Katalyst Kaleidoscope

March 2021: Tax and Regulatory Insights

Summary of Contents

A. Income Tax highlights

1. SC: Payments made for use of software not taxable as royalty

A long-standing controversy on whether software is royalty has been resolved in favour of the appellant by the Supreme Court in case of **Engineering Analysis Centre of Excellence Private Limited**[1] wherein it held that that cross-border payments made for sale of software to a nonresident shall not be taxed as 'Royalty'.

The SC divided the batch of appeals into four categories as under:

(i) Cases where computer software is purchased directly by resident end-user from a non-resident supplier or manufacturer;

(ii) Cases where resident Indian companies act as distributors or resellers, by purchasing computer software from non-resident suppliers or manufacturers and then resell the same to resident Indian end-users;

(iii) Cases where the non-resident distributor or vendor purchases the software from a non-resident seller and resells the same to resident Indian distributors or end-users;

(iv) Cases where computer software is affixed onto hardware and is sold as an integrated unit/equipment by a non-resident supplier to resident Indian distributors or end-users.

Ruling in favour of the taxpayers, the SC made the following observations and comments:

SC observations on the transaction:

- The SC examined the provisions of the Copyright Act, and held that the creator of the computer programme has the exclusive right to do or authorize the doing of several acts in receipt of such work; the right to reproduce a computer programme and exploit the reproduction commercially is at the heart of the said exclusive right, however, the making of copies or adaptation of a computer programme in order to utilize the said computer programme for the purpose for which it was supplied, or to make up back-up copies as a temporary protection against loss, destruction or damage so as to be able to utilize the computer programme for the purpose for which it was supplied, ***does not constitute an act of infringement of copyright***.

- Further, on examination of the End-User Service Agreement ('EULA') / distribution agreement, the SC found that what was granted to the distributor was only a non-exclusive, non-transferable license to resell the computer software. Apart from a 'right to use' the computer programme by the end-user, there was no further right given to

[1] Civil Appeal No. 8733-8734 of 2018

sub-license or transfer, nor was there any right to reverse-engineer, modify or reproduce in any manner otherwise than permitted by the license to the end-user.

- Hence, the license that was granted was not a 'license' that transfers an interest in all or any of the copyright rights but is a 'license' that imposes restrictions or conditions on the use of computer software.

SC observations on TDS Liability:

- The SC noted that once a relevant Double Taxation Avoidance Agreement ('DTAA') applies, the provisions of the Income-tax Act, 1961 ('ITA') can apply to the extent they are more beneficial to the assessee and not otherwise. Further, Explanation 4 to Section 90 of the ITA stipulates that where a term is defined in the DTAA, the definition contained therein has to be applied. It is only where there is no such definition that the definition in the Act can be applied.

- The SC relied on its earlier ruling in **GE Technology Centre Private Limited**[2], where it was held that TDS deductions can only be made if the non-resident assessee is liable to pay tax under section 195 of the ITA.

- The SC ruling in **PILCOM**[3] case was distinguished (which was in the context of deduction u/s 194E of the ITA on payments made to non-resident sportsperson/association) and the SC observed that section 194E deals with TDS without reference to chargeability under the ITA by the concerned non-resident assessee.

Applicability of definition of "Royalty" amended retrospectively in the ITA:

- The SC acknowledged the fact that persons mentioned in Section 195 (i.e., deductors of tax at source) cannot be expected to do the impossible, that is, apply the expanded definition of royalty inserted by said explanation, for the relevant assessment year, at the time when such explanation was not actually and factually in the statute.

- The SC noted that once a relevant DTAA applies, the provisions of the ITA can apply to the extent they are more beneficial to the assessee and not otherwise. Further, Explanation 4 to Section 90 of the Act stipulates that where a term is defined in the DTAA, the definition contained therein has to be applied. It is only where there is no such definition that the definition in the Act can be applied.

[2] C.A. Nos. 8735-8736/2018
[3] 2020 SCC Online SC 426

Katalyst Comments:

As seen from above, the key issue was whether there was a right of reproduction by the person making the payment or not. If there is not right of reproduction, even if termed as a "license", it is an equivalent of a 'copyrighted article' and not a 'copyright right'. Ruling in favour of the taxpayers, the SC has elucidated that cross-border payments made for such software to a non-resident, shall not be taxed as 'Royalty'.

While the definition of 'Royalty' has been expanded vide Finance Act 2012 under the ITA, the judgement has granted the benefit of the beneficial provisions of the DTAA despite which would be applicable if the software transaction is undertaken by any non-resident assessee coming from a Treaty country.

2. Delhi ITAT: Rejection of Fair Value Report without sufficient reasoning by AO not justified

During the year under consideration, Rockland Hospitals Limited had subscribed to 3,26,741 equity shares of the assessee company (**Rockland Diagnostics Services Pvt Ltd**[4]) at INR 10 each (i.e., INR 32,67,410) at a share premium of INR 33 (i.e., INR 1,07,82,453).

