KATALYST ADVISORS

Katalyst Kaleidoscope

June 2022: Tax and Regulatory Insights

SUMMARY OF CONTENTS

A. Income tax Highlights

1. Supreme Court: Loss arising on assignment of loan allowed as short-term capital loss[1]

The Supreme Court dismissed a tax department SLP on the captioned matter, and thereby the fallout is that the concept seems to have been accepted.

2. Delhi ITAT: Different valuation for issue of shares to each joint venture partners on the basis of Joint Venture Agreement[2]

In the given case, the assessee Joint-venture company had issued shares of Face Value of Rs. 10 to the Non-resident Joint-venture partner at the value of Rs. 60 per share and to Resident Joint-venture partner at the value of Rs. 40 per share. The issue of shares to the resident venture partner was supported by valuation report of a Chartered Accountant under DCF method. As per the Joint-venture agreement entered into, the cost of the project was to be borne by non-resident and resident entities in the proportion of 60:40 whereas the shareholding was to be maintained in proportion of 50:50, due to which the shares were issued to the non-resident at a higher value of Rs. 60 than the issue price to resident entity of Rs. 40.

The Tribunal held that the valuation of shares is a question of fact. Section 56(2)(viib) read with Rule 11UA(2)(b) makes such valuation report admissible evidence, unless it is discredited on facts. In the given case, the Assessing Officer has not discredited the details of project such as costs, revenues, etc. nor has he considered the facts of the Joint-venture agreement pursuant to which shares have been issued at different values to resident and non-resident venture partners. Hence, the valuation of shares under DCF method was acceptable and there could be no income assessable u/s 56(2)(viib) in the hands of the assessee company.

Katalyst Comments:

(i) Provisions of Section 56(2)(viib) are not applicable in case of issue of shares to non-resident entity. In the given case, the shares were issued to resident entity at Value computed on DCF basis and the shares to non-resident were issued at a value excess of such fair value. As the valuation was accepted in case of shares issued to resident and as the provisions of sec. 56(2)(viib) are not applicable in case of shares issued to non-resident, no tax implications arose for the issuer assessee company.

[1] **Reliance Natural Resources Ltd** [137 taxmann.com 61 (SC)] dated February 25, 2022
[2] **Mais India Medical Devices (P.) Ltd** [139 taxmann.com 94](Delhi Trib.) dated May 31, 2022

(ii) Incidentally this is one more case law amongst the torrent of case laws, on an outlier provision, which should not be on the statute book, to start with.

3. Mumbai ITAT: Advance given to shareholders out of ordinary business activity is not deemed dividend u/s 2(22)(e)[3]

The assessee company had granted advance to a shareholder who held more than 20% shares of the Company and the Assessing Officer treated such advance as deemed dividend u/s 2(22)(e) of the Act.

The assessee explained that the advance was given by it to the shareholder out of ordinary business to acquire land on behalf of the assessee. The assessee had also sought to file additional evidence before the CIT(A) under Rule 46A, which was not permitted by the CIT(A).

Hence, the Tribunal remanded the matter back to the CIT(A) with directions to admit the additional evidence and decide the issue on merits of the case.

Katalyst Comments:

- *There being no specific exemption to advances made in ordinary course of business by a company other than that engaged in business of lending of money u/s 2(22)(e), the outcome of this issue would be important to watch for.*

- *In another decision in relation to deemed dividend[4], the Ahmedabad Tribunal held that deemed divided can be assessed only in the hands of a shareholder and not a non-shareholder; the context is that the assessee company had received a loan from another company, in which 50% shareholders of the assessee company were holding more than 20% shares.*

4. Bangalore ITAT: Conversion of loan into shares of a company with negative net-worth and subsequent sale of such shares incurring capital loss held as a bogus transaction[5]

In the case of Capital Global Advisory (a registered merchant banker), the assessee had granted loan to a company (MCAPL) of Rs. 5.64 Cr. This loan was subsequently converted to equity shares of such company. The shares were converted at face value whereas the net-worth of such company was negative i.e. (-) 4.43 Cr. Within 7 days of conversion of loan to

[3] **Mukesh Shivdas Sonar** [Mum. Trib. – ITA No. 1802/Mum/2020]
[4] **Amit Intertrade (P.) Ltd.** [137 taxmann.com 488 (Ahmedabad - Trib.)]
[5] **Capital Global Advisory Pvt. Ltd** [TS-468-ITAT-2022(Bang)]

shares, the assessee company sold the shares at a price of Rs. 0.15 Cr and booked short term capital loss.

