KATALYST
ADVISORS LLP

Katalyst Kaleidoscope

June 2020: Tax and Regulatory Insights

A. Income-tax Highlights

1. AAR denies[1] benefit under India-Mauritius DTAA ('Treaty') to Mauritian entities on indirect transfer of shares of Indian Entity

The seller companies ("applicant companies") are private companies incorporated in Mauritius, holding Category 1 Global Business License and are tax residents of Mauritius for the purposes of the Treaty. The seller companies invested in a Singapore company which further invested in multiple Indian companies and thereby derived value substantially from its investments in India. As a part of larger global transaction, the applicant companies proposed to transfer the shares of Singapore company to a Luxembourg based entity. The applicant companies approached the Indian tax authorities under Section 197 of the Income Tax Act, 1961 ('the Act') to seek a nil withholding certificate which was denied by the tax department on the ground that the applicant companies allegedly did not exercise independence in their decision making and therefore were not eligible to avail benefits under the Treaty. The applicant companies thereafter filed applications before the AAR under Section 245Q(1) of the Act to determine the taxability arising upon transfer of shares of Singapore company under the Act read with Treaty provisions.

The AAR rejected the application of the applicant companies on the premise that the transaction was designed for avoidance of tax, basis the following observations:

- While computing capital gains, not only the sale of shares but also the purchase of shares is relevant and therefore, the entire transaction of acquisition as well as sale of shares as a whole has to be looked and a dissecting approach of examining only the sale of shares cannot be adopted.

- 'Notes to Financial Statement' of the applicant companies states that the principal objective of the applicant companies was to act as an investment holding company for a portfolio investment domiciled outside Mauritius. The AAR further noted that the applicant companies had not made any investment other than investment in the Singapore Company. Although the holding-subsidiary structure might not be conclusive proof of tax avoidance, the purpose for which the subsidiaries were set up does indicate the real intention behind the structure and AAR therefore concluded that the real intention of the applicant companies was to avail the benefit of the Treaty.

- 'Control and management' do not mean day to day affairs of the business but would mean the 'head and brain' of applicant companies. In the given case, AAR referred to the minutes of the board meetings and observed that the key decisions were taken by the non-resident Director. Further, AAR noted that authority to operate the principal bank account was with US-based director who was also authorized signatory for sellers' immediate parent company, a director

[1] Tiger Global International II Holdings (116 taxmann.com 878) [2020]

of the ultimate holding companies of the seller companies and was also declared as the beneficial owner of the seller companies. Accordingly, AAR concluded that the 'head and brain' of the applicant companies was not situated in Mauritius but was situated in USA.

- The holding structure of the applicant companies coupled with control and management are the relevant factors for determining the design for tax avoidance and therefore the applicant companies were only a 'see through' entities set up to avail benefits of the Treaty.

Further, AAR also applied the yardsticks laid down by Apex Court[2] in case of Vodafone International Holding BV and concluded that in the absence of any direct investment in India nor any taxable revenue generated in India, the said arrangement was a pre-ordained transaction which was created for tax avoidance purpose. Lastly, AAR also held that since the sale involved shares of a Singapore company, the benefit provided under Article 13(4) of the Treaty will not be available to the applicant companies by concluding that the objective of India-Mauritius DTAA was to allow exemption of capital gains on transfer of shares of Indian company only and any such exemption on transfer of shares of the company not resident in India, was never intended by the legislator.

Katalyst Comments: *The Mauritius route was intended to incentivize foreign investments into India. It was quite apparent that Mauritius companies would not really have "substance" in most cases, but would be a routing entity. The Government was aware of this, and that is why the CBDT issued a circular no 789, dated 13 April, 2000, which provided for a tax residency certificate ("TRC") as an adequate evidence of treaty access. In this context, and given that the Mauritius (and Singapore) route is anyway not subject to capital gains exemption for investments made post 1 April, 2017, this ruling is very unfortunate and will send further negative signals to foreign investors, whom India needs on an ongoing basis for several years to come.*

2. ITAT allows[3] set-off of losses from demerged company claimed by filing revised return after intimation u/s. 143(1) of the Income Tax Act, 1961 ('the Act')

