KATALYST ADVISORS

# Katalyst Kaleidoscope

January 2022: Tax and Regulatory Insights

## Summary of Contents

## A. Income Tax highlights

### 1. Bangalore Tribunal: Justification of Share Premium u/s 56(2)(viib) vis-à-vis need for a Valuation Report [1]

The Bangalore Tribunal recently held that the assessee-company was required, by law[2], to obtain a valuation report (from a SEBI registered merchant banker) justifying valuation of a company (in which equity is sought to be infused at premium) **as per the Discounted Cash Flow Method ("DCF") or Net Asset Value ("NAV").** Section 56(2)(viib) seeks to tax any unjustified share premium at the time of equity infusion in an Indian company by resident individuals.

In the instant case, the assessee-company was also required by law under the FEMA Act, 1999 to obtain a valuation report for determining the price per equity share as per **internationally accepted pricing methodology ("IAPM").** The IAPM, in addition to the NAV/ DCF methods, accepts other methods such as comparable company multiple method, comparable transaction multiple method, etc. Therefore, the assessee-company, as also was the view of the Assessing Officer ("AO"), was of the view that a valuation report under the tax laws was not required to be filed separately. This position was reversed by the Bangalore Tribunal.

***Katalyst Comments:***

*While the provisions of section 56(2)(viib) only apply to investment by a resident, and the provisions of valuation report under FEMA apply to investments by non-residents (and therefore, mutually exclusive), there could be certain scenarios where there may be certain mismatches. For example, in case of a downstream investment by an Indian company, which is foreign owned and controlled, or an investment by an individual who is a non-resident as per FEMA but a resident as per the ITA, a valuation report as per IAPM would need to be obtained under FEMA, while that under section 56(2)(viib) of the ITA would require one to obtain valuation report as per NAV/ DCF method. As a result, there could be a mismatch.*

*In light of the above, valuation approaches under tax and regulatory provisions should be aligned on the basis of the principle remains that intrinsic valuation of any company should ideally be based on IAPM and should not be restricted to only NAV/ DCF methods.*

[1] Medicon Leather Pvt. Ltd v. ACIT [TS-1146-ITAT-2021(Bang)]
[2] Section 56(2)(viib) of the Income-tax Act, 1961 ("ITA") read with Rule 11UA of the Income-tax Rules, 1961 ("Rules")

## 2. Bangalore Tribunal: Disallowance of Depreciation on Enhanced Goodwill on Slump Sale[3]

The Bangalore Tribunal recently disallowed depreciation on enhanced goodwill arising as a result of allocation of excess purchase consideration over the fair value of assets and liabilities. In the present case, as a result of slump sale, the net assets were fair valued (on the basis of an independent valuation report) in the books of the transferee company, which resulted in lower valuation of certain portion of debtors and inventory (based on the net realizable value).

While taking cognizance of the decision of the Supreme Court in the case of Smifs Securities[4], the Tribunal did not contest the principle that depreciation should be allowed on the brand value and the goodwill recorded in the books of the transferee company, the Tribunal disallowed the enhanced goodwill which resulted from lower valuation of debtors and inventory on the basis that non-depreciable assets (such as debtors and inventory) were effectively converted into a depreciable asset (i.e., goodwill). If the transferee company intended to write-down the value of debtors and inventory, it could have done so only by way of provision for doubtful debts/ bad debt or diminution in value of inventory.

***Katalyst Comments:***

*While "goodwill" per se is not eligible for depreciation post enactment of Finance Act, 2021, it is interesting to note that depreciation on brand value newly recognised in the books of the transferee company was not contested by the tax authorities. Incidentally, under the acquisition method of accounting under IndAS 103 (applicable for third party acquisitions), the acquirer is mandatorily required to fair value all assets and liabilities and recognise previously unrecognised assets (such as brands and other intangibles), and only attribute the balance excess purchase consideration as residual goodwill. This judgment reiterates that other intangible assets recognised on the basis of a proper valuation report should be eligible for depreciation.*

## 3. Ahmedabad Tribunal: Exclusion of day of arrival while considering residential status[5]

An assessee is treated as a "resident" in India u/s 6 of the ITA, inter alia, if he stays in India for less than 182 days (or, post Finance Act, 2020, if he stays in India for less than 120 days, provided he has an Indian-sourced income of more than INR 15 Lacs). The key question

