KATALYST ADVISORS

Katalyst Kaleidoscope

March 2022: Tax and Regulatory Insights

SUMMARY OF CONTENTS

A. Income tax highlights

1. Change in shareholding of ultimate parent company should not trigger disallowance of set-off of brought forward losses [1]

The taxpayer, a WOS of WSP GRP Cyprus Holding Limited ("WSP Cyprus"), claimed set off of brought forward losses which was disallowed by Revenue on the basis that there had been a change in the taxpayer's ultimate holding company and hence, under section 79 of the Income-tax Act, 1961 ("Act"), such losses could not be set-off.

On appeal, Delhi Income-tax Appellate Tribunal ("ITAT") observed that in the year of incurrence of loss and in the year in which the loss was being set-off, there was no change in the shareholding pattern of the taxpayer. It also observed that WSP Cyprus, being the immediate holding company, continued to hold 99.9% of the shares of the taxpayer. Relying on the decision of Delhi High Court ("HC") in the case of Yum Restaurants, Delhi ITAT stated that it is a well settled proposition that registered shareholder is to be considered the beneficial owner of shares, unless such shares are held in the capacity of a nominee/agent/trustee of the real owner and thus, upheld the Commissioner of Income-tax (Appeal)'s order deleting the disallowance of set-off of brought forward losses under section 79 of the Act.

Katalyst comments:

While Delhi HC in case of Yum Restaurants[2] has held that ultimate beneficial holding is not relevant in determining the applicability of section 79 of the Act, Karnataka HC in the case of AMCO Power Systems[3] and Mumbai ITAT in the case of Wadhwa & Associates Realtors[4] have held that section 79 of the Act should not be triggered even if there is a change in the immediate shareholders, so long as the beneficial ownership/ voting power remains with the same entities. Clearly, the unfortunate trend of conflicting decisions/judgements is not helping.

2. Guarantor to a Share Purchase Agreement not liable to withhold tax on payment made by its wholly owned subsidiary towards acquisition of shares[5]

The assessee was a US-based company ("US Hold Co"). Its wholly owned subsidiary ("WOS"), also a US-based company acquired shares of a Bermuda based company called Techpac

[1] WSP Consultants India Pvt. Ltd [TS-151-ITAT-2022(DEL)]
[2] TS-7-HC-2016(DEL)
[3] TS-607-HC-2015(KAR)
[4] TS-82-ITAT-2018(Mum)
[5] Ingram Micro Inc. [TS-160-HC-2022(BOM)]

Holding Ltd ("THL"), which indirectly held shares in an Indian subsidiary, in FY 2004-05 under a Share Purchase Agreement ("SPA"). US Hold Co. merely acted as a guarantor for its WOS in the SPA. Based on the annual report of the US Hold Co (which referred to acquisition of THL) found during the search and seizure proceedings from its Indian step-down subsidiary, the revenue authorities issued show cause notice to the US Hold Co with respect to withholding obligation under section 195 of the Act on payments made for acquisition of THL shares.

Pursuant to a writ petition filed by the US Hold Co, Bombay HC observed that there is nothing to indicate that the US Hold Co made any payment to anyone, and it had only extended a guarantee which was not invoked, since the WOS did not default in payment of purchase consideration to THL's shareholders. Bombay HC observed that the annual report only indicates what the group achieved, and it cannot, by any stretch of imagination, be held that it was the US Hold Co who had purchased and paid for the shares of THL. Bombay High Court referred to the SPA which has been signed by the WOS (and not the US Hold Co) and held that the shares were purchased by the WOS and not the US Hold Co and therefore, the question of invoking section 195 of the Act on the US Hold Co does not arise, since it was only a guarantor of the share purchase transaction.

