KATALYST
ADVISORS LLP

Katalyst Kaleidoscope

January 2021: Tax and Regulatory Insights

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A. Income Tax

1. Kolkata Income Tax Appellate Tribunal ("ITAT"): Transfer of tenancy rights held taxable as capital gains[1]

The assessee paid an amount of INR 8 lakhs by way of construction loan to the landlord for the purpose of obtaining tenancy rights. During the year under consideration, the assessee received INR 10 Cr on account of surrender of tenancy rights and offered such income under the head Capital Gains and claimed deduction under section 54EC and 54F of the Income Tax Act, 1961 ("ITA"). The assessing officer rejected the claim of the assessee on the ground that the amount received by the assessee was just a compensation for vacating the tenancy and, as a consequence, the assessing officer assessed the income from surrender of tenancy rights as "business income".

The Kolkata ITAT observed that the amount of INR 8 lakhs paid by way of "construction loan" for possession of flat was directly linked to acquisition of tenancy rights. Further, the Kolkata ITAT, relying on the Calcutta High Court ruling in A. Gasper[2] and Supreme Court ruling in D.P. Sandu Bros. Chembur (P) Ltd[3], held that the acquisition of tenancy rights would fall within the ambit of definition of "capital asset" under section 2(14) of the ITA and, transfer of tenancy rights was chargeable to income tax under the head "Capital Gains", thereby granting relief under section 54EC and 54F of the ITA.

2. Karnataka High Court: Deemed gift provision is not applicable to bonus shares[4]

The assessee, an individual, received 1 Cr bonus shares from M/s Manipal Education and Medical Group (India) Pvt. Ltd. The Assessing Officer treated the receipt of bonus shares as deemed gift under "Income from Other Sources" by invoking the provisions of section 56(2)(vii) of the ITA and assessed the fair market value of the bonus shares being INR 12.49 Cr under Rule 11UA as income in the hands of the assessee.

The Karnataka High Court stated that the issue of bonus shares by capitalization of reserves is merely a reallocation of the company funds and there is no inflow of fresh funds or increase in the capital employed. Further, the High Court also stated that the total funds available with the company remained the same and issue of bonus shares did not result in any change in the capital structure of the issuing company. The High Court also observed that in substance, when a shareholder gets bonus shares, the value of the original shares held by him goes down, and the market value as well as intrinsic value of two shares put together will be the same (or nearly the same) as per the value of original share before the issue of bonus shares. Thus, any

[1] Smt Shikha Roy [2020] ITA No. 1915/Kol/2019 dt. November 25, 2020
[2] A. Gasper Vs. CIT (1979) 117 ITR 581 (Calcutta High Court) dt. March 30, 1978
[3] CIT Vs. D.P. Sandu Bros. Chembur (P) Ltd [2005] 142 Taxman 713 (Supreme Court) dt. January 31, 2005
[4] Dr. Ranjan Pai [2020] ITA No. 501 of 2016 (Karnataka High Court) dt. December 15, 2020

profit derived by the assessee on account of receipt of bonus shares is adjusted by depreciation in the value of equity shares held by him.

In the light of the above, the High Court held that when there is an issue of bonus shares, the funds remain with the company and nothing comes to the shareholders as there is no transfer of property and the deemed gift provision under the ITA are not attracted.

Katalyst Comments:

Deemed gift provisions under the ITA were introduced as a counter avoidance mechanism, and the intent is not to tax any and every transaction, but only those which are logically covered by the section. Although the above judgement brings clarity on taxation in the hands of shareholders upon receipt of bonus shares, the fact that such issues arise is very unfortunate and is a needless waste of time and energy. In the light of the widened taxation net of deemed gift provisions (section 56(2)(x) of the ITA), the CBDT should come up with a circular elucidating the transactions to which deemed gift provisions should not apply and, as a consequence, unwarranted litigation can be avoided.

3. Madras High Court: Private discretionary trust considered as a representative assessee and thereby taxable as an "individual" (and not Association of Persons) for voluntary contribution received from the group companies[5]

The assessee, a private discretionary trust, received voluntary contribution of INR 25 Cr from six Shriram Group entities, which was credited to the capital account of the trust. Such contribution was received by the trust for the benefit members and senior executives of Shriram Group.

