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A. Income Tax Highlights

1. SC: Dismisses review petition on telecom license fee on 'capital v/s revenue' issue¹

The Supreme Court dismisses Bharti Hexacom's review petition against the judgement dated October 16, 2023 holding telecom license fee as capital expenditure (*Please refer October 2023 Katalyst Kaleidoscope*).

2. Madras HC: After CIRP, company's tax prosecution cannot continue against new management; old officers liable²

In the given case, the assessee company underwent the Corporate Insolvency Resolution Process (CIRP), and its management was taken over by the resolution applicant; however, the assessee and its erstwhile managing director faced prosecution under section 277 for false verification involving undisclosed income. Consequently, the assessee sought to quash the prosecution through a criminal original petition under section 482 of the CPC, arguing that according to section 32A of the IBC, the liability of a corporate debtor is entirely discharged once the resolution plan is approved by the NCLT.

The Madras HC observed that once the CIRP is initiated against the corporate debtor and the application is accepted by the NCLT, a moratorium comes into effect, and when the corporate debtor gets into the hands of the new management, all the past liabilities including criminal liability are absolved; however, persons in-charge and responsible for running the company prior to the commencement of the CIRP, cannot escape from criminal charges.

Accordingly, the HC dismissed the prosecution against the assessee company under new management, citing the Supreme Court judgment in 'Ajay Kumar Radheshyam Goenka v. Tourism Finance Corporation of India Ltd.'³ The Court affirmed that the new management does not inherit criminal liability and cannot be subject to criminal prosecution; additionally, as the former managing director had already passed away, the charges against him also ceased.

3. Delhi HC: Maharashtra Government's sales-tax subsidy held as capital receipt; explained through 'purpose test'⁴

In this case, the assessee company received a sales tax subsidy from the Maharashtra Government under the 'Dispersal of Industries Package of Incentives, 1993' scheme. This scheme aimed to encourage the establishment of new and expanded units in underdeveloped and developing areas. The company declared a loss of INR 205 crore,

¹ Bharti Hexacom Limited [TS-95-SC-2024]

² Vasan Healthcare Pvt. Ltd [TS-56-HC-2024(MAD)]

³ Supreme Court of India Criminal Appeal No. 172 of 2023

⁴ Indo Rama Textiles Ltd [TS-51-HC-2024(DEL)]

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treating the subsidy as a capital receipt. However, the Assessing Officer (AO) reduced the loss to INR 181 crore, considering the subsidy as a revenue receipt; upon appeal, both the Commissioner of Income Tax (CIT) and the Income Tax Appellate Tribunal (ITAT) concluded that the sales subsidy was of a capital nature. Consequently, the Revenue appealed to the Delhi High Court.

The Delhi HC dismissed Revenue's appeal based on examination of the purpose of the subsidy using the "purpose test," which assesses whether the subsidy aids in conducting business operations or in setting up a business; upon review of the scheme, the court observed that its objective was to industrialize developing areas rather than enhance production capability or profitability. Consequently, it was held that the sales-tax subsidy is to be treated as a capital receipt.

4. Madras HC: Post-amalgamation assessment not solely based on modified return, invalid; grants liberty to reassess⁵

The assessee, engaged in textile business, amalgamated with another entity through a scheme sanctioned by NCLT with effect from 01 April 2020, which resulted into the dissolution of the latter. The assessee filed a standalone return for the AY 2021-22, followed by a modified return manually after being served with a scrutiny notice. Subsequently, the assessing officer issued an assessment order based on the standalone returns; dissatisfied with this decision, the Assessee filed a writ petition.

The Madras High Court noted that the assessment procedure commenced after the effective date of the merger. Consequently, the Court invalidated the assessment order, asserting that post-amalgamation, a consolidated modified return should serve as the foundation for assessment, as stipulated in Section 170A; however, the assessing officer instead considered the standalone returns of both the Assessee and the transferor company. Consequently, the Assessee's writ petition was allowed.

5. Bombay HC: Quashes reassessment proceedings on share premium received from Mauritian investor⁶

In the Assessment Year 2009-10, the assessee company issued shares with a face value of Rs. 10 each at a premium of Rs. 12,842 per share. The assessment of this transaction was subjected to scrutiny; subsequently, the company received a reassessment notice under section 148 (based on a communication received from a senior officer), alleging that income had escaped assessment due to excessive share premium. The assessee objected to the same, which was rejected by the Assessing Officer. In response, the company filed a writ petition.

⁵ Pallava Textiles Private Limited [TS-64-HC-2024(MAD)]

⁶ Godrej Projects Development Pvt Ltd [TS-59-HC-2024(BOM)]

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The Bombay High Court observed that the initial assessment had been conducted thoroughly, taking into consideration the balance sheets, valuation report and other details as asked for in the course of scrutiny; therefore, reopening the assessment solely based on a change of opinion by the Assessing Officer was considered hypothetical and an insufficient justification to believe that income had escaped assessment. Consequently, the reassessment notice was quashed by the court.