The taxpayer ('resulting company') and demerged company filed a joint petition before the High Court for approval of scheme of arrangement pursuant to which a specific division of the demerged company was proposed to be demerged into the assessee company with effect from a retrospective appointed date. Pending approval of demerger from the High Court, the assessee company filed its return of income without taking demerger into account. However, pursuant to the scheme of demerger approved by the High court, the assessee company filed a revised return of income for the said assessment year showing "nil" income and claimed the set-off of brought

[2] 341 ITR 1
[3] ITA No. 606/Kol/2018

forward losses and unabsorbed depreciation of the demerged division. However, the revised return of income was filed after receipt of intimation u/s 143(1). The assessing officer rejected assessee company's set-off claim and rejected revised return filed by the assessee company. On appeal, CIT(A) allowed the appeal of the assessee company. Aggrieved by the order of CIT(A), the assessing officer filed appeal before the Tribunal.

The Tribunal noted that the conditions stipulated u/s 72A(4) read with section 2(19AA) of the Act were fulfilled and therefore, the assessee company was eligible to claim set-off of brought forward losses pertaining to the demerged division by placing reliance on the Apex Court decision[4]. Further, the Tribunal held that the right to file revised return of income does not lapse with the issuance of intimation u/s 143(1) and such an intimation cannot be said to be "completion of assessment" and more so, when assessment has subsequently been completed under section 143(3) of the Act. The Tribunal placed reliance on the Apex Court decision[5] and concluded that the tax officer was bound to accept the revised return filed by the assessee pursuant to the scheme of demerger sanctioned by the High Court.

3. ITAT disallows[6] interest on borrowings advanced by the taxpayer to its sister concerns for 'equity infusion' in other group companies

The assessee company, engaged in the business of investment in shares, filed its return of income for the AY 2013-14. The assessee company borrowed an amount of INR 13 Crs and gave interest-free advance to its sister/ associate concerns, which in turn was utilized by such sister/ associate concerns towards equity investment in another sister/ associate concern. The assessing officer, inter-alia, disallowed interest and loan processing charges on the aforementioned loan availed by the assessee company.

The Tribunal held that reliance placed by the assessee company on the Apex Court decision[7] in the case of Hero Cycles (P) Ltd. vs. CIT is not applicable, since the funds borrowed by the assessee company were specifically utilized for infusion of equity in the associate concerns, which is totally different from the facts of the case law relied upon where the interest free funds were given to subsidiary company. The Tribunal dismissed assessee company's appeal and upheld the order of CIT(A).

[4] Marshall Sons & Co. (India) Ltd. v. ITO (1997) (2) SCC 302
[5] Dalmia Power Ltd vs ACIT (Civil Appeal No 9496-99 of 2019)
[6] ITA No. 489/DEL/2017
[7] 379 ITR 347 (SC) (2015)

4. Central Board of Direct Taxes ("CBDT") notifies[8] Cost Inflation Index for Financial Year 2020-21

CBDT has notified cost inflation index for the financial year 2020-21 as 301 (Base date is 1st April, 2001).

5. CBDT notifies[9] new Form 26AS (Annual Information Statement)

A new Section 285BB, introduced by Finance Act 2020 requires the tax department to upload in the registered account of the taxpayer a statement of information relating to taxpayer's specified financial transaction, payment of taxes, demand/ refund and pending / completed proceedings, which is in the possession of an income-tax authority.

Pursuant to above, CBDT has now introduced a new rule 114-I – (Annual Information Statement) and revised Form 26AS with effect from 1st June, 2020 which will now contain information relating to specified financial transactions, payment of taxes, demand/ refund and pending/completed proceedings undertaken by a taxpayer in a particular financial year that has to be mentioned in the income tax returns.