The assessee filed its return of income in the capacity of a trust and contended that the status is of an AOP and therefore deemed gift provision under section 56(2)(vii)(a) of the ITA which at the relevant period i.e., FY 2013-14 covered only individual and HUF. It is in this context that the question whether the trust was an AOP or individual arose, and if such trust is assessed as an AOP, it would have been outside the ambit of the deemed gift provision under section 56(2)(vii)(a) of the ITA in the hands of the trust.

Both the Joint Commissioner of Income Tax ("JCIT") and the Commissioner of Income Tax ("CIT") disagreed and treated the INR 25 Cr as income from other sources, recommending that the amount be taxed accordingly.

[5] CIT Vs Shriram Ownership Trust [2020] TCA No. 242 of 2018 (Madras High Court) dt. December 8, 2020

On perusal of the facts the Madras High Court relied on the Supreme Court ruling in the case of Indira Balkrishna[6] and held that the beneficiaries did not come together with a common purpose, which is a prerequisite for formation of an AOP, and the beneficiaries also played no role in the operation of the assessee.

Accordingly, it opined that when the assessee trust had received the INR 25 Cr on behalf of the beneficiaries who have been identified, then the assessee is a representative assessee as defined under section 160(1)(iv) of the ITA and the benefit is derived by the assessee on behalf of the beneficiaries and to be taxed as an "individual". Since the assessee or the trustees are only the representatives of the beneficiaries, the income is required to be taxed in the like manner and to the same extent as it would be in respect of beneficiaries.

Further, relying on the Supreme Court ruling in the case of Sodra Devi[7], the Madras High Court concluded that the word "individual" is wide enough to include a group of persons forming a unit and accordingly, the assessee was rightly assessed as an "individual" and in this context, the amount of the contribution was also considered as taxable.

Katalyst Comments:

i. *The High Court Ruling has reiterated the position which were adopted earlier in various judicial precedents that a private discretionary trust having all beneficiaries as individuals is to be assessed as an "individual" and not "association of persons". Further, the interpretation of the Madras High Court that the term "individual" is not only restricted to a human being, but wide enough to include a group of persons constituting a unit could have implications for private discretionary trusts which have filed their returns as an AOP.*

ii. *The important aspect to note is that the deemed gift provision applies to all assessees with effect from April 1, 2017; accordingly, a contribution of this nature may become taxable in the hands of the trust as "income from other sources" at the maximum marginal rate (now ~ 43%) which is a significant deterrent to such contribution.*

4. Delhi ITAT: Gift of Shares held as stock-in-trade by company, purportedly as part of family settlement is not taxable as business income in the hands of the donor company[8]

The assessee company was engaged in the business of financing of goods, material, movable and immovable properties and are also trading in shares, securities, stocks and debentures. The assessee gifted shares of certain listed companies of the O P Jindal Group (which was held as stock-in-trade) to four different companies of the O P Jindal Group as a part of family

[6] Indira Balkrishna [1960] 39 ITR 546 (Supreme Court) dt. April 14, 1960
[7] Smt. Sodra Devi TS-5005-SC-1957-O (Supreme Court) dt. May 17, 1957
[8] Manjula Finance Ltd [2020] ITA No. 3727/Del/2018 dt. December 18, 2020

settlement / arrangement. At the time of assessment, the assessing officer came to a conclusion that the aforementioned transaction was not a valid gift of shares and held that the shares were transferred in lieu of certain gains in the process of the family settlement agreement and as a consequence, taxed the difference between the fair market value and cost of acquisition of shares as business income in the hands of the assessee donor company.

The Delhi ITAT held that the assessee company being a separate and distinct entity cannot be considered to be a part of family for "family realignment". ITAT further stated that although the term "family settlement" is not limited to the meaning conferred by succession laws, it cannot be so farfetched that a different corporate entity whose shares are held by some of the members of family, is considered as part of "family" under the family arrangement. Therefore, Delhi ITAT concluded that the aforementioned transaction undertaken by assessee company needs to be tested devoid of any consideration under a family arrangement.