[3] M/s Middleby Celfrost Innovations Pvt. Ltd. v. DCIT [TS-1177-ITAT-2021(Bang)]
[4] CIT v. Smifs Securities Limited (2012) 24 taxmann.com 222(SC)
[5] Pradeep Kumar Joshi v. ITO [[2021] 133 taxmann.com 283 (Ahmedabad - Trib.)]

therefore, especially, with reduced threshold of number of days (from 182 days to 120 days) would be the manner of computation of number of days stayed in India. While, as a resident, global income of an individual would be taxable in India, as a non-resident, only his Indian-sourced income will be taxable in India, and therefore, this computation becomes critical.

It is in this context, the Ahmedabad Tribunal held the day of entry into India (i.e., the day of arrival) was to be excluded while computing the number of days stayed in India.

### 4. Ahmedabad Tribunal: Taxability of Compensation on Relinquishment of Right to Sue[6]

The Ahmedabad Tribunal recently held that compensation received on relinquishment of right to sue (in the context of an arbitration proceedings) is not taxable under the normal provisions of the ITA, since the said receipt is a capital receipt, and not "receipt pursuant to transfer of a capital asset". The ITA defines capital asset to mean property of any kind, a term which is also used in Transfer of Property Act, 1882 ("TOPA").

Relying on various precedents, the Tribunal observed that the term "property of any kind" under the ITA as well as TOPA would essentially mean a property which is capable of being transferred by a person. In case of a "right to sue", it is merely a right, which will not be enforced in future (in the present case, as a result of consummation of arbitration), and therefore, such release of right to sue cannot be equated to "transfer" of a "property".

Similarly, the Tribunal also held that such capital receipt (credit to the P&L account) cannot be taxed under section 115JB of the ITA (i.e., Minimum Alternate Tax) since such capital receipt was not taxable under the normal provisions in the first place.

***Katalyst Comments:***

*This decision brings out an important distinction between merely a capital receipt dehors of any "transfer of property" versus capital receipt upon transfer of a capital asset. In the latter case, such capital receipt would be taxable as capital gains, while in the former, such capital receipt, not being in the nature of income would not be taxable. Further, in the context of MAT, another principle which emerges is that the provisions of MAT cannot be invoked artificially to tax capital receipt which is otherwise not taxable under normal provisions of the ITA (say, in the case of write back of loans).*

[6] Income Tax Officer v. M/s. Ganeshsagar Infrastructure Pvt. Ltd. [TS-1183-ITAT-2021(Ahd)]

### 5. Mumbai Tribunal: Deducibility of Interest on Zero Coupon Convertible Bond[7]

The Mumbai Tribunal recently held that the redemption premium payable at the time of redemption of a Zero-Coupon Convertible Bond ("ZCCB") should be allowed as a deduction as an interest expense proportionately during the tenure of the ZCCB, even though such redemption premium was adjusted against securities premium account (which is permitted under Companies Act, 2013), and not routed through the P&L Account.

Further, the Mumbai Tribunal held that given that the bonds were listed, and the redemption premium was only payable at the time of redemption of such bonds, the issuer company could have identified the beneficiary of such bonds beforehand, and therefore, there should not be withholding tax implications, even though deduction of such interest expense was claimed by the assessee-company.

***Katalyst Comments:***

*One of the key principles which emerged out of this decision is that the accounting treatment in books could be at variance with the tax treatment, but merely because certain expense (which is ascertained and will accrue on a yearly basis) is not debited to the P&L account, an assessee should not be barred from claiming a tax deduction on the same, which such assessee could have otherwise claimed. Further, in case where identification of beneficiary of such income is not possible to be determined at the time of claim of such expense, then the withholding tax implications should not arise.*

## B. Corporate Law Highlights

### 1. Mumbai NCLT: Absence of Representation in a Scheme implies No Objection[8]

The Mumbai NCLT recently held that if there are no objections received from regulatory authorities (mainly, Regional Director and Official Liquidator) in case of a Scheme of Arrangement u/s 230-232 of the Companies Act, 2013 within the statutorily defined time limit of 30 days from the date of service of notice (u/s 230(5) of the Companies Act, 2013), it shall be presumed that the authorities do not have any objections to the Scheme of Arrangement.