An independent CA valued the equity shares on the on the basis Discounted Cash Flow ('DCF') method. The said basis was disregarded by the Assessing Officer ('AO') mainly on the ground that the valuation of equity shares was based on a projection of revenue which did not match with actual revenues of subsequent years. Consequently, the entire share premium was deemed as an "unjustified premium" and was accordingly taxed as income in the hands of the assessee company u/s 56(2)(viib) of the ITA.

The Delhi ITAT observed that as per section 56(2)(viib) of the ITA read with Rule 11UA of the Income tax Rules, 1962 ('IT Rules'), every assessee has an option to value the shares and determine its Fair Market Value ('FMV') either by DCF or Net Asset Value method and the AO cannot examine or substitute his own value in place of the value so determined. Since the AO has not pinpointed any specific inaccuracies or short comings in the valuation report and merely rejected the same on assumption, the Delhi ITAT held that the AO was not justified in rejecting the valuation report as submitted by the assessee and directed the AO to examine the issue afresh after giving due opportunity to the assessee to present its case.

Katalyst Comments:

(i) While the above ruling reassures the assessee to choose any option as prescribed to value the FMV of its shares, the fact that the ITAT has stated that since AO was unable to pinpoint any specific inaccuracies, leaves a chance for rejection of the DCF Valuation in case the assessee is unable to justify the suitable parameters of projections while determining the FMV under the valuation method adopted. Hence, it is important for

[4] ITA No. 316/Del/2019

assessees to take cognizance of the risks involved, if any, before conclusion of the relevant transaction. In any case, in cases concerning primary infusion into a company, Rule 11UA(2) of the IT Rules was amended in 2018 and subsequent to that amendment, only a SEBI-registered Category 1 merchant banker (and not a chartered accountant) can now issue a valuation report for the purposes of section 56(2)(viib) of the ITA. Therefore, the chances of litigation in relation to justification of valuation on a DCF basis may reduce.

(ii) The larger issue is that, expecting an assessee to justify that share premium is not "excessive", is a classic case of outlier legislation, and totally contrary to ease of doing business.

3. AAR: Capital gains upon sale of shares of Indian Company acquired prior to 31st March 2017 not taxable in India in the hands of Singapore-based Investment Company

BG Asia Pacific Holding Pte Limited ('BG Asia'), a Singapore-based investment company, had acquired ~ 65% stake in Gujarat Gas Company Ltd ('GGCL'), an Indian listed entity in 1990. In 2012, as part of its global restructuring exercise, BG Asia proposed to transfer its stake in GGCL as an 'off market transaction' and sought an advance ruling to determine its tax liability as per provisions of the IT Act and India – Singapore DTAA ('India-SG DTAA').

The AAR perused the facts of the case and held as under:

(i) **On divestment of shares in GGCL**: AAR observed that the decision to divest non-core businesses was not just limited to Indian jurisdiction but also extended to investments in Brazil and Italy pursuant to bonafide business restructuring. Hence, it quashed the Revenue's contention that that the affairs of the BG Asia were arranged with a primary purpose of availing treaty benefits.

(ii) **On investment activity being considered as bonafide business activity**: AAR also rejected the Revenues contention that assessee's group investment holding was not a bonafide business activity by relying on SC ruling in **Vodafone International Holdings B.V.**[5] and Andhra Pradesh HC ruling in case of **Sanofi Pasteur Holding SA**[6] and held that it is well established globally that investment business in itself a legitimate business.

(iii) **Applicability of minimum total annual expenditure of SGD 2,00,000 under Limitation of Benefit ('LoB') clause**: AAR took cognizance of the Tax Residency Certificate and the certificate issued by Tax Authority of Singapore certifying its annual expenditure and principal activity. Further, AAR also considered the details of dividend income, administrative expenses and payroll cost as per audited accounts for past 10 years

[5] (2012) 341 ITR 1 (SC)
[6] (2013) 354 ITR 316 (AP)

and opined that such expenses were much above the prescribed limit stipulated in Article 3.3 of the Protocol to the India-SG DTAA.

(iv) **Applicability of LoB clause to holding companies**: AAR rejected the Revenue's contention that the intention of LoB clause was to curb the use of holding companies, not having any bonafide business activity in India or Singapore, from getting any treaty benefits by stating that no such condition is mentioned in the India-SG DTAA that the Treaty benefit under Article 13(4) will not be available to holding companies and hence the one cannot read the DTAA and the Protocol beyond what is provided therein.

Katalyst Comments:

While this is a welcome ruling of the AAR for investors from Singapore and Mauritius who invested in India prior to 31st March 2017 and divest their shareholding thereafter, the Government needs to issue a circular to avoid such endless and needless litigation. The uncertainty around the finality of this position would lead to complex indemnities (both in time and value terms) being negotiated between the acquirers and the sellers, thereby adding to the timelines and uncertainty of deal consummation.

