

Katalyst Kaleidoscope

March 2019: Tax and Regulatory Highlights

A. Income-tax Highlights

1. Mumbai Income Tax Appellate Tribunal ('Tribunal')¹ holds that there is no restriction on corporates to make gifts; such gifts are exempt u/s 47(iii) of the ITA
 - In this case, the assessee company transferred listed company shares to its group concerns by way of gift (as a part of internal restructuring with an intention to consolidate the media assets of the group) and suffered loss on such transfer, which was voluntarily not claimed by assessee.
 - However, AO during the course of assessment, considered these transactions to be a colourable device and taxed the notional profit under the head income from other sources after substituting the market value of the shares as selling price. The CIT (A), upheld the order of AO stating that the transactions are colourable device.
 - On further appeal, Tribunal held in favour of the assessee on account of the following:
 - Tribunal observed that there is nothing that prohibits a company from giving or receiving gifts. Only requirement is that it should be authorized by its Memorandum of Association.
 - Tribunal referred to the provisions of Sections 5, 122, 123 of Transfer of Property Act, 1882 ('TOPA'), which indicate that there is no restriction on corporates to transfer shares by way of a gift. There is no requirement in TOPA for a 'gift' to be made only between natural persons out of natural love and affection, which means that as long as a donor company is permitted by its memorandum/articles of association to make a 'gift', it can do so. Further, it is clear from Section 123 of TOPA, that an oral agreement with transfer of possession is sufficient to complete a gift of a movable property.
 - Tribunal relied on the Hon'ble Gujarat High Court ('HC') ruling in the case of Prankriya Pharmace² wherein it was held that in case where an assessee gifted its shares to its sister concern, such transaction would fall within the ambit of Section 47(iii) of the ITA and therefore such a transaction is exempt from capital gains tax.

¹ Jayneer Infrapower & Multiventures (P) Ltd vs DCIT [2019] 103 taxmann.com 118 (Mumbai-ITAT)

² Prankriya Pharmace^m v. ITO [2016] (238 Taxmann 185) (Guj HC)

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- Tribunal also placed reliance on the order of Chennai Tribunal in the case of Redington (India) Ltd³ wherein it was held that there is nothing against a company making gift of its property to another company.

Katalyst comments:

1. *Mumbai Tribunal has held that there is no legal bar on corporates to make gifts; however, if gift involves shares of an unlisted company, one needs to examine implications u/s 50CA of the ITA.*
 2. *In case of receipt of gift, there could be implications u/s 56(2)(x) of the ITA for the recipient.*
2. Delhi Tribunal⁴ rules on Aamby Valley's amalgamation scheme and holds that the receipt of shares of step-down subsidiaries, as a consequence of merger of wholly owned subsidiary company with the parent company is not taxable in the hands of parent company
- In this case, the assessee company had a wholly owned subsidiary (WOS) which in-turn had 8 direct subsidiaries (SPVs) and 3 step-down subsidiaries. Pursuant to the amalgamation of its WOS, the assessee company received shares of SPVs held by such WOS and the same were recorded by the assessee at fair value by crediting the general reserve.
 - During the course of assessment proceedings, AO held that receipt of shares of SPVs upon merger was liable to tax u/s 56(2)(viiia) of the ITA.
 - The Tribunal held that:
 - i. Section 56 (2)(viiia) of the ITA is applicable only where there is "transfer" of shares. In the case of amalgamation, it cannot be said that there is a transfer of shares as there is only statutory vesting of the assets by virtue of the Scheme;
 - ii. Section 56(2)(viiia) of the ITA excludes from its scope, amalgamation which is not regarded as transfer u/s 47(vii) of the ITA; however, since this case involves merger of WOS the conditions of pre-amended Section 47(vii) [i.e. the consideration for amalgamation was received in the form of allotment of shares of amalgamated company] could not have been complied with and in order to remove this defect, the Finance Act, 2012 amended clause (a) of Section 47(vii) of the ITA to that effect.

