KATALYST
ADVISORS LLP

Katalyst Kaleidoscope

November 2021: Tax and Regulatory Insights

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A. Income Tax highlights

1. Bangalore ITAT: Tax department not giving due weightage to valuation report; addition of share premium under section 56(2)(viib) deleted[1]

The assessee-company allotted rights shares and non-cumulative convertible preference shares in FY 2015-16 at a total premium of Rs. 258.24 Cr. based on a share valuation report obtained from a Chartered Accountant where the value for the shares was arrived at by adopting Discount Cash Flow (DCF) Method and also under Net Asset Value (NAV) Method.

The Assessing Officer ('AO') rejected the assessee-company's approach, valued the shares himself using the NAV method and made an addition under section 56(2)(viib) of the Income-tax Act, 1961 ('ITA') of the amount received in excess of the NAV value determined by him. Even the DRP upheld the AO's approach and the assessee-company appealed to the Bangalore Tribunal.

The Tribunal observed that the AO had not actually examined the DCF method valuation furnished by the assessee-company and has ignored the methodology prescribed in Rule 11UA for valuing quoted shares (which were investments made by the assessee-company), which accounts for the major difference in the valuation. The Tribunal noted that the NAV method valuation determined by the AO himself suffered from major defects and thus, held that the AO's opinion regarding the rejection of the valuation reports relied upon by the assessee-company was liable to be rejected. The Tribunal restored the issue to the file of the AO for fresh examination to determine whether the valuation reports have been prepared in accordance with Rule 11UA.

Katalyst Comments:

This decision reiterates an important principle already laid down by courts in relation to Rule 11UA i.e. the AO should give due consideration to the valuation report adopted by the assessee, as long as it is in accordance with Rule 11UA.

[1] GMR Enterprises Pvt. Ltd [TS-1005-ITAT-2021(Bang)]

2. **Supreme Court: Flat owned as business asset on which depreciation was allowed shall continue to be considered as a depreciable business asset and taxable under section 50 upon sale; non-use for two years prior to sale[2] not relevant**

Assessee purchased a flat in 1974 and used it as a branch office, on which depreciation was allowed till AY 1995-96. The assessee discontinued its claim of depreciation in AY 1996-97 on the ground that it was no longer used for business purposes. The flat was then sold in AY 1998-99 and the assessee treated the profit on the sale of the flat as long term capital gains.

The Kerala High Court had held in this case that for sale of a depreciable asset to be covered under section 50 of the ITA, there was no need for the assessee to have claimed depreciation continuously for the entire period upto the date of sale. It further held that since the assessee had been allowed depreciation on the flat as a business asset, it continued to be a part of the depreciable asset block, despite its non-use in the two years before the sale and therefore, profit arising thereon would be taxable as short term capital gains under section 50 of the ITA. The Supreme Court upheld the High Court order and the taxability under section 50.

3. **Delhi High Court: Withholding on dividend receivable by a Dutch company allowed to be at 5% based on the Most Favoured Nation clause in the India-Netherlands Tax Treaty[3]**

The assessee-company held 58.39% shares in an Indian company, which proposed to distribute dividend of Rs. 65.68 Cr to the assessee-company for FY 2021-22. Since the assessee was eligible to the beneficial tax rate of the India-Netherlands Tax Treaty, it filed an application under section 197 of the ITA for a certificate with lower withholding tax rate on the dividend receivable. Although the tax rate applicable to dividend income as per the relevant Article of the India-Netherlands Tax Treaty is 10%, the said application requested for a lower withholding tax rate of 5% based on the Most Favoured Nation (MFN) clause in the Protocol of the Treaty, since India has entered into Tax Treaties with other OECD member countries such as Slovenia / Lithuania / Colombia wherein tax rate on dividend income was agreed at a lower rate of 5%. However, the application to withhold tax at 5% was rejected and a certificate issued under section 197 of the Act at the rate of 10% was issued, the assessee-company filed a writ petition with the High Court.

[2] Sakthi Metal Depot [2021] 282 Taxman 384 (SC)
[3] Deccan Holdings B V [TS-1008-HC-2021(DEL)]

It was contended by the assessee-company that the issue was fairly covered and concluded by the rulings of the High Court in the case of Concentrix Services Netherlands B.V. v. ITO (TDS)[4] and Nestle SA v. Assessing Officer[5] and that the certificate issued under section 197 of the ITA to the assessee-company was in contravention of the settled position of law. The counsel for the Revenue admitted that the issue was covered in the aforementioned cases and hence, the High Court set aside the impugned order and directed that a certificate under section 197 of the ITA be issued in favour of the assessee-company, indicating therein, that the rate of tax on dividend is 5% under India-Netherlands Tax Treaty.