6. **Mumbai ITAT: Date of shares delivery determinative of holding period, not SPA execution date⁷**

The assessee, a US tax resident, had acquired CCPS issued by Progeon Ltd. (now Infosys BPO Ltd.) vide Share Purchase Agreement (SPA) dated June 14, 2002, which were converted into equity shares on June 30, 2005; thereafter, on April 20, 2006, the assessee entered into another SPA for sale of these shares, which was subject to conditions precedent to the sale.

On June 30, 2006, part of the consideration was received and assessee treated the profits arising as long-term capital gain (LTCG) by treating the effective date of transfer as June 30, 2006; however, the AO considered the same as short term capital gain, treating April 20, 2006 (i.e. the SPA execution date) as the date of transfer. The CIT(A) upheld the assessment order.

Upon appeal, the Mumbai ITAT held that the effective date of transfer shall be the date of receipt of sale consideration and the delivery of shares, and not the date of execution of SPA, relying upon the coordinate bench ruling in Hami Aspi Balsara, and on the CBDT circular no. 704 dated April 28, 1995, wherein it is stipulated that “in case the transactions take place directly between the parties and not through stock exchanges the date of contract of sale as declared by the parties shall be treated as the date of transfer provided it is followed up actual delivery of shares and the transfer deed. Consequently, the ITAT allowed the assessee’s appeal, and all the gain on transfer of shares was treated as LTCG.

Katalyst Comment:

The above is a classic example of needless litigation on a point which should have been so obvious to the revenue authorities; most SPAs will have a ‘Conditions Precedent’ (CP), and the transaction contemplated therein is subject to satisfaction of those CPs. If these CPs are not fulfilled, the transaction does not even go through, and therefore the issue of the revenue authorities contending that the tax trigger is on the date of the SPA was totally unjustified, in the first place.

⁷ Citicorp International Finance Corporation [TS-112-ITAT-2024(Mum)]

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7. Delhi ITAT: Deduction u/s 80IC allowed to HUL's ancillary unit as activity tantamounts to 'manufacture'⁸

The assessee operates as a 100% ancillary unit to Hindustan Unilever Limited (HUL) and sought deduction under section 80IC (Special provisions in respect of certain undertakings or enterprises in certain special category States), contending that processing of raw materials received from HUL and subsequent supply to HUL's main plant constituted 'manufacturing'; however, the Assessing Officer rejected this claim, asserting that the assessee's activities were those of a service provider rather than a manufacturer.

On appeal, the Delhi (ITAT), drawing on the Supreme Court's precedent in cases like Quasi Noorul, Kores India, and NC Budhiraja, concluded that the assessee's industrial activities constitute manufacturing or production because the process deployed brings into existence such goods that are both chemically and commercially distinct from the original materials; additionally, the fact that the assessee obtained necessary government permissions further confirms that the activities undertaken qualify as manufacturing.

Katalyst Comment:

There have been a series of Supreme court judgements, such as in the case of Noorul, Kores India, and NC Budhiraja, as mentioned above, observing that the test of manufacture is, "whether the commodity which is subject to the process of manufacture can no longer be regarded as the original commodity but is recognized in the trade as a new and distinct commodity"

8. Bangalore ITAT: rejects section 11 exemption; microfinancing with exorbitant interest rate & profit intent, not considered charitable activity⁹

The assessee, a trust registered under sections 12A and 80G, primarily provided loans to individuals who were unable to obtain them from financial institutions; however, it charged high-interest rates ranging from 18% to 20%; consequently, the exemption under section 11 was denied to the trust, a decision upheld by the CIT(A).

Upon appeal, observed that the assessee provided loans to members of 'Self Help Groups' rather than directly assisting impoverished individuals, contrary to the trust's stated objective of aiding the financially disadvantaged. The ITAT concluded that the assessee's microfinance activities were purely commercial, aimed at profit-making, without any charitable intent; further it was also held that the non-cancellation of registration under section 12AA does not automatically warrant exemption under section 11 and that the same could be examined at each stage of assessment in each AY.

⁸ Beeam Industries Pvt. Ltd [TS-62-ITAT-2024(DEL)]

⁹ Sanghamitra Rural Financial Services [TS-72-ITAT-2024(Bang)]

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B. Corporate Law Highlights

1. SC: Upheld NCLAT order; borrower not to exercise right over that part of the escrow account which was assigned¹⁰

In the given case, the lender bank sanctioned a financial facility to the appellant borrower (ILFS) and a Master Facility Agreement (MFA) was entered between parties which envisaged creation of a separate escrow account; additionally, an assignment and administration agreement was also executed between the parties, under which the indebtedness of the appellant was payable from the business centre service agreement/ lease & licensing revenue, after setting aside the payment for principle and interest as and when due.