³ Redington (India) Limited v. JCIT [TS-419-ITAT-2014(CHNY)]

⁴ Aamby Valley Ltd [TS-80-ITAT-2019(DEL)]

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- iii. The amendment u/s 47(vii) of the ITA is clarificatory and hence retrospective in nature and since all the conditions u/s 47(vii) of the ITA were complied with the provisions u/s 56(2)(viia) of the ITA could not be invoked.
- Additionally, in relation to the issue of amount credited to the general reserve on account of the fair valuation of SPV shares, the Tribunal held that:
 - i. Relying on the Supreme Court ('SC') judgement in the case of Godhra Electricity⁵, the addition made u/s 28(iv) of the ITA should be deleted (in the context of non-taxability of hypothetical income). Tribunal also stated that the transaction of merger is not carried out in the ordinary course of business, which is an essential requirement, if Section 28(iv) of the ITA is to be invoked.
 - ii. The addition made u/s 115JB of the ITA is also not sustainable, placing reliance on the SC decision in the case of Apollo Tyres Ltd⁶ and held that since amount was not credited to P&L account, such amount cannot be included for the purpose of computing MAT liability.
- 3. Hyderabad Tribunal⁷- Allows of claim of depreciation on 'Network Rights' acquired pursuant to acquisition of Cable TV Business treating it as 'Goodwill'
 - In this case, assessee acquired a Cable TV Business, and allocated the consideration paid over and above the tangible assets pertaining to Cable TV Business towards Network Rights. Assessee treated such Network Rights as intangible assets and claimed depreciation thereon.
 - The Assessing Officer ('AO') treated such Network Rights as Goodwill and disallowed the depreciation claim of assessee stating that Goodwill is not specifically covered u/s 32(1)(ii) of the Income-tax Act, 1961 ('ITA').
 - Assessee having accepted AO's treatment of Network Rights as Goodwill, Hon'ble Tribunal relying on SC judgement in the case of Smifs Securities Limited⁸, allowed depreciation claim on such Network Rights treating it as Goodwill.

⁵ Godhra Electricity Co. Ltd vs CIT [1997] 91 Taxman 351 (SC)

⁶ Apollo Tyres Ltd. v. CIT [2002] 255 ITR 273/122 Taxman 562 (SC)

⁷ Apna Incable Broad Band Services Private Ltd [TS-95-ITAT-2019(HYD)]

⁸ CIT vs Smifs Securities Limited [2012] 24 taxmann.com 222 (SC)

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4. Bangalore Tribunal⁹ upholds AO's action of discarding Discounted Cash Flow ('DCF') method and adopting Net Asset Value (NAV) method of valuation for Angel Tax provisions u/s 56(2)(viib) of the ITA

- In this case, assessee allotted shares to its parent company at a premium. The AO examined the Valuation Report and found that the said Valuation Report had relied only on the projections certified by the Management of the assessee company, which had been prepared to justify the high premium and therefore rejected the DCF method of valuation adopted in the said valuation report and computed value of the assessee company's shares as per NAV method.
- On appeal, Tribunal upheld the order of AO and held that 'the provisions of law do not make an exception to shares issued to the promoter company / parent company. It provides for taxing of any excess share premium over the FMV of the shares, irrespective of the character or position of the person to whom such shares are issued. Merely because the recipient of the shares is the parent company of the assessee, it does not give the assessee freedom to value the shares at any price.'
- Tribunal also clarified that that the AO has disregarded the use of DCF Method for the reason that the parameters taken by the assessee in adopting the DCF Method were defective and the same could not be accepted.
- Tribunal remarked that although share premium is a capital receipt, share subscription money in excess of FMV is an income u/s 2(24)(xvi) of the ITA.

Katalyst comments:

1. *Provisions of Section 56(2)(viib) of the ITA do not only apply to start-ups, but apply also to private companies. While determining fair value, wherever there is requirement of obtaining valuation report from a Merchant Banker, projections based on justifiable underlying assumption is important.*
 2. *On a broader note, such a provision in the law reflects a disturbing trend of outlier legislation and is totally contrary to 'Ease of doing business'.*
- #### 5. Delhi Tribunal¹⁰ holds that capital reserve arising upon amalgamation pursuant to fair value recordal of assets is not 'revaluation reserve'; deletes Book profit adjustment

- In this case, assessee company merged its 2 WOS and accounted such merger as per the 'Purchase Method' specified under AS-14, which resulted in creation of capital reserve.