The Tribunal held that there was no commercial expediency in the transaction of investment made by the assessee in a company having negative net-worth. Further, the value at which the shares were allotted to the company were also not commensurate with the net-worth of the company. The entire transaction of purchase of shares and sale of shares was required to be seen in entirety on account of negative net-worth of the investee company. Hence, it was held that the assessee company had created artificial short-term capital loss on the basis of paperwork for making investment in company. Thus, the transaction was held to be bogus by the Tribunal.

Katalyst Comments:

- *There may be genuine cases in which loans are given at the time the company is financially sound, but on account of it turning it to company with negative net-worth and/ or default of repayment, such loans are converted to equity shares, fair market of which could be less than the face value.*

- *In the given case, the period between acquisition and sale of shares was only 7 days, for which commercial expediency is difficult to establish. However, the commercial expediency could have been there at the time of granting such loan, which aspect has not been touched upon by the Tribunal. The assessee in the given case, as an alternative plea, had also claimed loss under business income to the extent of value erosion of such loan granted, which was not accepted by the Tribunal.*

- *In light of decisions like the above and with applicability of GAAR, establishing commercial expediency for each transaction has become of utmost importance.*

5. Chennai ITAT: In case of insufficient communication to AO regarding merger, assessment concluded in name of amalgamating company is valid[6]

In the case of Iris Engineering Industries, an assessment order was passed in the name of the assessee, which got merged with Ravilla Aerospace. It was observed by the Tribunal that the assessee had only filed a letter to the revenue authorities stating that it was merged with another company without providing any details of order approving such merger. As the communication regarding merger by the assessee was insufficient, the revenue authorities could not be held to be aware of the merger and hence the assessment order passed in the name of the amalgamating company was valid. The Tribunal distinguished the judgement of Supreme Court in the case of Maruti Suzuki [TS-429-SC-2019] on facts.

[6] **IRIS Engineering Industries Pvt. L**td [TS-401-ITAT-2022(CHNY)]

Katalyst Comments:

The intimations filed with statutory authorities post approval of scheme of arrangements by NCLT should be detailed, as regards the approved scheme.

6. CBDT notifies Circular No. 12/2022 for implementation of Sec. 194R of the Act (TDS on benefit or perquisites for business income earners)

Section 28(iv) of the Income-tax Act provides for tax on benefit or perquisite arising from business or profession in which a person is engaged. Section 194R was introduced vide Finance Act, 2022 with effect from July 01, 2022; to provide for deduction of tax on the value of such benefit or perquisite provided by a person to any other person engaged in business or profession.

This section was introduced to ensure reporting of income u/s 28(iv) by the recipient of such benefit or perquisite, and in this context, CBDT has notified Circular No. 12/2022 providing for guidelines in implementation of Sec. 194R. Gist of guidelines provided vide the said circular are as under:

- The deductor is not required to check whether the amount of benefit or perquisite is taxable in the hands of the recipient u/s 28(iv) or not.
- The benefit/ perquisite on which tax is required to be deducted can be in cash, kind or both.
- Transactions of sales discount, cash discount and rebates have been specifically exempted from the purview of Sec. 194R, for removal of difficulty, despite them being qualified as a perquisite/ benefit in connection with business. However, free samples, rewards in form of cash or kind, etc. are covered under this section and TDS will have to be deducted thereon.
- In case benefit/ perquisite is provided to any individuals who are under employment, then the employer shall be treated as the recipient of the benefit and TDS is to be deducted accordingly.
- The value of benefit/ perquisite provided in kind will be at purchase price in case of purchased products provided to recipient, sale price in case of own manufactured products and fair market value in any other case; valuation to exclude GST component.
- Reimbursement of out-of-pocket expenses incurred by consultant in course of providing services will be treated as perquisite/ benefit. Exception to this is in cases where the invoice of such expenses is also in the name of recipient of service and not the consultant.
- Expenses towards dealer/ customer conferences to the extent it is not attributable to ‘leisure component/ trip’, ‘family members accompanying attendees’ or ‘days of prior

