KATALYST ADVISORS

Katalyst Kaleidoscope

July 2022: Tax and Regulatory Insights

SUMMARY OF CONTENTS

A. Income tax highlights

1. Pune ITAT: disallows set off of losses where sole underlying purpose of demerger was tax benefit[1]

The facts of the case were that the assessee company was engaged in the business of sales and service of diesel engines, its spare parts and related equipment; it claimed set off of brought forward loss and depreciation aggregating to approximately Rs. 20 crore that vested with the assessee as a result of the demerger. The contention of the assessee was that once the demerger had been approved by the jurisdictional High Court (now NCLT), the Revenue department cannot question the motive behind the demerger.

The Tribunal noted that the assets of the demerged undertaking were held for sale, and, on facts, the sole motive behind the demerger was of a tax set off. It observed that the assessee did not carry out any business of the demerged undertaking and put the assets of the demerged unit for sale.

Katalyst comments:

This is a situation of a GAAR invocation which, in the context of GAAR provisions, as they stand now, requires an Approving panel to permit the invocation. However, there is no reference to GAAR invocation in the Tribunal order, but it is implied from the observations made by the Tribunal of the conditionalities of Section 72A.

In any case, the Tribunal order further underlines the point that if any structuring or restructuring initiative is solely tax driven, then the revenue department will likely invoke GAAR. On the other hand, if there is a commercial motive behind the structuring or restructuring initiative and tax benefit is only incidental, then the assesse is in a far more defensible position.

[1] Cummins Sales & Services (I) Ltd. [TS-523-ITAT-2022(PUN)]

2. Karnataka HC: NIL TDS Certificate can be issued to payee even under Section 195 on reimbursement payments[2]

Flipkart challenged the validity of the Assessing Officer order whereby an application for a nil TDS certificate was rejected. The context was that Flipkart had made payments in the nature of "pure reimbursement" to Walmart Inc. and, in that context, had requested for a nil TDS certificate.

The revenue stand was that Section 195(2) which permits a payer applicant to apply to the tax department does not contemplate nil deduction at tax. The High Court held that this view of the Revenue department is not tenable. It further held that an application under section 197 can alternatively be made by the recipient of the payment, but that does not mean that the application under section 195(2) is not tenable.

Katalyst comments:

There are various factually interesting observations regarding reimbursement of cost vis-à-vis taxation on gross basis and the trend of the observations of the Court (although not fully conclusive on the facts of that case) can be very helpful in other matters.

3. Delhi ITAT: Non-compete fees do not qualify for depreciation under section 32[3]

The facts of the case were that the assessee had acquired a restaurant and in terms thereof, the transferor had transferred all its rights, copyrights, trademarks etc. in respect of the restaurant. The assessee had also made payment towards non-compete fee. This non-compete payment was treated by the assessee as capital expenditure and depreciation was claimed thereon.

[2] Flipkart Internet versus DCIT, 139 Taxmann.com 595 (Karnataka) dated June 24, 2022
[3] Sagar Ratna Restaurants (P.) Ltd 139 taxmann.com 87

The ITAT noted that the Delhi High Court in Sharp Business System[4], in a similar situation, had held that non-compete fee is not covered by the list of intangible assets entitled to depreciation; in case of non-compete, it is not a right against the world at large and not something which can be traded or transferred. The advantage of the non-compete right is restricted only against the seller and therefore, it is not a right in rem but a right in personam.

In this context, even though there are other conflicting judgements of other non-jurisdictional High Courts, the Delhi High Court followed the decision of the jurisdictional High Court and disallowed the claim.

4. Calcutta HC: Shares and securities held as investments; taxable as capital gains and not business income[5]

The facts were that the assesse company was engaged in the "business" of investment in shares, mutual funds and debentures and declared short term capital gains of investment. The revenue was of the view that this should be considered as business income.

The Calcutta High Court held that since the shares had been held as investment and not as stock in trade, and similar transactions were accepted by the tax department for earlier years, the treatment as capital gains were correct.

Katalyst comments:

This kind of issue arises often and it is obvious that just because the entity is an investment company it does not mean that the profits are business income; the period of holding and several other aspects, including quantum of transactions are relevant as per the CBDT Circular No. 6/2016 dated February 29, 2016 and Circular No. 4 dated June 15, 2007.