Katalyst Comments: *Although the new Form 26AS (Annual Information Statement) is notified with the intent of bringing greater transparency between the taxpayers and the tax department, too much information is also leading taxmen on a fishing expedition. This impacts ease of doing business.*

6. CBDT notifies[10] Income Tax Return Forms for AY 2020-21

The CBDT has notified the Income Tax Return Forms ("ITRs") for AY 2020-21. From an overall perspective, the newly notified forms have certain new fields that have been introduced in order to warrant additional information/ disclosures from the taxpayers. Some of the key changes are:

- A new schedule DI has been introduced which seeks details of investments (chapter VIA deductions, deduction u/s 10AA and deductions u/s 54 to 54GB) to be taken into account for determining total income considering the extended deadlines for making such investments;
- Certain additional details are sought from the non-corporate assessees such as details of amount greater than INR 1 crore deposited in a bank account, details of amount spent on foreign travel if amount exceeds INR 2 lakhs, etc;
- An option for opting section 115BAA/ 115BAB (reduced tax for specific domestic companies) is now provided;

[8] Notification No 32/2020 dated June 12, 2020
[9] Notification No 30/2020 dated May 28, 2020
[10] Notification No 31/ 2020 dated May 29, 2020

- A new Schedule 112A seeking detailed information (such as ISIN Code, name of share/ unit, sale price, full value of consideration, cost of acquisition, FMV as on 31st January 2018, etc) on sale of equity share in a company or unit of equity oriented fund or unit of a business trust on which STT is paid under section 112A is introduced.

Katalyst Comments: *In its desire to make the Income Tax Return Form more comprehensive, the taxpayers have been burdened with too many disclosures and information while filing the Income tax Return Form. This has already created challenges for the taxpayers in filing their returns and is a deterrent to the concept of ease of doing business in India.*

B. Corporate Law Highlights

1. Ministry of Corporate Affairs notifies[11] Companies (Share Capital and Debentures) Amendment Rules, 2020

MCA has amended the Companies (Share Capital and Debentures) Rules, 2014 by allowing companies to issue sweat equity shares not exceeding 50% of its paid-up capital for a period of upto 10 years from the date of its incorporation or registration. Additionally, the requirement with regard to Debenture Redemption Reserve and investment or deposit of sum in respect of debentures maturing during the year is now removed for NBFCs and listed companies issuing privately placed debentures.

2. NCLAT dismissed minority shareholders' appeal and upholds NCLT order approving selective capital reduction

Atlas Copco (India) Ltd ("ACIL" or "the Company") was delisted from Bombay and Pune Stock Exchange in 2011. The holding company of ACIL held 96.32% of the share capital and the balance 3.68% was held by non-promoter shareholders. Thereafter, in 2018 the Company filed a company scheme petition before NCLT for selective capital reduction u/s 66 of the Companies Act, 2013 of 3.68% of share capital held by non-promoter shareholders, after passing a special resolution approved by the shareholders. However, a few non-promoter shareholders voted against the resolution and also filed objections to the proposed scheme of capital reduction with NCLT by alleging that offer price as well as proposed capital reduction of 'minority shareholders' is unfair. ACIL submitted an undertaking, on directions of NCLT, that the objecting shareholders can continue as a shareholder. Accordingly, NCLT admitted the application filed by the company for the proposed Capital Reduction.

The objecting shareholders challenged the order of NCLT and appealed before NCLAT. Further, the objecting shareholders reiterated the arguments that the valuation of shares was carried out in an unfair manner and without any due diligence and also stated that the option of retaining shares

[11] Notification dated June 5, 2020

was not provided at the time of passing special resolution. Also, the objecting shareholder stated that the option of retaining shares through Affidavit filed by company, on direction of NCLT, is unacceptable and the resolution can only be modified by the shareholders in legally convened meeting.

NCLAT upheld NCLT order and dismissed minority shareholders' appeal and held that there was no irregularity in the valuation done by the valuer and accepted the contentions made by the Company that the valuation was undertaken based on past as well as future projections. Further, NCLAT held that the NCLT is imbibed with the powers to modify the scheme and therefore the directions given by the NCLT, pertaining to option of retaining shares by objecting shareholders, is within the four corners of the law.