⁹ TUV Rheinland NIFE Academy Pvt. Ltd [TS-92-ITAT-2019(Bang)]

¹⁰ Priapus Developers P. Ltd [TS-121-ITAT-2019(DEL)]

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- Subsequently, assessee company sold such shares which resulted in loss while calculating taxable capital gains and 'Book Profit' for the purposes of MAT u/s 115JB of the ITA.
- AO made an addition in the 'Book Profit' to the extent of capital reserve generated pursuant to merger treating the same as revaluation reserve for the reasons that loss on sale of investments in WOS was debited to P/L account and not to capital reserve account created pursuant to merger.
- On appeal, Tribunal deleted the addition made by AO and held that:
 - The capital reserve was created based on the amalgamation scheme approved by the Court and tax authorities did not raise any objection before the Delhi HC against such scheme.
 - The amalgamation order passed by the HC is a judicial order and has statutory force and in case, the tax department had any objection, then same should have been taken up before the Hon'ble HC, for which sufficient time was allowed.
 - Once the order of amalgamation is passed by the Hon'ble HC, tax department cannot clamour that such an amalgamation has been used by the assessee as a tool for tax evasion or as colourable device.
 - In any case, it is not revaluation of any asset held by assessee, because all the assets belonged to the amalgamating companies and these assets entered in the books of assessee by virtue of amalgamation valued on FMV as mandated by the HC.

6. Gratuity exemption limits enhanced

CBDT has issued a notification¹¹ for enhancing income tax exemption limit for gratuity u/s 10(10)(iii) of the ITA from existing Rs 10 lakhs to Rs 20 lakhs.

¹¹ Notification No. 16 /2019/F. No. 200/8/2018-ITA-I

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B. Indian Accounting Standards

7. Proposal to amend definition of 'Business' under IND AS 103 – 'Business Combination' to assess whether transaction should be recorded as a business combination or asset acquisition

- The Institute of Chartered Accountants of India has issued an Exposure Draft of the proposed amendments to the definition of "Business" under "Ind AS 103 – Business Combinations", inviting comments to be received on or before April 6, 2019;
- The proposed amendments are intended for clarification of the term "Business" to assist entities to determine whether a transaction should be accounted for as a business combination or as an asset acquisition;
- The proposed amendments to the definition of "Business" are broadly as under:
 - Definition of 'Business' to specifically include providing of Goods and Services, generating investment income (dividend or interest) and generating other income from ordinary activities;
 - Definition of 'Input' and 'process' is amended to include contribution to the creation of output. Further definition of 'output' include providing of Goods and Services, generating investment income (dividend or interest) and generating other income from ordinary activities;
 - Various tests are introduced to determine Business or Asset acquisition such as concentration to fair value test, assessment of a substantive acquired process test based on elements of business;
 - If concentration test is met, the set of activities and assets is determined not to be a business and no further assessment is needed; concentration test is met if substantially all of the fair value of the Gross Assets acquired is concentrated in a Single Identifiable Asset or a group of Similar Identifiable Assets;
 - If concentration test is not met or option of not applying concentration test is exercised, then assessment shall be made based on the Elements of Business and assessment as to whether an acquired process is substantive.

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C. FEMA, Reserve Bank of India ('RBI') Regulations and Securities and Exchange Board of India ('SEBI')

8. Finalisation of Voluntary Retention Route ('VRR') Scheme for Foreign Portfolio Investors ('FPIs') to invest in Indian debt market

- RBI has released a Circular¹² finalizing the VRR Scheme to boost long term foreign investment in Indian debt market. VRR is a special channel for FPIs, which provides operational flexibility to manage their investments in Indian debt market.
- Further another was Circular¹³ issued by RBI that provides for hedging of the foreign exchange rate risk by FPIs investing under VRR.
- In continuation of the above, SEBI¹⁴ vide circular dated March 1, 2019 has withdrawn the provisions under SEBI Circular dated June 15, 2018 with immediate effect in relation to the limitations on FPIs for investments in the Indian debt market
- Investment through VRR scheme would be free of the macro-prudential and other regulatory norms.