[7] 63 Moon Technologies Limited (formerly Financial Technologies (India) Limited) v. DCIT [TS-1162-ITAT-2021(Mum)]
[8] Borchers India Chemicals Pvt. Ltd. with Milliken Chemical and Textile (India) Co. Pvt [LSI-1074-NCLT-2021(MUM)]

***Katalyst Comments:***

*Any Scheme of Arrangement is undertaken for strategic purposes such as consummating a deal through merger/ demerger, consolidation/ simplification of group structure, carving out certain undertaking(s) from a combined entity through a demerger, etc. Under such strategic considerations, time is of an essence and therefore, this decision would serve to optimize timelines while undertaking a Scheme of Arrangement.*

### 2. Kochi NCLT: Related Party Transactions not approved by Board and shareholders are invalid[9]

The Kochi NCLT, while adjudication upon a petition for oppression and mismanagement, held that any related party transactions undertaken without due approvals such as that of the board of directors and shareholders (u/s 188 of the Companies Act, 2013) would be invalid and therefore, be a ground for oppression of the minority shareholders and mismanagement by the majority shareholders.

***Katalyst Comments:***

*The Companies Act, 2013 lays down certain checks and balance to ensure that the rights of the minority shareholders are protected. One such check is approval of the unrelated shareholders in case of a related party transaction in certain cases such as purchase/ sale of property, leasing of property, availing services, etc. Further, if the quantum of such transaction exceeds certain thresholds, then approval of minority shareholders would also be required. In the era where there is tremendous focus on corporate governance, such compliances would be necessary to ensure that the rights of minority shareholders are adequately protected.*

### 3. Repercussions of violation of provisions for Private Placement of Securities

After a private placement of shares undertaken by Valley Monks Private Limited, the Registrar of Companies levied penalty on the said Company along with its directors for violation of provisions of Section 42 of Companies Act, 2013 on the basis of the following:

a. The company missed giving reference of 'Section 42' in the extracts of Board Resolution, Extraordinary General Meeting ("EGM") resolutions and in the disclosures required in the notice to EGM;

[9] Sulochana Gupta & Anr. vs. RBG Enterprises Pvt. Ltd. & Ors. [LSI-1073-NCLT-2021(KOC)]

b. Special Resolution in Form MGT-14 was filed with the Ministry of Corporate Affairs after the issue of private placement offer cum application letter when ideally it should be filed prior to issue of such letter;

c. The Company did not open any separate bank account for receiving application money;

***Katalyst Comments:***

*Given the disproportionate penalties with the Registrar of Companies may impose, it is imperative to ensure that the relevant compliances in relation to private placement (and others) under the Companies Act, 2013 are strictly complied with even in cases of private companies. While the need of the hour is deregulation, especially in case of private companies, till such time such deregulations take place, private companies should be cognizant of heavy penalties in case of non-compliances under the Companies Act, 2013.*

## C. Securities' Law Highlights

### 1. Key amendments in certain regulations

| Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) (Amendment) Regulations, 2022[10] | |
|---|---|
| Restriction on use of Initial Public Offer ("IPO") proceeds in case object being future inorganic growth | • If target to be acquired / invested in, is unidentified - amount allocated shall not exceed 25% of total amount raised (amount for such objects plus General Corporate Purpose ("GCP") shall not exceed 35% of total amount)<br>• Above limits are not applicable if proposed acquisition / investment object is identified and applicable disclosures thereto are made |
| Monitoring Agency related and sstricter norms for reporting of issue proceeds | • Credit Rating Agency to act as monitoring agency instead of Public Financial Institutions and Scheduled Commercial Banks<br>• Monitoring to continue till 100% utilisation *(currently 95%)*<br>• Utilisation of amount raised for GCP to be disclosed in monitoring agency report<br>• Placing monitoring agency report on a quarterly basis *(earlier annual)* |