stay/ overstay to such conference' – will not be treated as perquisite/ benefit for recipient i.e. dealers/ customers.

- In case of benefit/ perquisite in kind, the deductor can obtain a declaration from recipient for payment of tax on such perquisite by way of advance tax and report the same in its TDS return (Form 26Q). Payment of tax by deductor on perquisite in kind will also be included in valuation of such perquisite.
- The threshold limit of Rs. 20,000 is to be considered for the transactions from April 01, 2022; but tax deduction will be required to be made only with regard to benefit provided after June 30, 2022.

Katalyst Comments:

- *The section is a classic example of adding to compliance burden and is totally contrary to the concept of Ease of Doing Business.*

- *The guidance provided by the circular with regard to expenditure on business conferences is vague on definition/ aspects of leisure component, primary object of conference, cost of prior stay or overstay, etc. which will give rise to further litigation. This circular also provides for deduction on value of perquisite even if such perquisite may not fall under sec. 28(iv) in the case of recipient, which is contradictory to the intent of insertion of sec. 194R, as described in the memorandum to Finance Act, 2022, which was to provide for reporting of receipt of such benefits/ perquisites u/s 28(iv) by such recipients.*

- *The circular does not cover situations where more than one sections are applicable say 194J and 194R, 194C and 194R, etc. The term 'Social Media Influencer' is not defined in the circular or act.*

7. CBDT notifies Cost Inflation Index for FY 2022-23

CBDT vide Notification No. 62/2022 dated June 14, 2022 has notified the Cost Inflation Index for FY 2022-23 at **331**.

B. Corporate Law Highlights

1. Fast-track merger u/s 233 of the Companies Act, 2013 – consent of 90% creditors

In a scheme of amalgamation filed u/s 233 of the Companies Act, 2013, the petitioner companies had obtained and filed consents of 90% of the creditors present and voting in the meeting of such creditors. However, the Regional Director required the petitioner companies

to obtain and furnish consent letters of 90% of total creditors of each company and not just the creditors present and voting.

Katalyst Comments:

- *Section 233(1)(d) does not specify whether the 90% consent is to be reckoned with total value of creditors or only the value of creditors present and voting in the meeting of the creditors. The interpretation of RD suggests that 90% consent is to be reckoned with value of total creditors of the company. This would in a way mean that all the creditors of the company are required to attend the meeting and 90% of such creditors should grant consent to the scheme.*

- *In practice, given the time lag between date of filing of Scheme and the meeting date, many creditors would have been paid off, and hence would not have any interest in attending any such meeting.*

- *Companies contemplating fast-track merger u/s 233 must consider this issue while obtaining the consent from creditors to avoid any delay in approval by the RD. The real answer lies in MCA clarifying that this requirement is for those creditors ''attending and voting''.*

2. Amendments for aligning provisions of Companies Act, 2013 with FDI Policy (PN 3)

In the year 2020, the Government of India had notified Press Note 3 (PN 3) which provided for requirement of government approval for investment by a Foreign entity of a country which shares land border with India. Now, amendments to various rules under the Companies Act, 2013 have been made to include the following declaration (whichever is relevant):

- The compliance to FEMA (NDI) regulations is not required, or
- The compliance to FEMA (NDI) regulations had been made and approval is obtained.