[4] 211 Taxmann 567
[5] Purvanchal Leasing Ltd 137 taxmann.com 253 (Calcutta)

5. Chennai ITAT: Business held to be set-up when the necessary infrastructure was acquired and the taxpayer started paying salaries and allowance of the experts[6]

The Assessing company was engaged in the business of investing, owning and operating renewable energy like biomass power, wind power etc. The context was that the assessee had made a claim of expenses since its stand was that it had acquired land, obtained various approvals, deployed technical personnel and signed long time Power Purchase Agreement with clients; accordingly, although the revenue had not yet been generated in the relevant assessment years, a loss was claimed by the assessee company on the basis that the business was "set up".

The Tribunal held, on the basis of various judicial precedents[7], that the business can indeed be said to have been "set up"; it held that the real test to be applied is when a businessman would regard the business as being commenced and approach must be from a common-sense point of view.

Katalyst comments:

This is a very useful and logical decision; it could also be relevant in the context of demonstrating as to what is an "undertaking" vis-à-vis a provision like Section 2(19AA), in the context of demergers.

6. Supreme Court: Delay in filing declaration fatal to claim under section 10B[8]

Section 10B of the Income Tax Act provided for a deduction of 100% of profits for an Export Oriented Unit till AY 2012-2013; however, there was a procedural condition that the tax payer can chose that the provisions do not apply to it by filing a declaration before the due

[6]Orient Green Power Co. Ltd vs ACIT, Company Circle -V(1) Chennai [2022] 195 ITD 49/138 taxmann.com 383
[7] Western India Vegetable Products ITR 151 (Mumbai) and India Commercial Vehicles 416 ITR 343 (Mad)
[8] Civil Appeal No. 1449 of 2022 (arising out of Special Leave Petition (Civil) No. 7620/2021)

date of filing of the return. The tax payer filed its return without a no claim declaration, but then subsequently filed such a declaration.

The matter went up to the Supreme Court and the key argument of the assessee was that the time limit for filing such a claim was directory and not mandatory, and since the return was filed, so belated filing should be accepted. The Supreme Court, relying on the wordings of Section 10B (8), held that the subsequent filing cannot be accepted and Section 10B being an exemption provision has to be strictly construed.

Katalyst comments:

(i) This is an unfortunate judgement from various perspectives. In the case of Bajaj Tempo Ltd v. CIT (1992)[9], the Supreme Court had held that an incentive provision should be construed liberally, but here, the Supreme Court seems to have taken a contrary stand.

(ii) Even though Section 10B is not on the statute book, there are other provisions such as under section 115BAA for a concessional rate for tax for companies which requires the exercising of the option by filing a form and basis this Supreme Court judgement, a delay in filing of the form could lead to non-allowability of the concessional tax rate.

B. Corporate Law and RBI highlights

1. Bengaluru NCLT: Scheme of Arrangement – Accounting Treatment / Creditors' Meeting and commercial wisdom of stakeholders[10]

In the present Scheme of Amalgamation, the Transferee Company was a subsidiary of the Transferor Company. The Registrar of Companies (RoC) had made certain observations and

[9] 196 ITR 188 (SC)
[10] *United Technologies Pvt. Ltd. & Value Info solutions Pvt. Ltd., CP (CAA)No.23/BB/2021, NCLT, Bengaluru, dated June 8, 2022*

the Companies involved in the amalgamation has made submission before NCLT which has been tabulated below:

S no	RoC observation	Petitioner submissions
1	As per the Balance Sheet, the Transferor Company had subscribed to Compulsorily Convertible Debentures (CCDs) of Transferee Company; further, as the Transferor Company was subsidiary of Transferee Company, its investment in the CCDs was contrary to the provisions of Section 19 of the Companies Act.	The CCDs, until conversion, shall remain as debentures with no voting rights and therefore, provisions of Section 19 will not be applicable. In any case, CCDs will be cancelled in both the companies as a contra-entry.
2	Stock swap valuation seemed highly inflated.	Valuation was done by a recognized Registered Valuer and RoC cannot state it was inflated, unless it is demonstrated that there is another mode of valuation and / or fraudulent valuation. Further, commercial wisdom of Board / shareholders / Creditors cannot be ordinarily challenged.
3	Petitioner Company received approval only from certain value of creditors. Hence, approval from the remaining creditors was needed	On the meeting day, the requisite quorum was present i.e., 7 Unsecured Creditors representing Rs. 34,48,86,759/; and all of them voted in favor of the Scheme. Hence, Section 230(6) of the Companies Act was duly complied.

4	The Petitioner Company had written off substantial bad debts and made huge provisions for doubtful debts	The bad debts written off and provisions made for doubtful debts were as per the accounting standards and were certified by the Auditors of the Company.

Katalyst comments:

This is a helpful decision and brings out the point that vague and unsubstantiated objections from regulatory authorities need not be entertained.

On a broader note, such objections are a significant impediment to the process of getting schemes of arrangement approved, and clearly impact Ease of Doing Business.