Meanwhile, the NCLT and NCLAT issued an interim stay order in response to a petition by the Union of India, halting legal actions against the borrower, including enforcement of security interests and financial facility invocation.

Following this, the borrower requested the lender to reverse a debited amount from the escrow account as per their earlier agreement; however, the NCLAT held that the borrower could not claim rights over the assigned portion of the escrow account. The borrower appealed, arguing that there was no transfer of receivables' title to the lender and that the escrowed receivables were their assets deposited as loan security.

The Supreme Court observed that the concerned case is an assignment and not a pledge, and relevant provisions of the Transfer of Property Act, 1882, and discussion with authorities support the conclusion that the receivables of the lender stood absolutely assigned to the respondent bank; consequently, the Supreme Court upheld the NCLAT's decision, dismissing the appeal, and accordingly, the transfer of rents etc. payable by IIFL tenants should be transferred to the bank.

2. NCLAT: Stays NCLT's insolvency order against Dream 11¹¹

The NCLT admitted an insolvency application under Section 9 against Sporta Technologies Pvt. Ltd, the owner of Dream 11, filed by one of its operational creditors. This creditor, undergoing insolvency resolution itself, claimed that Sporta Technologies failed to pay a license fee amounting to over Rs. 7.5 crores as per a 2019 license agreement. The demand note for this fee was issued on April 20, 2020; incidentally, Sporta Technologies did not respond to the Section 8 demand notice.

However, the National Company Law Appellate Tribunal (NCLAT) intervened by putting a stay on the aforementioned order until February 23, 2024. This decision was made considering that the operational creditor's application was constrained by specific provisions of section

¹⁰ Supreme Court, Civil Appeal No. 4708 of 2022 in ILFS vs HDFC Bank (October 19, 2023)

¹¹ Piyush Jani, Resolution Professional for Reward Business Solutions vs. Sporta Technologies Pvt Ltd. [LSI-111-NCLT-2024(MUM)] & Bhavit Sheth vs. Madan Bajrang Lal Vaishnawa, IRP of Sporta Technologies Pvt. Ltd & Anr. [LSI-112-NCLAT-2024(NDEL)]

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10A. The section stipulates that no Corporate Insolvency Resolution Process (CIRP) application can be filed for any default occurring on or after March 25, 2020, for a period of one year, and this aspect had not been taken into account by the NCLT.

3. MCA: Deployment and usage of 'Change Request Form' (CRF) on MCA-21¹²

The Ministry of Corporate Affairs (MCA) has introduced 'Change Request Form' (CRF) on the V3 portal to enhance the convenience of users accessing MCA-21 services, which is intended for use in exceptional circumstances, such as submitting requests to ROCs or addressing needs that cannot be met through existing functionalities; it is crucial to note that the CRF should not substitute any mandatory reporting, registry, or other requirements stipulated by the Companies Act, 2013, and the LLP Act, 2008.

C. SEBI / RBI / Other Highlights

1. SC: Strikes down Electoral Bonds Scheme as unconstitutional¹³

On January 2, 2018, the Ministry of Finance notified the Electoral Bond scheme 2018 in exercise of the power u/s 31(3) of the RBI Act. The electoral bond is in the nature of a promissory note which is a bearer banking instrument and does not contain the name of the buyer; the following are some key features of the scheme:

- The bonds may be purchased by a citizen of India or a company or any other entity.
- It can be encashed only by an eligible political party as defined i.e. one which is registered u/s 29A of the Representation of People Act, 1951
- The bond is valid for 15 days from the date of issue
- The value of the bond should be considered as income by way of voluntary contribution received by the eligible political party

The petitioners instituted proceedings u/s 32 of the Constitution of India challenging the constitutional validity of the EB scheme and also various related provisions.

In a detailed judgement after dealing with a large number of issues, the Supreme Court held as follows:

- The EB scheme and provisions like Section 182(3) of the Companies Act which in its amended form permits uncapped political contributions are violative of the constitution
- The issuing bank (State Bank of India) shall stop issuing electoral bonds
- SBI shall submit details of the electoral bonds purchased since the interim order of the Court dated 12th April 2019 to the election commission of India.
- Electoral bonds which are within the validity of 15 days, but not yet encashed shall be returned by the political party in possession of the bond to the issuing bank and the issuing bank shall refund the amount to the purchaser.

¹² General Circular No. 02/2024 File No. 04/130/2021-eGov-MCA Ministry of Corporate Affairs Government of India

¹³ Association for domestic reforms versus Union of India, Judgement dated February 15, 2024

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- It may be mentioned that it was a 5 bench judgement led by Chief Justice of India, Dr. Dhananajaya Chandrachud, but with a separate judgement by Justice Sanjiv Khanna who agreed with the conclusions, but with a different reasoning.