4. Ahmedabad ITAT: Loss in value of shareholding due to capital reduction by subsidiary, allowable as business loss

In this case, the assessee[7] had invested in share capital of its subsidiary namely Indian Britain BV and during the year under consideration, the said subsidiary had reduced its share capital, by way of share cancellation due to heavy losses. The losses incurred by the assessee of INR 99.90 Cr was not claimed as a deduction from profit and gains of business and profession in its return of income, but was claimed as a long-term capital loss by the assessee on account of write-off the said investment in the subsidiary

However, in the assessment proceedings, the assessee company claimed the aforesaid losses as business loss stating that investment in the subsidiary was made for the purpose of its business to set up supply chain system and manufacturing units in global overseas market. However, the AO disregarded the assessee's claim and the question before the Ahmedabad ITAT was whether the assessee was right in claiming long-term capital loss as revenue loss during the course of appellate proceedings.

The Ahmedabad ITAT observed that the assessee incurred losses on account of capital reduction, by way of share cancellation, by the subsidiary due to heavy losses incurred by it on account of recession in textile industry in Europe. Hence, due to deterioration of economic conditions, continued financial difficulty and other adverse factors, the subsidiary incurred huge losses and became a sick unit.

[7] Dy. CIT vs. GHCL Ltd. & 10 others

Hence, the ITAT allowed the claim of the assesse by stating that since it has made an investment in subsidiary company on account of business development out of commercial expediency, accordingly on reduction of its capital of the said subsidiary, the loss incurred in the value of shares were in the nature of business losses.

Katalyst Comments:

This judgment substantiates the premise that "business" can not only be undertaken by the company itself, but can also be deemed to have been undertaken by the company itself, even if the business is actually carried out by its subsidiary. From a commercial perspective, it should not matter if the business is actually undertaken by the company or its subsidiary, as long as it could be considered as a logical extension of the business of the company. The principle expounded by this judgment could form a basis of to not only claim business losses of the holding company but also help in demonstrating that an "investment in subsidiary" is not a mere investment but an extension of the company's business and therefore, an integral "undertaking" of the company.

5. CBDT notification on residential status of individuals visiting India in FY 2019-20 and facing double taxation due to forced stay in India

CBDT issued a circular[8] wherein it has been provided that if any individual is facing double taxation even after taking into account the reliefs provided by the relevant DTAA, such individual may electronically furnish the specified information by 31st March 2021 in 'Form – NR' (prescribed format annexed to the said Circular).

The Form-NR will be submitted to the Principal Chief Commissioner of Income-tax (International Taxation) for further examine the below:

(i) Whether any relaxation is required to be provided in the case of that particular individual taxpayer; and

(ii) If required, then whether general relaxation can be provided for a class of individuals or specific relaxation is required to be provided in individual cases.

Katalyst Comments:

On directions received by the SC[9] and in an attempt to provide "relief" to Non-residents who were forced to stay back in India, CBDT has issued the above circular which merely stresses upon the existing provisions under the ITA and DTAA and what their implications would be in the existing circumstances.

[8] CBDT Circular No. 2 of 2021 dated 3rd March 2021
[9] Dated 10th February 2021

CBDT has unfortunately not addressed issue in case of such NRIs who would generally make regular visits to India and were genuinely stranded in India due COVID-19 pandemic in FY 2020-21. The said circular is a half-hearted attempt to comply with the direction of the SC and does not address the certain issues, including the following:

- *An increase in tax liability on Indian-sourced income such as interest income* or *dividend income, as a result of becoming a resident of India (i.e., increased in tax liability from 28.5% to 36% (for Indian dividend income) or 43% (for other income such as interest income);*

- *The distinction between the status of "Resident and Ordinary Resident" ("ROR") and Resident but Not Ordinary Resident ("RNOR") is not taken into account – as a result of becoming a ROR (say, on account of forced stay in India for more than 182 days), there will be hardships faced by the taxpayer in terms of tax compliances and disclosures in the return of income;*

- *Although the said clarification that the taxpayer may only become a RNOR in India and therefore, only his foreign income would be taxed in India, the said circular fails to acknowledge that if a taxpayer stayed in India for more than 182 days and if such taxpayer was not a NR for 9 out of 10 preceding financial years, then such taxpayer would become a ROR and not RNOR; and*

- *Lastly, the said circular does not take into account, at all, the possibility that a taxpayer may involuntarily become a resident only by virtue of the provisions of ITA in cases where there is no DTAA entered into by India with that particular country.*

6. Insertion of Rule 29BA and Form 15E for payers to apply for certificate under section 195(2) of the ITA for lower withholding tax for payment to non-residents

Provisions of section 195(2) provide that where the person responsible for paying sum chargeable under the ITA to a non-resident considers that the whole of such sum would not be income chargeable in the case of the recipient, he may make an application to the AO to determine the ***appropriate of such sum so chargeable*** and upon such determination, tax shall be deducted only on that proportion of the sum which is so chargeable. However, no format was prescribed for making the application under such provisions and hence, deductors / payers made an application on plain paper and physically submit it to the AO.

In order to streamline the above process, CBDT has inserted Rule 29BA[10] under IT Rules laying down the standard operating procedures for deductors / payers applying to the AO to determine an appropriate proportion of sum (other than Salary) payable to non-resident

[10] Notification No. 18/2021 F. No. 370142/24/2019-TPL dated 16th March 2021 inserting Income-tax (5th Amendment) Rules, 2021

which is chargeable to tax and has prescribed the format under Form 15E to operationalize the provisions of the section 195(2) of the Act.