The Delhi ITAT observed that all the ingredients of a valid gift are satisfied, relevant amendments were made to the articles of association of the assessee company, and necessary resolutions were passed by the board of directors and shareholders of the assessee company to undertake the transaction to transfer shares as gift and for acceptance of the gift. Further, Delhi ITAT observed that there was no amount credited in the books of account of the assessee company, no assets were acquired by the assessee company, no benefit was received by the assessee company, and also there was no promise of any future consideration in lieu of the alleged gift of shares by the assessee company to the group companies of O P Jindal Group, and therefore, held that the assessee has not received any consideration or benefit in lieu of the above gift.

Lastly, the Delhi ITAT stated that only real income can be taxed in the hands of assessee company and not hypothetical income. Finally, the Delhi ITAT held that gift of shares, held as stock in trade, by the assessee company to its group companies, in absence of any consideration, would not be charged to tax in the hands of the assessee donor company.

5. Mumbai ITAT: Trust for liquidating/recurring NPAs acquired from banks is not an AOP [9]

Assessee trust was set up by Asset Reconstruction Company (India) Ltd. ("ARCIL") in pursuance of SARFAESI Act, 2002 and RBI guidelines to acquire financial NPA ("Non-performing Assets"). As per the scheme the assessee was to set up the trust with the consortium partners. The Assessee trust had accordingly taken over certain NPAs which would be securitized and then the Security Receipts ("SRs") would be issued to the Qualified Institutional Buyers ("QIB") who would subscribe to the SRs. Certain impairment provisions made on these NPA's were reversed by the assessee trust during the year under consideration. The Assessing Officer held that such reversal of provision should be subjected to tax.

[9] Scheme A1 of ARCIL CPS 002 XI Trust [2020] 119 taxmann.com 216 (Mumbai ITAT) dt. September 10,2020

The Assessee arguments against taxability as under:

- The Trust was only a pass thru mechanism so incomes are to be taxed in the hands of the SR holders which was not acceptable to the Assessing Officer.

- The SR holders contribution was revocable; thus, the income arising from revocable transfer shall be assessed in the hands of the contributors pursuant to section 61 of the ITA.

- Besides this, there was no concerted effort by the SRs to join together, such as to constitute an AOP.

- If the assessee trust were to be taxed, it would tantamount to double taxation once in its hands and in the hands of the SRs, as well.

The Revenue's contentions were as follows:

- The SRs are not revocable, and, thus taxable in the hands of the Trust.

- Since ARCIL was only acting as a Trustee and there being no Trust under the scheme, it should be taxed as an AOP, as there was a concerted effort to pursue asset securitization of NPAs as a business activity.

- The scheme of the trust was a colourable device to thwart taxes.

In the above context and the disputes that arose as explained above, the Mumbai ITAT held in favour of the assesse trust on all the key questions as follows:

- As to whether the Trust was a colourable device, the ITAT held that “the observations of the AO that the assessee trust was not a valid trust, for the reason, that its contributors and beneficiaries were the same, clearly militates against the express provisions of the India Trust Act, 1882, and thus, cannot be accepted”.

- On whether it can be held to be a non-revocable trust, the Mumbai ITAT held that “we have no hesitation in observing that the income therein arising has to be brought to tax in the hands of the SR holders, i.e., as per the provision of sections 61 to 63 of the ITA. In so far, the view taken by the AO, that as the revocation of the contributions is conditional

upon the consent of the contributor's holdings 75% of the units, we are afraid that the same would not render the contributions as irrevocable."

- In relation to the status of the trust, as to whether it is an AOP "in the case before us, we find that the CIT(A) had rightly observed that there is nothing on record which would suggest that the beneficiary had agreed to associate for any common objective. In fact, the beneficiaries who do not have any control over the activities carried on by the trustee in managing the trust had made their respective investments based on the offer documents, and on the basis of their investments made in the trust were allotted to the SRs which represented their undivided and proportionate interest in the corpus of the trust. Hence Assessing Officers unsubstantiated view that the assessee was to be treated as an AOP cannot be sustained".

- Regarding the taxability of the income, the ITAT held "we are unable to accept the claim of the AO that the amounts which are first realized / received in the books of the assesse trust, and then passed on to the SR holders, such amounts were liable to be assessed as the income of the assessee trust. As the principle of diversion of income at the source by overriding title is attracted, therefore, the receivable of NPAs were the income of the SR holders, irrespective of the fact that the same had flowed through the books of account of the assessee trust".