Katalyst Comment:

This is a landmark judgement, but obviously, has sparked off a debate on the larger issue of political funding, and also has a special significance in the context of elections around the corner

2. SEBI: Violation of PFUTP Regulations in case of Zee Business Channel¹⁴

SEBI conducted an investigation to examine high correlation between the trading activities of certain entities and the stock recommendations given by guest experts of Zee Business channel during the period from February 1, 2022 to December 31, 2022, and to determine if there were violations of the SEBI (PFUTP Regulations); subsequently, a search and seizure operation was carried out on the premises of suspect entities, and the following are some of the key findings:

- SEBI observed a significant correlation between the trading activities of Profit Makers and the stock recommendations made by Guest Experts on Zee Business.
- On advance information sharing front, the trading activities based on this advance information were observed, resulting in favorable price movements and increased trade volumes.
- Such practices were deemed manipulative, exploiting the anticipated impact of recommendations on stock prices and trading volumes

In context of the same, following directions have been issued which will remain in force until further orders:

- The concerned noticees are restrained from buying, selling or dealing in securities, either directly or indirectly
- Guest experts shall preserve the records of their various social media accounts maintained by them, directly or indirectly
- The concerned notices are directed to credit the amount of unlawful gains to an Escrow and deposit within 15 days from the date of service of this order; further no other debits should be made, without SEBI's permission
- Concerned noticees are directed not to dispose or alienate any of their assets/properties/securities, till such time the amount of unlawful gain is credited to an Escrow Account except with the prior permission of SEBI.
- Zee Media Corporation Limited is advised to preserve and maintain all records, documents, material, video records, etc., along with their content, related to the guest experts and concerned shows till the final order of SEBI is passed

¹⁴ WTM/KCV/ISD/ISD-SEC-6/30020/2023-24

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D. Goods and Service Tax Highlights

1. Telangana High Court: Dismissed writ challenging levy of GST on transfer of development rights¹⁵

Telangana High Court dismissed the writ challenging applicability GST on transfer of development right in case of joint development agreement ('JDA') and held that transfer of development right is a service and not an outright sale of immovable property. Transferring of the Development Rights does not result in transfer of ownership rights.

The HC clarified that the contention that the JDA eventually results in sale of land to the Developer is incorrect and misleading. It is only by way of a separate conveyance deed, that too, after the completion of the development activity the undivided share of land to the extent the petitioner is entitled, could be transferred and not solely by virtue of the JDA.

Katalyst Comment:

The judgment highlights that merely executing the JDA does not amount to an outright sale of land or transfer of ownership, title and possession to the developer. The HC found that, throughout the agreement, the landowner retained the bundle of rights over the land and developer has to achieve milestones/ timelines before claiming the right over the constructed area. It is likely that the matter will be go to the SC, to determine whether a notification can impose tax on a transaction akin to a sale.

2. West Bengal AAAR: ITC of construction of warehouse whether capitalized or not is not available¹⁶

West Bengal AAAR has allowed the appeal of revenue and held that ITC of construction of warehouse whether capitalized or not is not available as per the provisions of section 17 (5) (c) and (d) of the CGST Act. The AAAR has also modified the AAR order to the extent WBAAR restricted the ITC to only constructions expenses which are capitalised in books of account as per the explanation to section 17(5)(d) of the CGST Act

Katalyst comments:

The Orissa High court in case of Safari Retreats Pvt. Ltd [2019-TIOL-1088-HC-ORISSA-GST] has held that ITC of inputs and input services used for construction of mall is available if the petitioner is required to pay GST on rental/leasing income arising out of letting out of shops of mall. This case is pending before the Supreme court

¹⁵ Prahitha Construction Pvt. Ltd. vs. UOI & Ors. [TS-60-HC(TEL)-2024-GST]

¹⁶ In the matter of Mindrill Systems and Solutions Pvt Ltd [TS-48-AAAR(WB)-2024-GST]

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3. Allahabad HC: Quashes harsh penalty for wrong place of supply in E-way bill considering it as ‘technical error’¹⁷

At the time of generating the E-Way bill, the principal place of business was automatically reflected as the place of supply and goods were seized at the time of stock transfer to the factory. In this regard, the Allahabad HC has held that mere technical error committed by the petitioner cannot result in imposition of such harsh penalty. HC clarifies that “it does not appear that there was any intention whatsoever to evade tax” since invoices and bilties other E-way bills reflect correct address.

Katalyst Comment:

A reasoned judgement by the Allahabad HC; no penalty should be levied in case of absence of any intention to evade tax.

¹⁷ Hawkins Cookers Ltd. vs. State of U.P. [TS-66-HC(ALL)-2024-GST]