7. Provisions inserted to report information relating to income from Capital Gains, Dividend and Interest in Statement of Financial Transaction ('SFT')

CBDT vide a Notification[11] has amended Rule 114E of the IT Rules read with Section 285BA of the ITA thereby widening the scope of transactions to include information relating to capital gains, dividend income, and interest income to also be furnished under SFT. As per the notification the income and the person required to report the same is as under:

Sr. No	Income / Transaction	Specified Reporting Person
1	**Capital gains on transfer of listed securities or units of Mutual Funds**	• Recognized Stock Exchange • A Depository • Recognized Clearing Corporation • Registrar of Shares.
2	**Dividend Income**	• A Company declaring dividend
3	**Interest Income**	• A banking company or a co-operative bank • Post Master General • A registered deposit accepting NBFC

The above shall come into force from the date of its publication in the Official Gazette i.e., 12th March 2021.

<u>Katalyst Comments:</u>

As announced in the recent Budget Speech, the purpose of reporting of the above transactions seem to provide taxpayers with this information pre-filled in the ITR form. However, as there are no monetary limits set for reporting these transactions, all the transactions would be reported by the 'specified persons' to the Revenue Department. Hence, if an individual liquidates his mutual funds, earns dividend or interest income, such incomes will be shared with the tax department, without any monetary thresholds.

8. 'Notice of Amendments' to Finance Bill 2021 introduced in the Lok Sabha

The Finance Minister, has introduced 'Notice of Amendments' to the Finance Bill, 2021[12] in the Lok Sabha, wherein several amendments have been proposed to the original Finance Bill, 2021 which was introduced in the Lok Sabha on 1st February 2021. Key amendments proposed are as under:

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[11] No. 16/2021 dated 12th March 2021 and Income-tax (4th Amendment) Rules, 2021
[12] Finance Bill 2021, Notice of Amendments dated 22nd March 2021 as introduced in Lok Sabha

(i) **Insertion of New Provision under section 9B:** New provisions have been inserted to provide that where a partner or a member ('specified person') of a firm or other association of person / body of individuals ('specified entity') receives a capital asset or stock in trade ('identified asset') upon dissolution or reconstitution (i.e., admission, retirement or change in profit sharing ratio of the specified person in the specified entity), then the specified entity is deemed to have transferred such identified asset in the year in which such asset was received by the specified entity. The income would be chargeable to tax either under the head "Profits or gains of business or profession" or "Capital Gains" in accordance with the provision of IT Act in the hands of specified entity.

<u>Katalyst Comments:</u>

This provision is specifically inserted to tax distribution of any asset (either capital asset or stock in trade or any sum of money) in the hands of the specified entity, on the difference between the credit balances in the specified person's capital account and the value of assets/ amount of money so distributed, at the time of reconstitution of the specified entity in any manner.

(ii) **Definition of "written down value" ('WDV') to give effect goodwill the in block of assets:** The Notice of Amendment to Finance Bill 2021 provides that for AY 2021-22 (FY 2020-21), block of assets which includes goodwill is required to be reduced by an amount equal to the actual cost of goodwill as further decreased by -

- Actual amount of depreciation allowed before 1st April 1988; and
- Amount of depreciation allowable on such goodwill after 1st April 1988 as if the goodwill was the only asset in the relevant block.

However, the amount of such reduction shall not exceed the value of WDV of goodwill.

(iii) **Definition of 'Net worth' amended under provisions of Slump sale:** It is proposed to provide that the net worth as provided under section 50B(2) of the ITA (for computation of capital gains on slump sale) shall not include goodwill which has not been purchased by the assessee and the cost of acquisition to be regarded for such self-generated goodwill as NIL. It further provides that in case "capital assets" are forming part of the slump sale undertaking, its Fair Market Value on the date of transfer shall be deemed to be full value consideration received or accruing from transfer.

B. Corporate Law Highlights

1. Definition of Small Company amended and rules for One Person Company eased

(i) **For Small Company[13]:** Pursuant to the announcement made by the Finance Minister in the Budget 2021, MCA has amended the Companies (Specification of Definitions Details) Rules, 2014 by revising the threshold of paid-up share capital from INR 50 lakh to INR 2 Crore and turnover from INR 2 Crore to INR 20 Crore. The same will be effective from 1st April 2021.

Katalyst Comments:

This will not only help "small" companies but will also help relatively medium sized companies from various procedural compliances. Further, any merger between such small companies can also be undertaken with the approval of the Regional Director directly and without the approval of National Company Law Tribunal ('NCLT'), thereby streamlining the timelines for merger between such companies. Typically, any merger between promoter companies or subsidiaries of a large listed or unlisted company, etc. could be benefitted by the aforementioned amendment.

(ii) **For One Person Company[14]**:

- Reduction of the residency limit for an Indian citizen to set up an OPC from 182 days to 120 days and has granted permission to Non-Resident Indian citizens to incorporate OPCs.
- The lock-in period of 2 years (from the date of incorporation of OPC) for the purpose of voluntary conversion of status has been done away with.
- Further, OPCs have been permitted to convert into Public / Private Companies (other than Section 8 Company), without any thresholds' cross over on paid-up capital and turnover.