Katalyst Comments: *This is a useful order in the context of shareholders having minor holdings becoming a barrier to a 100% holding even though a fair price is provided to think for an exit.*

C. RBI and Foreign Exchange Regulations Highlights

1. RBI provides relaxation for debt investments by Foreign Portfolio Investors ("FPIs") through Voluntary Retention Route ("VRR")

Currently, FPIs need to invest at least 75% of their 'Committed Portfolio Size' ("CPS") within three months from the date of allotment. In view of the disruptions caused by COVID-19, RBI has decided to allow FPIs that have been allotted investment limits, between January 24, 2020 (the date of reopening of allotment of investment limits) and April 30, 2020, an additional time of three months to invest 75% of their CPS. For FPIs availing the additional time, the retention period for the investments (committed by them at the time of allotment of investment limit) would be reset to commence from the date that the FPI invests 75% of CPS.

Katalyst Comments: *Recognizing the financial impact of disruptions caused by COVID-19 pandemic globally, RBI has extended the timeline for investment of CPS by FPIs under VRR.*

D. Securities and Exchange Board of India ("SEBI")

1. SEBI increases[12] promoters' creeping acquisition limit to 10% under SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 ("Takeover Regulations")

SEBI has amended the Takeover Regulations to permit promoters owning 25% or more voting rights in a listed company to increase their stake beyond 5% (creeping acquisition limit) but up to 10% through preferential issue of shares, without triggering the open offer obligation under the Takeover Regulations. The said relaxation is available only for the financial year 2020-21.

[12] SEBI/LAD-NRO/GN/2020/14, dated June 16, 2020

2. **SEBI provides for relaxations relating to procedural matters of Takeover Regulations and SEBI (Buy-back of Securities) Regulations, 2018 ("Buy-back Regulations")[13]**

   In view of the impact of COVID-19 and lockdown measures of the Central and State governments, SEBI has temporarily provided relaxation on the procedural aspects pertaining to open offers under Takeover Regulations and buy-back tender offers under Buy-back Regulations opening up to July 31, 2020. Accordingly, service of the letter of offer and/or tender form and other offer related material to shareholders may be undertaken by electronic transmission, subject to fulfilment of specific conditions such as publishing such letters on stock exchange, company website, advertisement of dispatch of such letters in newspapers, through SMS to shareholder, etc.

3. **SEBI issues[14] advisory on disclosure of material impact of COVID–19 pandemic on listed entities under SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 ("LODR Regulations")**

   Emphasizing on the importance of timely availability of information about the impact of COVID-19 on listed companies and its operations to its investors and stakeholders, SEBI has issued an advisory for listed entities advising them to evaluate the impact of the COVID 19 pandemic on their business and disseminate the same to stock exchanges. Below is an illustrative list of information that listed entities may consider disclosing:

   - Impact of the CoVID-19 pandemic on the business;
   - Ability to maintain operations including the factories/units/office spaces functioning and closed down;
   - Schedule, if any, for restarting the operations;
   - Steps taken to ensure smooth functioning of operations;
   - Estimation of the future impact of CoVID-19 on its operations;
   - Details of impact of CoVID-19 on listed entities -
     - capital and financial resources;
     - profitability;
     - liquidity position;
     - ability to service debt and other financing arrangements;
     - assets;
     - internal financial reporting and control;
     - supply chain;
     - demand for its products/services;

[13] SEBI/CIR/CFD/DCR1/CIR/P/2020/83 dated May 14, 2020
[14] SEBI/HO/CFD/CMD1/CIR/P/2020/84 dated May 20, 2020

- Existing contracts/agreements where non-fulfilment of the obligations by any party will have significant impact on the listed entity's business;
- Other relevant material updates about the listed entity's business.

SEBI has also advised listed entities to revisit, refresh, or update its previous disclosures relating to the impact of COVID-19 pandemic on a timely basis, if possible.

Katalyst comments: *SEBI has advised listed entities to disclose impact of COVID-19 pandemic on the company and its operations and communicate to its investors and stakeholders in a timely and cogent manner. Therefore, it becomes imperative for the listed entities to provide such disclosures/ information, to the extent possible and quantifiable to the stakeholders.*

4. SEBI further extends[15] timelines for regulatory filings for AIFs and VCFs

SEBI, vide its Circular No. SEBI/HO/IMD/DF1/CIR/P/2020/58 dated March 30, 2020, extended the due date for regulatory filings for AIFs and VCFs for the periods ending March 31, 2020 and April 30, 2020 by two months. SEBI has now provided for a further extension of timelines for regulatory filings for AIFs and VCFs for the months ending March, April, May and June 2020, till August 7, 2020.