3. Lok Sabha passes Finance Bill, 2022 with amendments; receives Presidential assent [6]

Lok Sabha was presented on March 23, 2022 with the Finance Bill, 2022 with several amendments made to the Bill issued on February 1, 2022 ("Initial Finance Bill"). On March 25, 2022, Lok Sabha has passed the Finance Bill along with the amendments. On March 30, 2022, the President has given his assent to the Bill as passed by Lok Sabha. A gist of key amendments made to the Initial Finance Bill is captured below:

Provisions as per Initial Finance Bill, 2022 introduced on February 1, 2022	Amendments as approved by Lok Sabha/our comments
Assessment on successor entity in case of Business Reorganisation – section 170	
Sub-section (2A) was introduced to provide that the assessment or other proceedings made on the predecessor (i.e., amalgamating or demerged company) during the pendency of business reorganization (involving amalgamation or demerger of business), shall be deemed to have been made on the successor (i.e., amalgamated or resulting company).	- The term "business reorganisation" has been replaced with "succession" and the definition of the term "business reorganisation" has been deleted. - While "succession" has not been defined, it connotes a wider meaning and could include slump sale in addition to amalgamation or demerger based on judicial precedents.

[6] WSP Consultants India Pvt. Ltd [TS-151-ITAT-2022(DEL)]

Provisions as per Initial Finance Bill, 2022 introduced on February 1, 2022	Amendments as approved by Lok Sabha/our comments
Revision of tax return in case of Business Reorganisation – section 170A	
Section 170A was introduced to enable the successor entities to file modified returns in line with the National Company Law Tribunal ("NCLT")/ High Court order regarding the business reorganization within 6 months from the end of the month in which merger/ demerger order is issued.	- "Business reorganization" has been defined to mean reorganization of business involving amalgamation, merger, or demerger. - Also, "successor" has been defined to mean all resulting companies in the business reorganization.
TDS on long term capital gains under section 112A for non-residents – section 195 read with section 112A	
There was no amendment pertaining to TDS on long term capital gains under section in the Initial Finance Bill	Part II of First Schedule has been amended to reflect that TDS on long term capital gains of non-residents shall be deducted @ 10% on gains exceeding INR 1 lakh (in line with section 112A of the Act)
Virtual Digital Assets ("VDA") – section 115BBH	
For computing income from transfer of VDA, only cost of acquisition can be claimed as a deduction (and no other expenditure or loss).	Relevant clause is amended to reflect cost of acquisition, "if any". By virtue of this amendment, even if there is no cost of acquisition (for instance, in case of mining of VDA), the computation mechanism cannot be said to fail (in view of Apex Court decision in case of B. C. Srinivasa Shetty) and the entire income would become taxable.
No losses from other heads of income are allowed to be set off against income from transfer of VDA and no loss from transfer of VDA is allowed to be set off against income under any **other** provisions of the Act.	Word "other" is deleted; this clarifies that loss from transfer of one VDA cannot be set off against income from transfer of another VDA.
There was no mention of non-obstante clause in relation to the tax rate of 30% or applicability of "transfer" to any VDA irrespective of the form in which it is held in the Initial Finance Bill.	Non-obstante clause has been inserted in sub-section (1) that provides tax rate of 30% on income from transfer of VDA. A new subsection has been inserted to clarify that the definition of "transfer" shall

Provisions as per Initial Finance Bill, 2022 introduced on February 1, 2022	Amendments as approved by Lok Sabha/our comments
	apply to any VDA, whether held as a capital asset or otherwise.
Deductibility of surcharge and cess – section 40(a)(ii) read with section 155	
It was clarified that any surcharge or cess shall be deemed to be "tax" and not be allowed as deduction, retrospectively from FY 2004-05	Any claim of surcharge or cess made by taxpayers from FY 2004-05 onwards shall be considered as under-reported income as per the insertion of a sub-section to section 155 of the Act. Consequently, the taxpayer shall be subject to penal consequences unless it is *suo moto* reported to the tax officer and paid within prescribed time limit.