2. HC: Quashes ex-parte DGFT orders penalizing independent non-executive director, absent evidence of active role[11]

The Bombay HC quashed orders passed by the Joint Director General of Foreign Trade ('Respondent'/ 'DGFT'), inter alia, imposing penalties on a deceased independent non-executive director ('Petitioner' represented by his wife). HC further added that, "It is the cardinal principle of criminal jurisprudence that where there are allegations of vicarious liability, then there has to be sufficient evidence of the active role of each director".

Katalyst comments:

Relief for the independent directors (non-executive directors) where they are not actively managing the day-to-day affairs the Company.

[11] Meena Anand Suryadutt Bhatt vs. Union of India & Anr. dated July 8, 2022

3. Frame work for International Trade Settlement in Indian Rupees (INR)[12]

In order to promote growth of global trade with emphasis on exports from India and to support the increasing interest of global trading community in INR, RBI has decided to put in place an additional arrangement for invoicing, payment, and settlement of exports / imports in INR. Before putting in place this mechanism, AD banks shall require prior approval from the Foreign Exchange Department of Reserve Bank of India, Central Office at Mumbai.

The broad framework for cross border trade transactions in INR under Foreign Exchange Management Act, 1999 (FEMA) is as delineated below:

a. **Invoicing:** All exports and imports under this arrangement may be denominated and invoiced in Rupee (INR).

b. **Exchange Rate:** Exchange rate between the currencies of the two trading partner countries may be market determined.

c. **Settlement:** For this purpose, AD banks have been permitted to open Special Rupee Vostro Accounts. In order to allow settlement of international trade transactions through this arrangement, it has been decided that:

- Indian importers undertaking imports through this mechanism shall make payment in INR which shall be credited into the Special Vostro account of the correspondent bank of the partner country, against the invoices for the supply of goods or services from the overseas seller /supplier.
- Indian exporters, undertaking exports of goods and services through this mechanism, shall be paid the export proceeds in INR from the balances in the designated Special Vostro account of the correspondent bank of the partner country

The Rupee surplus balance held may be used for permissible capital and current account transactions in accordance with mutual agreement. The balance in Special Vostro Accounts can be used for following purpose:

- Payments for projects and investments;
- Export/Import advance flow management; and

[12] RBI Circular RBI/2022-2023/90 A.P. (DIR Series) Circular No.10

- Investment in Government Treasury Bills, Government securities, etc. in terms of extant guidelines and prescribed limits, subject to FEMA and similar statutory provision.

C. SEBI highlights

1. Modification in form for disclosure of shareholding pattern as per Regulation 31 of LODR[13]

SEBI through vide Circular No. CIR/CFD/CMD/13/2015 dated November 30, 2015 (as amended), prescribed formats for disclosure of holding of specified securities and shareholding pattern has now partially amended the format of disclosure.

Clause 2(d) of the said Circular is being partially modified as under:

I. In the disclosure of public shareholding, names of the shareholders holding 1% or more than 1% of shares of the listed entity are to be disclosed.

II. Names of the shareholders who are persons acting in concert, if available, shall be disclosed separately.

III. It is also specified that all listed entities shall disclose details pertaining to foreign ownership limits in the prescribed format.

Katalyst comments:

Endless additions and modifications to disclosures is adding significantly to compliance burden of companies. This Circular shall come into force with effect from the quarter ending September 30, 2022.

[13] SEBI vide Circular no SEBI/HO/CFD/PoD-1/P/CIR/2022/92 dated June 30, 2022

2. Filing of report with SEBI – Takeover code[14]

As per Regulation 10(7) of Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011, any acquisition of or increase in voting rights pursuant to exemption provided for in certain clauses of Regulation 10(7) requires the acquirer to within twenty-one working days of the date of acquisition, submit a report in such form as may be specified along with supporting documents to the Board giving all details in respect of acquisitions.

In this regard, acquirers and listed entities have been informed by BSE Limited that filings of the aforesaid report with SEBI are required to be done only by way of email on sastexemptionapplication@sebi.gov.in along with the details of the fees paid

3. SC: Affirms SAT order giving broader meaning to term "acquirer" under Takeover Regulations[15]

- SC directed that Regulation 10 of Takeover Code does not apply when the collective voting rights of the individual shareholder and the 'person acting in concert', taken together is 15% or more on the date when fresh shares or voting rights are acquired.

- SC further directed that "Past is passe and not present, and by giving 'retroactive' operation without good reason and ground such directions violates fundamental notions of predictability and legal stability.", and further added that "in the absence of express statutory authorization, delegated legislation in the form of rules or regulations, cannot operate retrospectively.