Declarations would now be required to be made in the following instances –

- Amalgamation with a Foreign Company
- Allotment of securities by the Company
- Incorporation of a new company
- Appointment of Director
- Application for DIN

3. Recognition of Special Purpose Acquisition Company (SPAC) under Regulatory framework

A Special Purpose Acquisition Companies ("SPAC") is a type of company that does not have an operating business and has been formed with the specific objective of acquiring a target company. This concept allows a shell company to make an Initial Public Offering ("IPO") without any commercial activity. After listing, the SPAC merges with or acquires a company, (i.e. the target), thereby allowing the target company to benefit from such listing without going through the formalities and rigours of an IPO.

Recently, the Company Law Committee ("CLC") has recommended to the Ministry of Corporate Affairs enabling provisions under Companies Act, 2013 be introduced for incorporation of SPAC.

Primary Market Advisory Committee of SEBI is also reported to have commenced work on evolving a regulatory framework for listing of SPAC.

Katalyst Comments:

Recommendation by CLC for introduction of SPAC under the Indian Regulatory Framework is a welcome step towards facilitating acquisition activities under a separate List Co.

4. Amalgamation of unregistered NBFC with a registered NBFC[7]

In the case of Ventex Trade Private Limited, a merger of 6 unregistered NBFCs was proposed with a registered NBFC. RD sought for a No Objection Certificate ("NOC") from RBI with regard to the 6 unregistered NBFCs.

The petitioner transferee company being a registered company contended that RBI grants following 3 options to an unregistered NBFC:

(i) To amalgamate with a registered NBFC,
(ii) To apply for RBI license for NBFC
(iii) To discontinue such activities

Hence, in the given case, the transferee company being a registered NBFC, NOC from RBI was not required. Also, it was submitted that the Transferee company had applied for NOC from RBI vide several letters, but NOC was not received.

[7] ***Ventex Trade Private Limited*** *[C.P (CAA) NO 04/ KB / 2022] (NCLT, Kolkata) order dated 20.04.2022*

The NCLT Kolkata granted approval to the scheme of amalgamation basis the above submission.

Katalyst Comments:

RBI mandates requisition of NOC in case of scheme of merger of a Non-NBFC with a registered NBFC where there is a change in equity shareholding of NBFC by 26% or in case of a change in more than 30% of directors excluding independent directors. All the NCLT benches may not be inclined to approve scheme of arrangement without NOC from RBI, in cases where it is required.

5. Supreme Court: Pawnee exercising right to record himself as 'beneficial owner' should not be considered as 'actual sale' of dematerialized securities[8]

In a recent judgment, the Supreme Court held that mere exercise of right by pawnee to record himself as the "beneficial owner" (which is a necessary precondition before the pawnee can exercise his right to sell) is not "actual sale" and would not affect the rights of the pawnor of redemption under section 177 of the Contract Act.

The Supreme Court observed that "Every transfer or sale is not 'actual sale' for the purpose of Section 177 of the Contract Act. To equate 'sale' with 'actual sale' would negate the legislative intent." Further, the pawnor's right to redemption under section 177 can be exercised even after the pawnee has been registered and has acquired the status of 'beneficial owner'. The right of redemption would cease on the 'actual sale', i.e. when the 'beneficial owner' sells the dematerialised securities to a third person.

Katalyst Comments:

This judgement can be useful in the context of beneficial ownership in relation to other legislations ; for example, Takeover code.

[8] PTC India Financial Services Ltd. vs. Venkateshwarlu Kari & Anr. [LSI-437-SC-2022(NDEL)]

C. SEBI Highlights

1. SEBI proposes introduction of regulatory framework on scheme of arrangement involving only debt listed entities in the Listing Regulations[9]

Presently, certain safeguards are available under the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 for schemes of arrangement involving merger, amalgamation etc., of entities with listed specified securities (defined as equity shares and convertible securities) to protect the interest of investors such as obtaining of NOC from Stock Exchange, review of scheme by SEBI with comments of Stock exchange thereupon, etc.
However, for listed entities with only listed debt securities/ NCRPS, no such compliances are mandated under SEBI (LODR) Regulations with regard to schemes of arrangement involving merger, amalgamation, etc.