2. Issue of Standard Operating Procedures for NCLT Benches to resume regular physical hearing w.e.f. 1st March 2021

NCLT an order[15] dated 26th February 2021, issued an SOP for physical hearing and virtual hearing to come in force from 1st March 2021.

The said SOPs will be applicable to all NCLT Benches and has specified that while all NCLT benches will continue to receive online filing of cases through the e-portal, the Advocates /

[13] MCA notification No. G.S.R 92(E) dated 1st February 2021
[14] MCA notification No. G.S.R 91(E) dated 1st February 2021
[15] File No. 10/03/2021-NCLT dated 26th February 2021

Representatives of the parties who opt to attend the hearing through Video Conference may send request with the item number to the concerned court officer.

C. Securities' Law Highlights

1. SEBI proposes new norms for Independent Directors

SEBI has issued a consultation paper[16] recommending changes in the manner of appointment, removal and remuneration of Independent Directors ('IDs') and their role in the audit committees of a listed entity. The key proposals laid down by SEBI are as under:

(i) **Definition of ID**: It is proposed a key managerial person or his relative, and anyone that has had a material pecuniary relationship with the company, its subsidiaries or promoters, can be appointed as an independent director in a listed entity only three years from the date when he ceases to have a pecuniary or employment relation with the listed entity (cooling – off period).

(ii) **Dual Approval Process for Appointment, Reappointment and Removal of IDs:**

Keeping in mind the interest of public shareholders, SEBI has proposed a dual approval process for appointment, re-appointment or removal of independent directors from the board of a listed entity as under:

- Appointment, reappointment or removal of independent director would require approval of both — shareholders (via an ordinary or a special resolution as case may be) and also majority of minority shareholders (via simple majority).
- Both votes would be done through a single process and meeting.
- Any candidate failing to get dual approval can be proposed again for independent directorship via a second vote after a period of Ninety days. The vote in such a case would be via a special resolution put to all shareholders.
- The same process would apply for removal of independent directors.

SEBI has also proposed more detailed disclosures by the Nomination and Remuneration Committee regarding selection of candidates for post of ID. And, in the case of vacancy in an ID post, the new candidate appointed by the board must be subject to shareholder approval within 3 months.

(iii) **Resignation of ID:** Noting the need to strengthen disclosures around resignation of ID, SEBI has proposed that:

- Entire resignation letter must be disclosed to the shareholders along with a list of his membership in committees of the board.

[16] Consultation Paper on Review of Regulatory Provisions related to Independent Directors as published on SEBI's website on 1st March 2021

- An independent director who resigns from a board citing pre-occupation, personal commitments etc. will be subject to a cooling period of 1 year before joining any other board.

(iv) **Audit Committee:** SEBI has proposed that 2/3rd of the total strength of an audit committee must comprise of IDs, while the remaining must be non-executive directors who are not related to the promoter.

(v) **Grant of ESOPs:** SEBI has proposed to allow long-vesting ESOPs thereby linking remuneration to profit or performance linked commission so that the IDs have "skin in the game".

SEBI has now sought the views of MCA on this issue as well as stakeholder comments by 1st April 2021.

Katalyst comments:

SEBI and the provisions of Companies Act have been tightening the framework for IDs making them increasingly accountable for the actions of promoters and managements, former CEOs and other executive directors. Due to such fiduciary responsibilities, it has become onerous for IDs and they are hesitant to accept appointments due to high risk and responsibilities attached to their responsibilities. While the purpose of introduction of SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, initially, was to have a "principle-based approach" rather than a "prescription-based approach" (which was so previously in many cases), with more specific regulations coming into play, such as the above, the Indian regulatory environment would move back to the latter, rather than the former.

2. SEBI guidelines on votes to be cast by Mutual Funds

To improve transparency and encourage Asset Management Companies ('AMCs') / Mutual Funds to diligently exercise their voting rights in best interest of the unit holders, SEBI has framed additional guidelines[17] which would be effective from 1st April 2021.

The key guidelines as stated by SEBI in this regard are as under:

(i) Mutual Funds (including their passive investment schemes like Index Funds, Exchange Traded Funds etc.) are required to compulsorily cast votes in respect of resolutions including
- Corporate governance matters, including changes in the state of incorporation, merger and other corporate restructuring provisions and anti-takeover provisions;

[17] SEBI Circular No. SEBI/HO/IMD/DF4/CIR/P/2021/ 29 dated 5th March 2021

- Changes to capital structure;
- Social and Corporate Social Responsibility issues;
- Appointment and removal of Directors, stock option plans and other management compensation issues;
- Related Party Transactions of the investee company; and
- Any other issue that may affect the interest of the shareholders in general and of the unit holders in particular.

(ii) The Mutual Funds shall also be compulsorily required to cast their votes for all remaining resolutions which are not covered as above with effect from 1st April 2022. However, SEBI has exempted those Mutual Funds having no economic interest on the day of voting, from compulsorily casting such votes.