Key salient features of the finalized VRR Scheme are as under:

- i. Investment made through VRR Scheme will not be subject to any minimum residual maturity requirement (cap on short-term investments at 20% of portfolio size), concentration limit or single/ group investor-wise limits applicable to Corporate bonds (50% of a single issue);
- ii. Investment through VRR Scheme shall be in addition to the general investment limit and shall be capped at INR 400 billion for VRR in Government securities and INR 350 billion for VRR in corporate debt instruments per annum;
- iii. FPIs shall be eligible to participate in any currency or interest rate derivative instrument, OTC or exchange traded, to manage their interest rate risk or currency risk.

¹² A.P. (DIR Series) Circular No. 21 dated March 1, 2019

¹³ A.P. (DIR Series) Circular No. 22 dated March 1, 2019

¹⁴ IMD/FPIC/CIR/P/2019/37 dated March 12, 2019

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Katalyst comments:

RBI has taken a step towards attracting stable investment in debt from FPIs by keeping the VRR scheme segregated from the general investment limits and having a broad scope for the eligible instruments.

9. Amendment in SEBI (Delisting) of Equity shares Regulation, 2015¹⁵ to introduce "Counter Offer" by Promoter(s) or Acquirer(s)

- An amendment has been made to SEBI (Delisting) of Equity shares Regulation, 2015 to allow promoter(s)/ acquirer(s) to make a "counter offer" in case price discovered through reverse book building is not acceptable to the promoter(s) or acquirer(s).
- Various timelines have been prescribed for counter offer process to implement the "Counter offer".
- The letter of offer for counter offer shall be in an abridged form containing relevant details pertaining to the counter offer, which shall include book value per share of company, activity schedule, etc.

10. SEBI issues consultation paper on 'Differential Voting Rights' ('DVR')

- SEBI has issued consultation paper on issuance of DVR for public comments to be received on or before April 20, 2019;
- The report proposes to provide a framework for issue of DVR for listed companies and for companies proposing to be listed on stock exchange(s);
- The issue of DVR as a mode of capital raising enables founders / promoters to have an autonomous space for managing and growing business without interference from fund infusers. It can be achieved by issue of shares with superior voting rights to founders and /or issue of shares with lower or fractional voting rights to raise funds from private / public investors;

¹⁵ Circular No.: SEBI/HO/CFD/DCR2/CIR/P/2019/35 dated March 13, 2019

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D. Corporate Law

11. Scheme of Arrangement: Issue of Non-Convertible Redeemable Debentures ('NCRD') out of accumulated profits under a Scheme of Arrangement

- Britannia Industries Limited has filed draft scheme of arrangement u/s 230 – 232 of the Companies Act, 2013 with Stock Exchange(s) proposing to issue fully paid up listed NCRD to its existing shareholders by utilising its excess retained earnings generated over the years;
- As the issuance of NCRD will be carried out from the retained earnings, it will constitute deemed dividend u/s 2(22)(b) of the ITA and accordingly, there will be levy of dividend distribution tax;

Katalyst comments:

Issuance of listed NCRD by way of utilizing accumulated profits of the company could be an alternative for giving one-time reward to the shareholders.

Bonus NCRD does not entail upfront significant cash outflow from the Company until the redemption. Additionally, it provides shareholders with regular interest income and upon redemption, they shall receive redemption amount.

12. Scheme of Arrangement: Reconstruction of capital of the company by reducing face value of shares by utilising debit balance of profit and loss account

- Himalchuli Food Products Limited ('Himalchuli') has filed draft scheme of arrangement u/s 230 – 232 r.w.s. 66 of the Companies Act, 2013 with BSE;
- Under the Scheme of Arrangement, reduction of face value of shares in Himalchuli will be carried out by utilising debit balance of profits and loss account, followed by a merger.

E. Stamp Duty Law

13. Tamil Nadu Stamp Duty entry for amalgamation or reconstruction notified

- Government of Tamil Nadu clarifies that stamp duty on property transfer in respect of the amalgamation or reconstruction of companies shall be levied at higher of the following:
 - 2% of the Market value of the immovable property; or
 - 0.6% of the aggregate market value of shares

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- Also, registration fees payable on such transaction is restricted to INR 30,000

Katalyst Comments:

The proposed amendment brings in much needed clarity on applicability of stamp duty and registration fees in Tamil Nadu on property transfer through a scheme of arrangement.