B. Corporate Law Highlights

1. MCA mandates April 1, 2022 as the date for certain provisions of the LLP (Amendment) Act, 2021 to come into force[7]

LLP (Amendment) Act, 2022 received Presidential assent in August 2021 but had not come into effect entirely. The Ministry of Corporate Affairs has not appointed April 1, 2022 as the date from when sections 1 to 29 of the LLP (Amendment) Act shall be effective.

Key provisions of the LLP (Amendment) Act, 2021 include introduction of small LLPs, standards of accounting being prescribed, decriminalization of certain offences, etc., which have been covered in detail in the August 2021 issue of Katalyst Kaleidoscope. Additionally, an important amendment is the insertion of Explanation to section 62 of the LLP Act, 2008 that an LLP shall not be amalgamated with a company.

Katalyst comments:

The amendment prohibiting merger of an LLP with a company concludes the controversy, albeit adversely, that had arisen during the scheme of amalgamation of Real Image LLP with Qube Cinema Technologies. In that case, NCLT Chennai bench had held that since there was no express statutory bar on merger of an LLP with a company, it should be permitted to amalgamate with a company; however, the National Company Law Appellate Tribunal denied the merger of an LLP with a company.

[7] MCA Notification S.O. 621(E) dated February 11, 2022

C. SEBI/ FEMA

1. Department for Promotion of Industry and Internal Trade (DPIIT) widens the exclusion from the meaning of "real estate business" under the FDI Policy[8]

As per the existing FDI Policy and FEM (Non-Debt Instruments) Rules, 2019 ("FEM NDI Rules"), FDI is not permitted in an entity which is engaged or proposes to engage in real estate business. Vide a press note dated March 14, 2022 issued by the DPIIT, the exclusions from the definition of "real estate business" have been broadened to include Real Estate Investment Trusts ("REITs") registered with and regulated by SEBI (REITs) Regulations, 2014. Additionally, it clarifies that earning of rent/income on lease of a property, not amounting to transfer, will not amount to real estate business.

Katalyst Comments

FEM NDI Rules already mention that investment in units of SEBI registered REITs and earning of rental/ lease income will not amount to real estate business, albeit by way of an explanation; this modification to the definition of "real estate business" will help in clarifying the matter.

2. Appointment of separate persons as Chairperson and Managing Director/ Chief Executive Officer[9]

Pursuant to the press release issued in February 2022 making this requirement voluntary instead of mandatory, SEBI has now issued SEBI (LODR) (Second Amendment) Regulations, 2022 to give effect to the same. As per the amendment, Regulation 17(1B) of SEBI LODR Regulations that required the listed companies to appoint separate persons to the positions of Chairperson and MD/ CEO has been deleted. Instead, this requirement has been shifted under the "Discretionary Requirements" under the Corporate Governance Schedule (Schedule II) to the SEBI LODR Regulations.

3. SEBI Consultation Paper on IPO Issue Price [10]

SEBI has issued a Consultation Paper on disclosures for basis of Issue Price for public comments. The two proposals captured in the Consultation Paper include the following:

[8] Press Note No. 1 (2022 Series), DPIIT File No. 5(3)/2021-FDI Policy dated March 14, 2022
[9] SEBI Notification F. No. SEBI/ LAD-NRO/GN/2022/76 dated March 22, 2022
[10] Consultation Paper issued on February 18, 2022

(i) Disclosure of Key Performance Indicators: At present, issuers are required to make disclosures, under the Basis for Issue Price section in the offer document, of the critical accounting ratios. SEBI observed that these parameters are descriptive of only those companies which are profit making and do not relate to loss-making companies. Accordingly, disclosures on key performance indicators of Company's business, that have been considered / have a bearing for arriving at the basis of issue price have been proposed.

(ii) Valuation: Issuer companies shall make disclosure of valuation of companies during past transfers/ allotments in the specified manner.