(iii) SEBI has mentioned that the votes shall be casted at 'Mutual Fund Level', and in case any Fund Manager of any specific scheme have a strong view against the other schemes' Fund Manager(s), the voting at scheme level shall be allowed, subject to recording of detailed rationale for the same;

(iv) Lastly, SEBI has directed the Fund Managers / Decision makers to submit a declaration on quarterly basis to the Trustees that the votes cast by them have not been influenced by any factor other than the best interest of the unit holders.

Katalyst Comments:

While the rationale to incorporate such obligatory guidelines on Mutual Funds and Asset Management Companies is to improve the market conditions, infuse more transparency, and encourage them to carefully exercise their voting rights in the best interest of the unit holders, however, the mandatory requirement of casting votes even in case of passive investment schemes, recording of detailed rationale by fund managers in case of conflict of views and submission of quarterly declarations to Trustees would be highly cumbersome and adds yet another compliance burden on the fund houses.

D. Foreign Exchange Laws Highlights

1. RBI eases rules for Foreign Portfolio Investors ('FPI') investments in NCDs and bonds under default

Currently, FPI investments in corporate bonds are subject to a minimum residual maturity requirement, short-term investment limit[18] whereby, the minimum residual maturity of not more than 30% of the NCDs held by the FPI shall not be less than 12 months. However, FPI

[18] Paragraph 4 (b)(ii)) and the investor limit (paragraph 4(f)(i)) in terms of Investment by Foreign Portfolio Investors (FPI) in Debt – Review Directions

investments in security receipts and debt instruments issued by Asset Reconstruction Companies and debt instruments issued by an entity under the Corporate Insolvency Resolution Process as per the resolution plan approved by the NCLT under the Insolvency and Bankruptcy Code, 2016 are exempt from these requirements.

Accordingly, RBI[19] has decided to exempt investments by FPI in Non-convertible Debentures ('NCDs') / bonds which are under default, either fully or partly, in the repayment of principal on maturity or principal instalment in the case of amortizing bond from the aforesaid requirements, thereby easing the norms for FPIs to invest in NCDs or bonds which are under default.

Katalyst Comments:

The RBI, in its monetary policy announcement on 5th February 2021, had stated that that investment by FPIs in defaulted corporate bonds will be exempted from short term limit and minimum residual maturity requirement under the medium-term framework. The above norms are introduced in relation to such announcement.

2. Department for Promotion of Industry and Internal Trade ('DPIIT'): Downstream investment made by NRI on non-repatriation basis to also be treated as domestic investment

As per Foreign Direct Investment Policy ('FDI') Circular of 2020 and Schedule IV of Foreign Exchange Management (Non-Debt Instruments) Rules, 2019, investments by Non-resident Indians ('NRIs') on non-repatriable basis are considered deemed to be at par with domestic investments made by residents.

The DPIIT[20] has now inserted a new clause (c) under Para 1.2(ii) in Annexure 4 of the FDI policy stating that the downstream investments by an Indian company owned and controlled by a NRI on a non-repatriation basis shall not be considered for calculation of indirect foreign investment. Accordingly, downstream investment by such Indian companies will also not be treated as FDI in India.

Katalyst Comments:

The above clarification is helpful for Indian company's which are owned and controlled by NRI and propose to undertake downstream investments, especially in sectors which have specified threshold / limits prescribed for FDI in India. While this is still at the policy stage, a corresponding amendment to the FEMA (Non-Debt Instrument) Rules, 2019 should come shortly.

[19] A.P. (DIR Series) Circular No. 12 dated 26th February 2021
[20] Press Note No. 1 (2021 Series) dated 19th March 2021

This amendment also substantiates the principle that, while any investment may be held by a non-resident, as long as it is held on a non-repatriable basis, it is as good as a domestic investment for the purposes of FEMA since the cross-border repatriability of sale or divestment proceeds from such investments is fully restricted (in excess of USD 1 Mn per financial year), therefore, for all practical purposes, it is akin to an investment made by a resident.

3. Bill introduced to increase FDI in Insurance sector to 74% introduced in Rajya Sabha

An Insurance (Amendment) Bill, 2021 is introduced in the Rajya Sabha, which inter alia seeks to raise the FDI limit in an Indian insurance company from the existing 49%, to 74% and to allow foreign ownership and control with safeguard.

The Bill, according to its Statement of Objects and Reasons, is aimed at achieving the objective of Governments FDI Policy of supplementing domestic long-term capital, technology and skills for the growth of the economy and the insurance sector, and thereby enhance insurance penetration and social protection.

Further, the Bill proposes to amend the definition of "Indian insurance company" to mean a company in which the aggregate holdings of equity shares by foreign investors including portfolio investors, do not exceed 74% of the paid-up equity capital of such Indian insurance company, and the foreign investment in which shall be subject to such conditions and manner, as may be prescribed.