[14] BSE Notice 20220621-55 dated June 21, 2022
[15] SEBI vs. Sunil Krishna Khaitan & Ors. [LSI-507-SC-2022(NDEL)]

D. Goods and Service Tax highlights

1. Renting of residential dwelling to the registered person for residential purpose is taxable under the reverse charge mechanism ('RCM')[16]

Renting of residential dwelling to a registered person for residential use was exempted from GST and the said exemption has been withdrawn by notification no. 4/2022-CT (R) dated July 13, 2022 and simultaneously service by way of renting of residential dwelling to a registered person has been added under the RCM w.e.f. July 18, 2022.

Katalyst comments:

Due to the withdrawal of exemption, if a residential unit is given on rent to a registered person for residential use, GST on same will be payable by a registered person under RCM. Earlier, if any employee was provided any residential accommodation by the Company for residential purpose, the Company was not required to GST as the same was exempt due to its residential use. Now, due to withdrawal of said exemption and amendment to the RCM notification, the Company being a registered person, is required to pay GST under RCM on such transaction.

2. Increase in Rate of Tax for works contract w.e.f. July 18, 2022

The rate of GST on works contract[17] has been increased as a measure of rationalization of rates for removal of inverted duty structure:

- Works contract for roads, bridges, railways, metro, effluent treatment plant, crematorium etc. [12% to 18%]

[16] Notification no. 5/2022-CT(R) dated July 13, 2022
[17] Notification no. 3/2022-CT (R) dated July 13, 2022

- Works contract supplied to central and state governments, local authorities for historical monuments, canals, dams, pipelines, plants for water supply, educational institutions, hospitals etc. & sub-contractor thereof [12% to 18%]
- Works contract supplied to central and state governments, union territories & local authorities involving predominantly earthwork and sub-contracts thereof [5% to 12%]

3. New option of GST payment at 5% under forward charge without availment of input tax credit ('ITC') provided to Goods Transport Agency [18]('GTA')

W.e.f. July 18, 2022, GTA service providers have been given an option of payment of GST @5% under forward charge without availment of ITC. Further, the existing option of RCM @ 5% by recipient and option to pay tax @ 12% (with ITC) under forward charge by GTA has been continued. Further, the GTA service provider is required to make a declaration before jurisdiction officer each year to confirm whether he is discharging GST liability under forward charge or under RCM.

4. Exclusion of period from March 1, 2020 to February 28, 202219 for refund filing purpose

The Time period from March 1, 2020 to February 28, 2022 will be excluded for calculation of the limitation period for filing refund claim by an applicant, as well as for issuance of demand/order by proper officer in respect of erroneous refunds. Further, it is pertinent to note that this amendment is effective from March 1, 2022.

Katalyst comments:

A welcome amendment; vide this amendment, the taxpayers have been given time to file refund claims which could not be filed/submitted during Covid pandemic.

[18] Notification no. 3/2022-CT (R) dated July 13, 2022
[19] Notification no. 13/2022-CT dated July 5, 2022

5. Extension of limitation period for F.Y.2017-18[20]

Limitation period for issuance of an order for demand and recovery of tax, interest and penalty in respect of FY 2017-18 is extended to September 30, 2023; this amendment is effective from March 1, 2022.

6. Key clarifications:

a. Utilization of amount available in the Electronic Credit Ledger (ECL)

It is clarified that any payment towards output tax, whether self-assessed in the return or arising because of any proceeding under the GST provisions, can be made by utilizing the balance available in the ECL except in case of payment being made under RCM. Further, it is also clarified that liabilities such as interest, penalty, fees or payment of erroneous refund sanctioned in cash cannot be paid through ECL.

b. Applicability of the proviso to all clauses of section 17(5)(b) of CGST Act

Section 17(5)(b) of the CGST Act provides a list of specified goods and services under sub-clause (i) to (iii) in respect of which input tax credit shall not be available. A proviso was introduced after sub-clause (iii) providing that ITC shall be available in respect of those supplies where it is obligatory for an employer to provide the supplies to employees under any law in force. The CBIC has clarified that the proviso is applicable to the whole of clause (b) of sub-section 5 of section 17 of the CGST Act

[20] Notification no. 13/2022-CT dated July 5, 2022

Our Offices:

Mumbai

71/75 Mittal Tower,
7th Floor, C Wing,
Nariman Point,
Mumbai - 400021
Tel: +91 22 4917 1616

Pune

#406-408,
Global Square Annexe, Near Bund Garden,
Yerwada, Pune- 411006
Tel: +91 20 4840 7700