Katalyst Comments:

This decision is an important one on several aspects, including the concept of an AOP, the concept of diversion by overriding title and the concept of what is a non-revocable or revocable trust.

B. Corporate Law Highlights

1. Ministry of Corporate Affairs ("MCA") amends[10] Companies (Compromises, Arrangements and Amalgamations) Rules to provide for purchase of minority shareholding held in demat form

MCA has amended Companies (Compromise, Arrangements and Amalgamations) Rules, 2016 pertaining to purchase of minority shareholding held in demat form which is elaborated as under:

[10] MCA Notification No. GSR 773(E), dt. December 17, 2020

- The company, shall within two weeks, from the date of receipt of the amount from acquirers, verify the details of the minority shareholders holding shares in demat form;

- The company is required to send notice to such minority shareholders intimating about the cut-off date on which the shares shall be debited from their accounts and credited to the designated demat account of the company or to the demat account of the acquirer, as specified in the notice;

- A copy of the notice will be published in two (widely circulated) newspapers and uploaded on the website of the company

- Upon intimation of cut-off date to the depository (along with submission of specified declarations), the depository will transfer the shares of the minority shareholders to the designated demat account of the company;

- On successful transfer of shares, the company will disburse the price of the shares so transferred, to all the minority shareholders after deducting the applicable stamp duty;

- Upon successful payment to the minority shareholders, the depository would transfer shares from the designated demat account of the company to the demat account of the acquirer.

Katalyst Comments:

Section 236 of the Companies Act, 2013 provides for a process of squeezing out minority shareholders by the shareholder(s) holding 90% or more of the issued equity share capital of the company. The amended rules facilitate the majority shareholders to acquire the shares held by minority shareholders in demat form in a seamless manner.

2. MCA extends[11] timeline for conduct of EGM

MCA has extended time for companies to conduct Extra Ordinary General Meetings (EGM) through Video-conferencing (VC) or OAVM or to transact items through postal ballot up to June 30, 2021 (earlier December 31, 2020).

[11] MCA General Circular No. 39/2020, dt. December 31, 2020]

C. Securities' Law Highlights

1. Securities and Exchange Board of India ("SEBI") issues[12] Master Circular in respect of Schemes of Arrangement

SEBI, from time to time, has been issuing various circulars/directions which lay down the detailed requirements to be complied by listed entities while undertaking schemes of arrangements. SEBI has now issued a Master Circular compiling all the relevant and updated circulars issued by SEBI dealing with schemes of arrangement, which are operational as on date.

Katalyst Comments:

It is important to note that in case of any inconsistency between the Master Circular and the applicable circulars, the content of the relevant circular will prevail.

D. Insolvency and Bankruptcy Code - Introduction of Pre-packaged Insolvency Resolution Process[13] under Insolvency and Bankruptcy Code, 2016

The experience from implementation of the Insolvency and Bankruptcy Code, 2016 ("IBC" / "the Code") including evolution of the ecosystem, stabilisation of the processes, growing jurisprudence has prepared ground to look at new initiatives to further improve the effectiveness of the Code. The efficacy of out-of-court workouts in delivering speedier resolutions provided regulators extend the same regulatory exemptions as available to settlements made under the IBC framework was considered and it was felt that a Pre-Packaged Insolvency Resolution Process ("PPIRP") may be introduced under the Code with necessary checks and balances, as an option for resolving insolvency.

The Ministry of Corporate Affairs, vide order dt. June 24, 2020, constituted a sub-committee of Insolvency Law Committee ("ILC"), under the Chairmanship of Dr. M S Sahoo, Chairman IBBI, to study and recommend a regulatory framework for a prepack insolvency resolution process.

[12] SEBI/HO/CFD/DIL1/CIR/P/2020/249, dt December 22, 2020
[13] File No. 30/20/2020-Insolvency Section dt. January 8, 2021

The sub-committee has designed such a framework within the basic structure of the Insolvency and Bankruptcy Code, 2016, and has invited public comments on the recommendations by January 22, 2021 on the below mentioned web-link: https://ibbi.gov.in/webfront/prepack_comment_irp.php

The salient features of the proposed pre pack vis-à-vis the current Corporate Insolvency Resolution Process ("CIRP") has been explained in the form of a table in the report, which is enclosed at **Annexure A**.