Katalyst Comments:

The earlier intent was to have the insurance companies as Indian-owned and controlled entities. This created restrictions and limitations from the perspective of raising capital to maintain solvency, exit for Indian promoters, entry of foreign strategic and financial investors, etc. In order to address the above, the present policy initiative is laudable. However, only time will tell whether this move will actually attract investors, since Budget 2021 stated new structure will have certain safeguards (rather restrictive conditions), viz., that the majority of Directors on the Board and key management persons shall be resident Indians, with at least 50% of Directors being Independent Directors, and specified percentage of profits being retained as general reserve.

E. Insolvency & Bankruptcy Code, 2016

SC: Person ineligible to submit resolution plan for Corporate Debtor, also cannot propose a scheme of arrangement

Vide a ruling dated 24th October 2019, NCLAT had held that a person who is ineligible u/s 29A of the Insolvency and Bankruptcy Code 2016 ('IBC') to submit a resolution plan is also barred from proposing a scheme of compromise and arrangement between the erstwhile promoters and creditors under section 230 of the Companies Act before the NCLT.

The Promoter of the Corporate Debtor (i.e., Gujarat NRE Coke Limited) challenged the NCLAT order on the ground that Section 230 of the Companies Act does not place any embargo on any person for the purpose of submitting a Scheme of Arrangement and accordingly, in the absence of a disqualification, NCLAT could not have read the ineligibility under section 29A of IBC into Section 230 of the Companies Act.

The SC very categorically held that that the stages of submitting a resolution plan, selling assets of a company in liquidation and selling the company as a going concern during liquidation, all indicate that the promoter or those in the management of the company must not be allowed a back-door entry in the company and are hence, ineligible to participate during these stages. Accordingly, it held that proposing a scheme of compromise or arrangement under Section 230 of the Companies Act, while the company is undergoing liquidation under the provisions of the IBC lies in a similar continuum.

Since section 29A read with section 35(1)(f) of the IBC disqualifies former promoters from participating in the insolvency process, such disqualification also extends to a proposal for revival under Section 230 of the Companies Act. Hence, the promoter of a company undergoing liquidation under IBC cannot propose a scheme of compromise and arrangement for revival with lenders even if there are no resolution plans submitted for the Corporate Debtor.

Katalyst Comments:

Section 29A of IBC is designed to prevent a backdoor entry to a class of persons considered to be ineligible to participate in a resolution process. Further, section 35 (1)(f) extends this ineligibility where the liquidator is conducting a sale of the assets of the corporate debtor in liquidation. In the context of the statutory linkage provided by the provisions of Section 230 of the Companies Act and the provisions of IBC, the SC has rightly held that where a scheme is proposed of a company which is in liquidation under the IBC, it would be far-fetched to hold that the ineligibilities which attach under Section 35(1)(f) read with Section 29A would not apply when Section 230 is sought to be invoked.

F. Other Highlights

1. IFSCA consultation paper regarding all-encompassing framework to facilitate issuers access to global capital in IFSCs

IFSC has issued a consultation paper titled 'Consultation Paper on Proposed International Financial Services Centres Authority (Issuance and Listing of Securities) Regulations, 2021' on 10th March 2021 wherein it is proposed to unify a regulatory framework for issuance and listing of securities for several types of issuers. The comments have been invited by 31st March 2021.

Some key features as outlined in the consultation paper are as under:

(i) The regulatory framework is intended to be for the following types of listing:
- An initial public offer of specified securities by an unlisted issuer;
- A follow-on public offer of specified securities by a listed issuer;
- Listing of specified securities by a start-up company or a SME;
- Secondary listing;
- An initial public offer of specified securities by a SPAC;
- Listing of depository receipts;
- Listing of debt securities (including SMART City bonds); and
- Listing of ESG focused debt securities.

(ii) The salient features of raising of capital through IPO on a recognized stock exchange through IFSC contains certain conditions including an issuer being eligible to make an IPO only if it has an operating revenue of at least USD 20 Mn in the preceding financial year or an average pretax profit of at least USD 1 Mn during preceding 3 years and an offer size being not less than USD 15 Mn.

(iii) A Special Purpose Acquisition Vehicle ('SPAC') shall be eligible to raise capital through IPO of specified securities on the recognized stock exchanges in IFSC, only if:

- The primary objective of the issuer is to effect a merger or amalgamation or acquisition of shares or assets of a company having business operations ("business acquisition").

- The issuer does not have any operating business.

- Additionally, the IPO size should not be less than USD 50 Mn, the sponsor should hold at least 20% of the post issue capital and the minimum application size in an IPO of SPAC would be USD 250,000.

Katalyst Comments:

This is a significant development, but as always, the key would be the conditionalities and of course, the implementation. Incidentally, ReNew Power, a pure play renewable energy provider has recently merged into a SPAC; the enterprise value is about USD 8 bn and the investors will hold 70% in the combined entity.

2. Central Government issued Information Technology (Guidelines for Intermediaries and Digital Media Ethics) Code) Rules, 2021

The Ministry of Electronics and Information Technology ('MEITY') and the Ministry of Information and Broadcasting 'MIB') have notified the Information Technology (Intermediary

Guidelines and Digital Media Ethics Code) Rules, 2021 on 25th February 2021 thereby laying down new codes of ethics for social media platforms and Over the Top ('OTT') platforms.