5. SEBI issues[16] informal guidance on reclassification of promoter's daughter as public shareholder

The applicant, promoter and managing director of a listed company, desires to gift part of his holding (more than 10%) to his two married daughters ('recipients'). Subsequent to the above transfer, recipients would be classified as promoters of the company. However, since the recipients are not involved in the management of the company and are married and living separate lives, they desire to be reclassified as 'public shareholders' instead of 'promoters'.

SEBI stated that by virtue of definition of 'promoter group' under the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018, the daughters of promoters are immediate relatives and are a part of promoter group irrespective of the fact that they are married and living a separate life or that they are not involved in management of the company. SEBI also clarified that as per SEBI (Listing Obligation and Disclosure Requirements) Regulations 2015, in case of gift of shares by a promoter/ person belonging to promoter group, immediately on such event, the recipient of such shares will be classified as a promoter/ person belonging to promoter group, as applicable.

Lastly, SEBI has clarified that under Regulation 31A of LODR Regulations, the promoter(s) and/or persons related to the promoter(s) seeking re-classification shall not together hold more than 10%

[15] SEBI/HO/IMD/DF6/CIR/P/2020/92 dated June 4, 2020
[16] SEBI/HO/CFD/CMD1/ow/2020 dated June 12, 2020

of the total voting rights in the listed entity and therefore, the daughters of promoter would not be eligible to seek re-classification from the promoter group to public.

6. **SEBI exempts Proposed Acquirers[17], in relation to Crimson Metal Engineering Company Limited, from making open offer under Regulation 11 of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 ("SAST Regulations"):**

SEBI has allowed an application seeking exemption from making open offer under SAST Regulations in the case of proposed transaction of direct acquisition of 12.91% equity shares of the Crimson Metal Engineering Company Limited between the acquirer trust, HUF of promoters and promoters disclosed for a period of less than 3 years (collectively, the acquirers) and transferors being individuals (disclosed promoters for more than 3 years) pursuant to a family arrangement, intended to streamline ownership and welfare of the promoter family.

The matter was placed before the SEBI Takeover Panel ('the Panel') and the Panel recommended grant of exemption as under:

1. In respect of acquisition of shares by the Trusts, the transferors themselves were the trustees and beneficiaries of the Trusts and such transfer would not result in change in control or shareholding of the promoter group and recommended granting exemption
2. In respect of acquisition of shares by HUFs, the Panel recommended grant of exemption as the shares were proposed to be transferred to the Kartas of HUFs by the respective family members
3. In respect of transfer of shares between grandchild and grandfather, the Panel recommended granting exemption as the transferor and transferee are lineal descendants.

Considering the recommendations of the SEBI Takeover Panel, SEBI allowed the application thereby exempting the acquirers from making open offer upon acquisition of shares of Crimson Metal Engineering Company Ltd from existing promoters.

Katalyst Comments: The above application was made in compliance with SEBI Circular dated 22nd December, 2017, which standardized the format of application under Regulation 11 of the SAST Regulations.

[17] WTM/GM/CFD/10 /2020-21 dated June 5, 2020

E. Goods and Services Tax (GST)

1. Input tax credit ('ITC') of detachable sliding or glass-partition fitted in co-working space, is available

The Appellate Authority of Advance Ruling ('AAAR'), Karnataka[18] has held that input tax credit relating to detachable sliding and stackable glass partitions fitting in the building for co-working work space/office space being let out by the appellant is available. The AAAR also reversed the ruling by the Authority of Advance Ruling ('AAR') and also held that the intent of fixing glass partitions is only to give a sense of privacy and demarcate work space area and the same can be dismantled and moved as per the requirement of applicant and hence, it can't be qualified as 'immovable property' and hence, ITC of the same is available.