E. Goods and Service Tax Highlights

1. Common maintenance deposit collected by a Co-operative society is liable to GST when it is non-refundable

The Gujarat AAR[14] has held that the applicant, being a Co-operative society is liable to GST on amount collected towards "Common Maintenance Fund" as deposit of Rs. 250 square foot of built-up area for future supply of services viz. maintenance, repair etc. of the common amenities, facilities, services, conveniences, utilities and common infrastructure of the Scheme meant for its members. Such deposits are mandatory as per Bye-laws and are non-returnable in nature and hence, the same are considered for supply of service by the Co-operative society to its members.

Katalyst Comments:

The Gujarat AAR seems to have mis-interpreted the definition of "consideration". The definition provides that deposit do not form part of "consideration" until it is applied for meeting the expenses. The Government should bring clarity on this issue to avoid needless litigation.

2. Gujarat High Court[15] directs revenue authorities to sanction IGST refund as drawback rates being the same, represents only Customs element

The petitioner had exported rope making machine and filed a drawback claim where lower drawback rate and higher drawback rate of said product was same. After filing the drawback claim, petitioner also filed IGST refund for the "zero rated" supplies. The authorities withheld

[14] In the application of Capital Commercial Co-op. (Service) Society Ltd. [TS-1161-AAR-2020-NT] dt. October 14, 2020
[15] Awadkrupa Plastomech Pvt. Ltd. vs. UOI [TS-1129-HC-2020(GUJ)-NT] dt. December 30, 2020

the refund claim on the ground that the petitioner claimed higher rate of drawback at one hand and also claimed IGST refund on the other hand. In this regard, the petitioner filed a writ petition with Gujarat High Court which held that the drawback rates being the same, it represents only the Customs element which did not get subsumed in the GST and thus, the petitioner cannot be said to have availed double benefit i.e., of the IGST refund and higher duty drawback. The revenue authorities were directed to immediately sanction the refund towards the IGST paid in respect of the goods exported i.e., "Zero Rated Supplies" made vide the shipping bills.

Katalyst Comments:

A welcome judgment. Post implementation of GST, IGST refunds of many taxpayers have not been processed in case where drawback was claimed and higher and lower drawback rates were same. Now, based on the Gujarat High Court ruling, the revenue authorities should be able to expedite IGST refund, which had embroiled in litigation due to same rates of drawback (higher and lower rates).

3. Karnataka High Court[16] directed revenue authorities to pass reasoned order for blocking Electronic credit ledger

The petitioner's ledger was blocked w.e.f. January 20, 2020 by the revenue authorities without assigning any reasons and petitioner was also not aware which authority blocked the credit ledger. Further, after continued correspondence with revenue authorities it was found that petitioner's ledger was blocked because one of its vendors was being investigated for issuing fraudulent invoices without actual supply of goods/services. In a writ filed before the Karnataka High Court, the High Court has directed the revenue authorities to pass a reasoned order as required under Rule 86A of the CGST Rules, 2017 ("CGST Rules"), while bearing in mind that for the purposes of Rule 86A (3) of the CGST Rules which stipulates that the blockage shall cease to have effect after the expiry of a period of 1 year from the date of blocking and hence, the blockage of the credit ledger and the impugned order cannot be sustained.

4. Other amendments to CGST Act, 2017 ("CGST Act") and CGST Rules

- Section **16(4) –w.e.f. January 1, 2021** - A registered person is entitled to avail ITC of debit note irrespective of the date of corresponding invoice. However, the said debit note should not have been issued pursuant to demand confirmed on account of fraud, mis-statement etc.

[16] Aryan Tradelink vs. The Union of India [TS-1143-HC-2020(KAR)-NT] dt. November 27, 2020

- **Rule 36(4) – w.e.f. January 1, 2021** - Restriction to claim ITC in respect of invoice or debit notes not furnished by the suppliers reduced from 10% to 5% of the credit available in GSTR-2B.