Hence, SEBI now intends to introduce a regulatory framework which may require debt listed entities (even if Equity is not listed) to seek No Objection Letter from Stock Exchange while entering into such scheme of arrangement.

Katalyst Comments:

This will be an addition to the compliance burden which business organisations are already struggling with.

2. SEBI informal guidance on registration of Portfolio Manager for managing Offshore Fund[10]

The querist had stated that it was an Investment Manager for a SEBI registered Category-III Alternative Investment Fund and it intended to provide management services to an Offshore Trust based in Ireland. It was inquired whether the Investment Manager was required to obtain registration as a Portfolio Manager under SEBI (Portfolio Manager) Regulations or whether it was exempted from the same being an Investment Manager of a SEBI registered AIF.

SEBI issued informal guidance that there was no exemption for an Investment Manager of a SEBI registered AIF under SEBI (Portfolio Manager) Regulations for obtaining registration as a Portfolio Manager and thus it was required to obtain registration as a Portfolio Manager for managing Offshore Trust.

[9] Consultation Paper on Introducing framework for Schemes of Arrangement for entities that have listed only debt securities/ NCRPS dated 20th May, 2022
[10] SEBI Informal Guidance Letter dated 20th May, 2022

D. Goods and Service Tax highlights

1. Services of overseas commission agent is taxable as 'intermediary services' and not as 'import of services' from outside India

Uttarakhand[11] AAR has held that services of overseas commission agent is not covered within the purview of 'import of services' as in order to qualify as 'import of services', place of supply should be in India. In case of 'intermediary services', place of supply is the place of service provider which is outside India as per the provisions of section 13(8) (b) of IGST Act, 2017 and hence, no GST on such transaction is payable under the reverse charge mechanism.

2. Support Services to overseas vessels entering/exiting India do not constitute 'export' and liable to GST at 18%

Tamil Nadu[12] AAR rules that end-to-end support services by Applicant to overseas shipping lines/charters on a principal-to-principal basis which involve bringing the vessel (goods) to the port, enabling the vessel (goods) leave the port, berth hire services for docking the vessels, lighthouse dues etc., are liable to be classified under SAC 9967 [Supporting services for vessel transport] and taxable at 18%. The AAR clarified that these services are rendered in respect of vessels which are physically available in the Indian Territory and the condition of 'place of supply' being outside India for 'Export of service' as per section 2(6) of IGST Act, 2017 is not satisfied and hence, these services are not classified as 'Export of Service'.

Katalyst Comments:

The support services provided to vessel transport in Indian territory is liable to GST in India and the same is not classifiable as 'export of service' as the place of supply for such service is in India.

3. Interim stay declined over the issue of input tax credit ('ITC') transfer

Odisha unit of JSW Steel Ltd. has paid GST under the reverse charge mechanism ('RCM') on bid premium, royalty etc. for availing licensing services for right to use the minerals. Further, Odisha unit has provided facilitation services to Maharashtra-Input service distributor (ISD) and paid GST on the same by utilizing ITC. Later, Maharashtra ISD has distributed the ITC to the various units of JSW Steel Ltd. In this regard, the Odisha[13] High Court has held that Odisha unit has transferred ITC to Maharashtra ISD in the garb of outward supply of facilitation

[11] **Dry Blend Foods Pvt. Ltd.** [TS-311-AAR(UTT)-2022-GST]
[12] **Translog Direct Pvt Ltd.** [TS-256-AAR(TN)-2022-GST]
[13] **JSW Steel Ltd. vs. UOI & Ors.** [TS-274-HC(ORI)-2022-GST]

services as no tax invoice from Odisha unit has been received by the Maharashtra ISD and hence, the transaction in question amounts to siphoning of tax amounts.

Katalyst comments:

The Odisha High court has challenged the facilitation service provided by the Odisha unit and held that said services were provided to transfer the unutilsed ITC to ISD in Mumbai so that ITC can be distributed to all other units. The High court has rejected the argument that ISD-Mumbai has been awarded the mining rights in Odisha and therefore, tax deposited by the Odisha unit belongs to ISD-Mumbai.

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