F. Special Economic Zone Act

14. Investment in Special Economic Zone (SEZ) through Trust route allowed

- Government of India (GoI) has notified an amendment to the definition of "person" u/s 2(v) of the Special Economic Zone (SEZ) Act, 2005 to include a trust and any other form of entity as may be notified by the GoI. This amendment will enable a trust to be considered for grant of permission to set-up a unit in a SEZ, including a unit to be set-up in the International Financial Services Centre (IFSC).

G. The Employees' Provident Funds and Miscellaneous Provisions Act, 1952

15. SC¹⁶ holds universality is the test to consider allowance as 'basic wages' for the determination of applicability of Provident Fund contributions

- A question before SC was raised that whether the allowances such as travel allowance, canteen allowance, special allowance, management allowance and conveyance allowance, etc, paid by an establishment to its employees would fall within the expression 'basic wages' for computation of contribution towards Provident Fund.
- Hon'ble SC has reiterated the principle that the crucial test to be applied for inclusion of allowances as part of "Basic Wages" is that of universality.
- The SC observed that to exclude an allowance from the ambit of basic wages, it must be demonstrated that the same is either (a) variable; or (b) linked to any incentive for production resulting in greater output by an employee; or (c) paid especially to those who avail the opportunity; and (d) that the allowance in

¹⁶ Multiple Appeals :

- a) The Regional Provident Fund Commissioner (II) West Bengal v. Vivekananda Vidyamandir And Others, Civil Appeal No. 6221 of 2011
- b) Surya Roshni Ltd. v. Employees Provident Fund and Others, Civil Appeal Nos. 3965-66 of 2013
- c) U-Flex Ltd. v. Employees Provident Fund and Another Civil Appeal Nos. 3969-70 of 2013
- d) Montage Enterprises Pvt. Ltd. v. Employees Provident Fund and Another, Civil Appeal Nos. 3967-68 of 2013
- e) The Management of Saint-Gobain Glass India Ltd. v. The Regional Provident Fund Commissioner, Employees' Provident Fund Organisation, Transfer Case (C) No.19 of 2019 (arising out of T.P. (C) No. 1273 of 2013)

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question is not paid across the board to all employees, in a particular category. Therefore, it must be demonstrated that the employee concerned had become eligible to get this additional amount beyond the regular work which he was otherwise required to put in, in which case, it should be excluded from the 'Basic Wages' on which provident funds is payable.

- After examining various judicial precedents¹⁷, the SC reached to the conclusion that allowances in question are essentially part of the basic wage camouflaged as part of an allowance so as to avoid deduction and contribution.

H. Indirect Taxes - Key GST Amendments

16. Rulings by the Appellate Authority of Advance Ruling ('AAAR'):

i. Taxability of sale of books, DVDs by a charitable trust

The Maharashtra AAAR¹⁸ has held that activities of selling of books, statues, CDs and DVDs for consideration by a charitable trust are covered under the ambit of 'business' and liable to GST.

ii. Taxability of food supplied at in-house factory canteen

The Gujarat AAAR¹⁹ has upheld the ruling of Advance Authority and held that supply of food & beverages to in-house factory canteen of the client is covered under the 'outdoor catering service' and liable to GST @ 18%.

iii. ITC for maintaining guest house for employees, not available

The Odisha AAAR²⁰ has reversed the findings of AAR and held that activities of maintenance of guest house, transit house and trainee hostel is not integral to appellant's business and hence, no ITC of the same is available.

¹⁷ Bridge and Roof Co. (India) Ltd. v. Union of India, (1963) 3 SCR 978; Muir Mills Co. Ltd., Kanpur v. Its Workmen, AIR 1960 SC 985; Manipal Academy of Higher Education v. Provident Fund Commissioner, (2008) 5 SCC 428; Kichha Sugar Company Limited through General Manager v. Tarai Chini Mill Majdoor Union, Uttarakhand, (2014) 4 SCC 37; The Daily Partap v. The Regional Provident Fund Commissioner, Punjab, Haryana, Himachal Pradesh and Union Territory, Chandigarh, (1998) 8 SCC 90