This new framework requires social media and OTT platforms to adhere to several guidelines, some of which are outlined as under:

(i) **Categories of Social Media Intermediaries**: Based on the number of users on the social media platform, intermediaries have been divided in two group i.e., Social Media intermediaries and Significant social media intermediaries

(ii) **Due Diligence to be followed by Intermediaries**: In case, due diligence is not followed by the intermediary, safe harbor provisions will not apply to them which protect social media intermediaries by giving them immunity from legal prosecution for any **content** posted on their platforms.

(iii) **Mandatory Grievance Redressal Mechanism:**

- Intermediaries shall appoint a Grievance Officer to deal with complaints and are required to share the name and contact details of such officers. Such appointed Grievance Officer shall acknowledge the complaint within twenty-four hours and resolve it within fifteen days from its receipt.

- A three-level grievance redressal mechanism is to be established under the rules with different levels of self-regulation such as
  - Level-I: Self-regulation by the publishers;
  - Level-II: Self-regulation by the self-regulating bodies of the publishers;
  - Level III: Oversight mechanism

G. Goods and Service Tax Highlights

1. CERA Audit cannot be extended to call for audit of a private equity

In a writ petition[21] filed before the Bombay High Court, it was held that an audit by officers of the Central Excise Revenue Audit (CERA) as per section 16 of the Comptroller and Auditor General's (Duties, Powers and Conditions of Service) Act, 1971 [CAG's (DPC) Act] pertaining to the audit of all receipts that are payable into the Consolidated Fund of India (and of each State and of each Union Territory) is required to be construed with respect to the accounts maintained in the Government departments / corporations belonging to the Government. Thus, CERA audit cannot be extended to audit a private entity. The notice was quashed which suffers from want of jurisdiction and statutory authority.

[21] Writ petition no. 1135 of 2019

Katalyst comments:

The judgment provides that the CERA audit cannot extend to private entities. This will support taxpayers to contest if such audits are initiated by the department. However, it is pertinent to note that there are independent powers to audit the accounts of private companies under pre-GST and GST regime.

2. The correctness and legality of tax paid by service provider cannot be challenged to deny credit to a service recipient

The appellant, a General insurance company entered into an agreement with car manufactures to issue insurance policies through car dealer network. For the services provided by the dealers, dealers raised the invoice and appellant availed the credit which was challenged.

In this regard, the Chennai bench of Customs Excise and Service Tax Appellate Tribunal (CESTAT)[22] has held that in case of any doubt about the actual nature of service provided vis-à-vis the particulars mentioned in an invoice to avail input credit, the service provider would be required to be reassessed and the service recipient cannot be denied credit basis the invoice raised by the service provider.

Katalyst comments:

The CESTAT has upheld the principle that the onus of determining the correctness of the nature of service provided is on the service provider and it should not affect the credit entitlement of the service recipient. However, the GST law provides other conditions for availment of ITC which put the onus on service recipient and the principle laid down by the judgment may not be entirely relevant.

3. Activities of liaison office in India of a Foreign entity do not amount to supply

Karnataka Appellate Authority of Advance Ruling ('AAAR')[23] has set aside the order of AAR and held that activities of liaison office ('LO') located in Bengaluru of the appellant (a company incorporated in Germany) are not covered within the purview of supply u/s 7 of the CGST Act, 2017 due to the fact that LO is defined (as per section 6(6) of Foreign Exchange Management Act (FEMA), 1999) as a place of business to act as communication channel and who does not undertake any commercial / trading / industrial activity and maintains itself out of inward remittances received from abroad. Also, RBI permission given to LO is subject to condition that LO will not generate income and not engage in any trade/commercial activity while such

[22] 2021 (3) TMI 24 (Chennai-CESTAT)
[23] In the matter of Fraunhofer-Gesellschaft Zur Forderung [TS-73-AAAR(KAR)-2021-GST]

LO will not have any signing/commitment powers & cannot earn any commission/fee or any remuneration.

Further, the AAAR has also clarified that LO in India is the geographical extension of parent company in Germany and LO does not have separate legal existence in law and hence, in absence of existence of two separate 'persons' as per GST law, LO and parent company in Germany are not 'related person'.

Katalyst comments:

A welcome ruling by the Karnataka AAAR. The AAAR has also clarified that LO in India and HO outside India are not related persons.

4. Refund[24] related issues clarified

(i) Para 41 of Circular No. 125/44/2019-GST dated 18th November 2019 modified to remove the restriction of non-availment of ITC by recipient of deemed export supplies on the invoices, for which refund has been claimed by such recipient;

(ii) For the purpose of Rule 89(4) of the CGST Rules, 2017 ('CGST Rules'), the value of export / zero rated supply of goods to be included while calculating "adjusted total turnover" will be same as being determined as per the amended definition of "Turnover of zero-rated supply of goods" in the said sub-rule;

(iii) The restriction of 150% of the value of like goods domestically supplied, as applied in "turnover of zero-rated supply of goods", would also apply to the value of "Adjusted Total Turnover" in Rule 89 (4) of the CGST Rules.

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[24] Circular No. 147/03//2021-GST dated 12th March 2021