[10] SEBI notification no. SEBI/LAD-NRO/GN/ 2022/ 63

| | |
|---|---|
| Limit on Offer for Sale ("OFS") | For Selling Shareholders and Persons Acting in Concert ("PAC"):<br>*Pre-issue shareholding* — *OFS limit basis pre-issue shareholding*<br>→ Greater than 20% — Not exceeding 50%<br>→ Less than 20% — Not exceeding 10%<br>• For shareholders and PAC holding more than 20% shares pre-IPO provisions of lock-in for 6 months shall be applicable |
| Price band | Minimum price band to be at least 105% of the floor price *(earlier 120%)* |
| Minimum subscription | In the event of non-receipt of minimum subscription, money to be refunded within four days form closure of issue *(earlier 15 days)* |
| Lock-in for anchor investors ("AI") | For all issues opening on or after April 1, 2022:<br>For 50% of the portion allocated to AI - 30 days<br>For the remaining portion - 90 days |
| Revised allocation mechanism for Non-Institutional Investors - *for issues opening on or after April 1, 2022* | *Application size* — *Allocation*<br>More than 2 lakh and up to 10 Lakh — 1/3rd of portion available<br>More than 10 Lakh — 2/3rd of portion available<br>• Allotment of securities shall be on draw of lots basis |
| Preferential issues | <u>Determination of floor price</u><br>• For frequently traded security - higher of 90/10 trading days' volume weighted average price preceding the relevant date or as per any stricter provision in the AoA;<br>• For infrequently traded security – basis valuation report by registered independent valuer;<br>• In case of change in control of more than 5% of post-issue fully diluted share capital – obtain valuation report in addition to above, committee of independent directors to be appointed for their comments. |

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Lock-in provisions
<table>
<tr><td rowspan="2">Promoters</td><td>For allotment up to 20% of post issue capital</td><td>18 months (existing 3 years)</td></tr>
<tr><td>More than 20%</td><td>6 months (existing 1 year)</td></tr>
<tr><td>Non-promoters</td><td colspan="2">Reduced from requirement of 1 year to 6 months</td></tr>
</table>
Permission to promoters to pledge locked-in shares:<br>
• If terms of sanction of loan specifies pledging, loan shall be sanctioned to issuer or its subsidiary<br>
• Purpose shall be one of the objects of preference issue<br><br>
Issue for consideration other than cash:<br>
Permitted only for share swap based on valuation report<br><br>
In-principal approval from stock exchange (“SE”)<br>
Issuer companies to apply for approval on the same day as the date of dispatch of notice for AGM/ EGM to shareholders
</td></tr>
<tr><td colspan="2">SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015</td></tr>
<tr><td colspan="2">Appointment /re-appointment as a managing director /whole-time director /manager, who was earlier rejected by the shareholders at a general meeting, shall be done only with the prior approval of the shareholders.</td></tr>
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## 2. SEBI Circular: NOC from secured creditors in Schemes of Arrangement by Listed Entities[11]

Earlier, SEBI had laid down a new requirement of obtaining NOC from secured lenders (banks/ financial institutions/ debenture trustees) at the time of seeking approval from the stock exchanges/ SEBI under R. 37 of the SEBI (LODR) Regulations, 2015.

While the requirement in cumbersome enough to begin with (given that, at a later stage, NCLT would anyway require listed entities to convene meetings of secured creditors wherein such secured creditors can give their consent), SEBI has clarified such NOC should be obtained prior to SEBI/ stock exchanges giving approval to the Scheme of Arrangement, and not at the time of submission of requisite approvals from stock exchanges/ SEBI.

[11] SEBI Master Circular - SEBI/HO/CFD/SSEP/CIR/P/2022/003 dt. January 3, 2022

### 3. Circular: Disclosure obligations of listed entities in relation to Related Party Transaction [12]

If a company has High Value Debt listed on the stock exchanges ("HVD") (i.e. entities having listed non-convertible debt securities with the outstanding value of such securities being Rs. 500 Cr. and above), while undertaking such related party transactions, such HVD would be required to present certain information to the audit committee and to the shareholders (akin to listed companies), such as type, material terms and particulars of the transaction, tenure of the transaction, value as a % of the total consolidated turnover, certain additional details in relation to loans/ deposits/ ICDs, etc. justification of the transaction, etc.