Katalyst Comments: *This ruling has reversed the ruling of AAR and allowed the ITC of detachable sliding or glass-partition fitted in co-working space on the basis that detachable sliding or glass-partition can be dismantled and moved as per the requirement and hence, same does not form part of building which is an immovable property and hence, provisions of section 17(5) (d) of blocked credit are not applicable and ITC of the same is available.*

2. GST is applicable on land development under Joint Development Agreement ('JDA') and sale of land and the said transaction can't be classified as supply of land which is exempt under GST

The AAAR, Karnataka[19] has upheld the ruling of AAR and held that when JDA is entered into by two parties to jointly reap the benefits of sale of land to customers, there is a clear rendering of service by the developer to landowner in developing the land which belongs to landowner. Hence, the activity can't be treated at 'sale of land' which is exempt under GST but the said activity of developing land is a supply of service and liable to GST.

3. Clarification regarding GST on director's remuneration

The CBIC has issued a circular[20] to clarify that GST is payable under RCM by the company in case where the remuneration has been paid to a director who is not the employee of the company. Also, in case where the directors perform in dual capacity as an employee and also as a service provider, GST under RCM is applicable on remuneration paid for the services performed by the director and not on the remuneration paid as 'salary'.

Katalyst comments: *There was needless ambiguity regarding applicability of GST on director's remuneration due to different rulings by the AAR of Karnataka and Rajasthan. The circular has*

[18] In the matter of WeWork India Management Private Limited [TS-292-AAAR-2020-NT]
[19] In the matter of Maarq Spaces Private Limited [TS-293-AAAR-2020-NT]
[20] Circular no. 140/10/2020-GST dated June 10, 2020

clarified that GST is applicable on remuneration paid to director who is not the employee of the Company. In a case where director acts an employee and also performs other services, in such case, if the Company deducts TDS u/s 192 of the Income Tax Act, 1961 on such remuneration, no GST is payable under Reverse Charge Mechanism. However, if the company deducts TDS on remuneration u/s 194J of the Income Tax Act, 1961, GST is payable under Reverse Charge Mechanism.

4. Refund related clarification

The CBIC has issued a circular[21] to clarify that the treatment of refund of ITC relating to imports, ISD invoices and the inward supplies liable to Reverse Charge (RCM supplies) will continue to be same as it was before the issuance of Circular No. 135/05/2020-GST dated 31st March, 2020. i.e. refund will be available if the details of said invoices are not reflected in FORM GSTR-2A.

Katalyst comments: *Important clarification by the CBIC. Post issuance of Circular No. 135/05/2020-GST dated 31st March, 2020, the refund of accumulated ITC was restricted to the ITC available on those invoices, which were uploaded by the supplier in FORM GSTR-1 and are reflected in the FORM GSTR-2A of the applicant. Now, it is clarified that refund of ITC relating to imports, ISD invoices and inward supplies liable to RCM will continue to be available even if the details of said invoices are not reflected in FORM GSTR-2A.*

5. Key recommendations of 40th GST council meeting held on June 12, 2020 (To be notified)

a) Waiver/reduction of late fees for pending GSTR-3B for the period July 2017 to January 2020, filed during July 1, 2020 to September 2020, based on the tax liability:

Sr No.	Tax liability	Late fees (Rs.)
1	No tax liability	Nil
2	Having tax liability	Maximum Rs. 500/- per return

b) Relaxation to Small Taxpayers having turnover upto Rs. 5 crores

Sr No.	Return for the period	Late fees	Interest
1	May, June and July 2020 filed by September 2020	No	No
2	Feb, March and April 2020, filed up to July 6, 2020	No	No interest till July 6, 2020
3	Feb, March and April 2020, filed beyond July 6, 2020	No	Reduced rate-9% till September 30, 2020

[21] Circular no. 139/09/2020-GST dated June 10, 2020

Do feel free to reach out to us for a detailed discussion on ketan.dalal@katalystadvisors.in

Our Offices:
Mumbai
71/75, Mittal Tower 'C'
Nariman Point,
Mumbai – 400021
Tel: +91 22 4917 1616

Pune
#402, Lunkad Sky Vista
New Airport Road, Viman Nagar,
Pune- 411014
Tel: +91 20 6749 7700