4. SEBI to amend AIF Regulations[11]

The SEBI Board has decided to amend the SEBI (Alternative Investment Funds) Regulations, 2012 (AIF Regulations) to provide flexibility to Category III - AIFs to calculate the investment concentration norms based either on investable funds or net asset value of the fund, while investing in listed equity of investee company, subject to SEBI specified conditions.

Katalyst comments:

Category III AIF is an AIF which employs diverse or complex trading strategies and may employ leverage including through investment in listed or unlisted derivatives. AIFs such as hedge funds or funds which trade with a view to make short term returns or such other funds which are open ended and for which no specific incentives or concessions are given by the Government or any other Regulator shall be included in the proposed amendment.

5. SEBI clarifies on applicability of amended Regulation 23 of SEBI LODR Regulations pertaining to Related Party Transactions

SEBI had amended Regulation 23 of SEBI LODR Regulations which deals with Related Party Transactions ("RPTs") (discussed in detail in the November 2021 issue of Katalyst Kaleidoscope). Pursuant to representations made by listed entities and industry bodies, SEBI has issued a circular[12] to provide certain clarifications, and the key ones are summarized below:

i. No fresh approval from shareholders required in case of RPTs which are approved by audit committee and shareholders prior to April 1, 2022;

[11] SEBI Notification No. SEBI/LAD-NRO/GN/2022/75 dated March 16, 2022
[12] SEBI Circular No. SEBI/HO/CFD/CMD1/CIR/P/2022/40 dated March 30, 2022

ii. However, RPTs which have been approved by the audit committee prior to April 1, 2022 but continue beyond such date and become "material" as per the amended materiality threshold, should be placed before the shareholders in the first meeting after April 1, 2022.

D. Goods and Service Tax highlights

1. Input tax credit ('ITC') of demo-car received as stock transfer is not available [13]

Haryana Appellate Authority of Advance Ruling ('AAAR') has upheld the ruling by AAR and held that ITC relating to stock-transfer of demo-care is not available to the Appellant as the demo-cars are not received with the intent to simply 'further supply of such motor vehicles, /sell as such' but these cars are used by dealers and sold after a year and hence, ITC of such stock-transfer is not available. Further, services of repair/ insurance/ maintenance used in respect of said vehicles with seating capacity up to 13 passengers is not allowed as per the provisions of section 17(5) (1) of the CGST Act.

2. External development charges and infrastructure development charges recovered by the builder from buyer form part of value of construction service [14]

Haryana AAAR has upheld the ruling of AAR and held that the captioned charges recovered by the builder from buyers form a constituent of the value of the construction service provided to the flat owners by the builder. Hence, the concept of pure agent is not applicable in such case and in view of section 15(2) of the CGST Act, external and infrastructure development charges form part of value of construction services and liable to GST.

3. Input tax credit of goods and services used for execution of 'Road work contracts' is eligible [15]

Andhra Pradesh AAAR uphold AAR and held that the activity of applicant i.e., construction/reconstruction of roads for the Engineering Department is a composite supply involving both goods and services and it is an immovable property and therefore satisfies the definition of "Works Contract Service" u/s 2(119) of CGST Act. Also, the AAAR has clarified that restriction of ITC as per section 17(5) (c) is not applicable in the instant case as output supply of the applicant is works contract service. Further, applicant constructs the road for 'Engineering department' and hence, restriction regarding construction for 'own account' as

[13] In the matter of BMW India Pvt Ltd [TS-772-AAAR(HAR)-2021-GST]
[14] In the matter of Ashiana Housing Ltd [TS-773-AAAR(HAR)-2021-GST]
[15] In the matter of the Superintendent of Central Tax, Central GST Range, Ravulapalem, Rajamahendravaram, Andhra Pradesh [TS-1260-AAAR(AP)-2020-GST]

per section 17(5) (d) is also not applicable. Hence, ITC of goods and services used for construction/reconstruction of roads is available to the applicant.

Katalyst comments: A welcome ruling by the Andhra Pradesh AAAR. ITC of inputs used to provide works contract service is available if the output supply is of works contract service.

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