- **Rule 59(4) – Following taxpayers shall not be able to file GSTR-1 – w.e.f. December 22, 2020**

  i. The person who has not furnished GSTR-3B for preceding 2 months (normal tax payers)

  ii. The person who has not furnished GSTR-3B for last quarter (person opted for QRMP)

  iii. The person who is required to pay at least 1% tax liability through cash, has not furnished GSTR-3B for last tax period

- **Rule 86(B) – w.e.f. January 1, 2021 –** Where taxable supply other than exempt supply and export in a month exceeds INR 50 lakhs, tax payer shall pay 1% of tax liability through cash. Following are the exceptions to this rule:

  i. Income tax paid in excess of INR 1 lakh in each of the two preceding financial years by person or proprietor or karta or managing director or any of its two partners, whole time directors, Members of Managing Committee association or board of trustee

  ii. Registered person has received fund in excess of INR 1 lakh under section 54 of the CGST Act on account of unutilsed ITC under section 54.

  iii. Registered person has cumulatively discharged his tax liability towards output tax through electronic cash ledger for an amount which is in excess of 1% of total output tax liability

  iv. The registered person in government department, PSU, local authority, statutory body

- **E-invoicing**

Sr no.	Turnover in preceding Financial Year	Effective date of E-invoicing
1.	Above INR 500 crores	October 1, 2020
2.	Above INR 100 crores	January 1, 2021
3.	Above INR 5 crores	April 1, 2021 (Notification is yet to be issued)

- **E-way bill – w.e.f. January 1, 2021**

  i. **Rule 138**- Validity of E-way bill to be one day for a distance of 200 kms (earlier it was 100 kms);

  ii. **Rule 138E**- E-way bill generation to be blocked if return not filed for two tax periods (earlier restriction was 2 months).

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Annexure A

Salient features of CIRP vs. Proposed Pre-pack Resolution Process

Parameter	CIRP	Proposed Pre-pack
Objective	Resolution through a resolution plan	Resolution through a resolution plan
Legal framework	Relatively more in the statute and less in regulations	Relatively less in the statute and more in regulations
Applicability	Companies and LLPs	Companies and LLPs
Initiation of process	Default above Rs.1 crore, excluding COVID-19 Default	Pre and post default stress, including COVID-19 default. In a phased manner, if required
Initiation by	Financial Creditor, Operational Creditor, or Corporate Debtor (“CD”)	Corporate Debtor, with consent of majority of unrelated Financial Creditors
Management of the CD	IP-in-possession with creditor-in-control	Debtor-in-possession with creditor-in-control
Role of IP	IRP appointed by the applicant and then RP by the CoC	RP, to be appointed with consent of majority of unrelated Fcs
	Managing affairs of the CD and conducting the process	Conducting the process
Claim collation	IRP to invite and collate	CD to provide. RP to verify.
Information memorandum	Prepared by RP	Draft prepared by CD and finalised by RP
Moratorium	Moratorium under section 14	Limited Moratorium
Interim finance	Yes	Yes
Avoidance transactions	Yes	Yes
Valuation	By two valuers	By two valuers
IRPC	Includes cost of running operations	Does not include cost of running operations
Invitation for resolution plans	Public process	First right of offer to promoters, Swiss Challenge
Ineligibility for resolution plan	Section 29A to applies	Section 29A to apply
Early closure of process	Under section 12A, on request of the applicant	With approval of 66% of voting share, present and voting; Suo moto by CoC

Parameter	CIRP	Proposed Pre-pack
Approval of resolution plan by CoC	66% of voting share	66% of voting share, present and voting
Consequence of termination of process	No termination allowed	Liquidation, with 75% of voting share of CoC
Consequence of failure of process	Liquidation	Closure
Binding outcome	Resolution plan binding	Resolution plan binding
Regulatory benefits	Yes	Yes
Clean Slate, post resolution	Yes	Yes
Role of IP and AA	Relatively more	Relatively less
Timeline	180 days till approval of resolution plan by the AA	90 days for filing of resolution plan with the AA plus 30 days for the AA to approve it
Cooling Off	12 months between two CIRPs	Three years between two pre-packs