¹⁸ In the matter of Shrimad Rajchandra Adyatmik Satsang Sadhana Kendra [TS-924-AAAR-2018-NT]

¹⁹ In the matter of Rashmi Hospitality Services Pvt. Ltd. [TS-921-AAAR-2018-NT]

²⁰ In the matter of National Aluminium Company Ltd. (NALCO) [TS-77-AAAR-2019-NT]

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17. Clarifications²¹ regarding treatment of sales promotion schemes:

Sr no.	GST Applicability	Taxability	Documents	ITC availability to supplier	ITC availability to recipient
1	Free samples and gifts (for unrelated parties)	Not applicable	Not applicable	Not available	Not applicable
2	Free samples and gifts above INR 50000 for related parties/distinct persons/employee	GST applicable	GST tax invoice	Available subject to conditions	Available subject to conditions
3	Buy one-get one free	Not free supply. Supply of two goods at one value and rate depends upon type of supply i.e. mixed or composite supply	Tax invoice	Available subject to conditions	Available subject to conditions
4	Discounts including 'Buy more, save more offers i.e. Volume and segregated discount over a period of time	If agreed earlier as per Section 15(3), value of supply can be adjusted by way of a credit note	Credit note as per Section 34 of the CGST Act	<ul style="list-style-type: none"> • Output GST can be adjusted by issuing credit note • ITC of inputs, input services and capital goods available subject to conditions 	The recipient is required to reverse ITC so that supplier can adjust the output liability
5	Secondary discounts (not known at the time of supply)	If not agreed earlier at the time of	Not known earlier and	<ul style="list-style-type: none"> • No adjustment 	Available subject to conditions

²¹ Circular no. 92/11/2019-GST dated March 7, 2019

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		supply, discount should be included in value of supply	hence, commercial/financial credit note could be issued	of output GST liability <ul style="list-style-type: none"> ITC of inputs, input services and capital goods available subject to conditions 	
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18. GST update on Real Estate in 34th GST Council Meeting ²²– Notification awaited

Sr no.	Particulars	Comments
1	New rate (as discussed in previous GST council meeting)	<ul style="list-style-type: none"> 1% (without ITC) for affordable housing (60 sqm in non-metro/90 sqm in metro & INR 45 lakhs value); 5% (without ITC) for other than non-affordable housing; Real estate projects with commercial space upto 15% of total carpet area shall be treated as residential property for GST purposes
2	Option to ongoing projects	<ul style="list-style-type: none"> 1-time option to continue to pay tax at old rates of 8%/12% with ITC on ongoing projects If the option not exercised within time, new rates will apply
3	Conditions for new rates	<ul style="list-style-type: none"> ITC is not available 80% of inputs and input services [other than capital goods, Transferable Development Rights ('TDR'), Joint Development Rights ('JDR'), Floor Space Index ('FST'), Long term lease (premium)] purchased from registered person On shortfall of 80% purchase, GST @ 18% under RCM is payable by the builder under RCM Tax on Cement purchase from unregistered person is payable under RCM @ 28%

²² Press release dated March 19, 2019

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Sr no.	Particulars	Comments
4	Transition for ongoing projects opting for new rates	<ul style="list-style-type: none"> For ongoing projects – transition on pro-rata basis based on a simple formula such that credit in proportion to booking of the flat and invoicing done for the booked flat is available subject to a few safeguards Mixed project - Transition shall also allow ITC on pro-rata basis in proportion to carpet area of commercial portion in the ongoing projects (on which tax will be payable @ 12% with ITC even after April 2019) to the total carpet area of the project
5	Treatment of TDR/ FSI and Long-term lease for projects commencing after 01.04.2019	<ul style="list-style-type: none"> Exempt - subject to the condition that the constructed flats are sold before issuance of completion certificate and tax is paid on them If exemption withdrawn – tax limited to 1% of value for affordable housing and 5% of value for other than affordable housing The liability to pay tax on TDR, FSI, long term lease (premium) shall be shifted from land owner to builder under the reverse charge mechanism (RCM).
6	Amendment to ITC Rules	<ul style="list-style-type: none"> ITC rules shall be amended to clarify on monthly and final determination of ITC and reversal thereof in real estate projects ITC rules shall also clarify the procedures for availing ITC for commercial units in a mixed project

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