### 4. NSE: Voluntary Adoption of NSE Prime with new norms for corporate governance[13]

The National Stock Exchange ("NSE") has launched a new corporate governance initiative vide National Stock Exchange of India Limited Prime Registration Norms, 2021 ("NSE Prime") on December 21, 2022, whereby companies listed on the NSE may voluntarily adopt these norms by making an application to NSE which shall grant the certificate after taking into account prescribed criteria. The framework that prescribes higher standards of corporate governance (including maintaining 40% public shareholding, robust composition of board of directors, disclosures of financial health ratios, etc.) for listed Companies than those required by regulations, resulting in additional disclosure requirements and higher quality of public information.

***Katalyst Comments:***

*The NSE is striving to introduce higher standards of corporate governance in India. The program replicates Brazil's successful 'Novo Mercado' (New Market), where companies commit to more stringent regulations outside the law. This will categorise the entities as Prime members and will help investors to distinguish them and gain their trust perhaps resulting in better valuation of such companies on account of increased corporate governance.*

[12] Circular No. SEBI/HO/DDHS/DDHS_Div1/P/CIR/2022/0000000006 dt. January 07, 2022
[13] https://archives.nseindia.com/archives/NSE_Prime_Norms.pdf

## D. RBI/ Foreign Exchange Laws

### 1. RBI issues clarification on Acquisition/Transfer of Immovable Property in India by Overseas Citizen of India[14]

RBI clarified by a press release that Non-resident Indians and Overseas Citizen of India are governed by the provisions of Foreign Exchange Management Act, 1999 and do not require prior approval of the RBI for acquisition and transfer of immovable property in India. The automatic approval route does not apply in case of transfer or acquisition of agricultural land, farm house or, plantation property, as per Chapter IX of the Foreign Exchange Management (Non-debt Instruments) Rules, 2019.

## E. Goods and Service Tax Highlights

### 1. Telangana AAR: No GST on High-sea sales and warehousing of imported goods in FTWZ

The Telangana AAR recently held that any supply of goods either on a high-sea sale basis or at the time of warehousing (at the Free Trade Warehousing Zone or FTWZ facilities of a third-party logistics service provider) would not be subject to GST at the time of high-seas sale and at the time of import of such goods in the FTWZ.

Further, if the supplier is situated in State A, while the FTWZ is in State B, and the ultimate customer is situated is either in State A or State C, then such supply of goods locally will be subject to either CGST/ SGST in case the customer is in State A, or only IGST, if such customer is in State C, and the location of FTWZ would not be relevant in such cases.

### 2. Maharashtra AAR: No GST on certain transactions between employer and employee

The Maharashtra AAR[15] has recently held that canteen services provided by the employer to the employees at a subsidized rate does not amount to supply, and therefore, is not subject to GST, especially in light of the fact that the employer is not engaged in the business of providing canteen services.

Similarly, with respect to transportation of employees by way of non-AC buses, the AAR has held that the said activity is neither incidental or ancillary to the business of the employer nor

[14] Vide Press Release no: 2021-2022/1439
[15] In the matter of M/s Emcure Pharmaceuticals Limited [2022-TIOL-10-AAR-GST]

can it be called an activity done in the course of or in furtherance of the employers' business and therefore, no GST is applicable on recoveries made from the employees towards such facility.

Lastly, with respect to the notice pay recovery, the Maharashtra AAR has held that in case of recovery of notice pay, the employer is being compensated for the employee's sudden exit as per the contractual arrangement and same does not amount to supply, since no services were rendered by the employee to the employer as a result of which notice pay was recovered.

### 3. Goa AAR: No GST applicable on sub-dividing larger plot of land into small plots for sale

The Goa AAR[16] has recently held that any sub-division of a larger plot of land and providing basic facilities such as roads, drainages, etc. as mandated by local civic authorities as a pre-condition for providing NOC for plot development cannot alter the basic nature of land as an immovable property per se, and therefore, cannot be construed as "supply of goods". Therefore, the Goa AAR has held that such sale of land/ immovable property merely on the basis of such value additions is not subject to GST.

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[16] In the matter of Shantilal Real Estate Services [TS-748-AAR(GOA)-2021-GST]