Katalyst Comments:

This decision does not only uphold the applicability of lower tax rate as per the MFN clause of the applicable Tax Treaty, it also brings out a critical principle i.e. the Revenue cannot disregard binding judgments on the ground that the Revenue proposes to file an appeal against such decisions.

4. US Tax Court holds Foreign Tax Credit under tax treaties not independent of domestic law[6]

The assessee was a US citizen residing in a foreign country. She claimed credit for taxes paid in earlier years in France and Italy against the levy of net investment income tax (NIIT) (i.e. tax on investment income such as capital gains, dividends, and rental property income) in the US while filing the income tax return for 2013. The tax credit was claimed as per Article 24(1)(a) of the US-France Tax Treaty and as per Article 23(2)(a) of the US-Italy Tax Treaty, respectively.

While scrutinising the tax return, the tax authorities, *inter alia,* informed the taxpayer that credit for foreign taxes is provided only against taxes levied under Chapter 1 of the US Internal Revenue Code (‘IRC’) whereas NIIT was a levy under Chapter 2A. The tax authorities accordingly opined that the credit for taxes paid in France and Italy was not available because the IRC does not provide for the offset of foreign taxes against the levy of NIIT. The assessee filed an appeal to the US tax court.

The US Tax Court held that the assessee is not entitled to offset taxes paid in France and Italy in earlier years against the NIIT in the US on account of the following:

[4] W.P.(C) 9051/2020 [2021] 127 taxmann.com 43 (Delhi)
[5] W.P.(C) 3243/2021
[6] Catherine S. Toulouse [TS-1034-FC-2021(USA)]

- The IRC provides that the offset of the foreign tax is permissible only against the levy of regular tax and not against the levy of NIIT. Further, the Income Tax Regulations specifically addressed the issue of foreign tax credit against the NIIT and explained that the IRC does not provide for foreign tax credit;
- The relevant text of the US-French tax treaty and US-Italian tax treaty explicitly provide that foreign tax credit must be determined as per the IRC. The claim of the foreign tax credit is, thus, limited by the IRC's provision of foreign tax credit.

Katalyst Comments:

This is an important ruling from the US tax perspective for all the entities earning investment income in India and paying taxes in India, with the intent of claiming tax credit of such taxes in the US. Article 25(1) of the India-US Tax Treaty also provides relief from double taxation subject to the limitations of the law of the US.

B. Corporate Law Highlights

1. Hyderabad NCLT approves scheme of arrangement involving demerger among group companies without a valuation report[7]

The petitioner had filed a scheme of arrangement with appointed date as 1 April 2019. Before the final hearing for the approval of the scheme, the Regional Director made some observations on the scheme, one of which required the petitioner companies to furnish a certificate from a Registered Valuer regarding the valuation of the proposed scheme.

The petitioner company submitted that a valuation report was not necessary in its case since there was no change in the shareholding pattern of demerged or the resulting companies. Therefore, since there was no share swap pursuant to the scheme, no valuation was necessary. The NCLT took note of the response provided by the petitioner company and approved the scheme of arrangement.

[7] GAR Corporation Pvt Ltd & Laxmi Infobahn one Pvt Ltd & Ors, CA/36/2021 in CP(AA) Merger & Amalgamation/ 34/2021, NCLT, Hyderabad, dated 01.10.2021

Katalyst Comments:

A demerger which is a mirror image scheme with the same shareholding does not require a valuation report or a swap ratio; the resulting company could decide to have whatever equity capital it requires as per the desired capital structure and the number of shares of the resulting company would depend on that, but there is no different percentage of shareholding. However, in practice, this gets difficult to explain and has caused needless burden to get a "swap ratio/ valuation report". In this context, the Hyderabad NCLT order will hopefully set a trend which will obviate the need for obtaining a swap ratio/ valuation report. In fact, the SEBI Master Circular dated 23 November, 2021 also expressly reiterates its earlier circulars that no valuation report is required in case of a mirror image demerger.

C. Securities' Law Highlights

1. SEBI amends the framework for schemes of arrangement by listed entities[8]

SEBI has issued a Master Circular amending certain provisions of the framework for Schemes of Arrangement by listed entities as laid down under earlier SEBI Master Circular dated 22 December 2020.

The key amendments introduced by the Circular are summarised below:

Additional documentation/ declaration

- While submitting a valuation report to the stock exchange for its in-principle approval, the listed entity must also submit an undertaking stating that there has been no material event impacting the valuation during the period under consideration for valuation report till the filing of the scheme documents with stock exchange.
- Declaration on any past defaults of listed debt obligations of all the entities forming part of the Scheme.
- No Objection Certificate (NOC) from the lending scheduled commercial banks/ financial institutions/ debenture trustees.

[8] SEBI Master Circular dated November 23, 2021

Fractional entitlement related amendments

- All fractional entitlements, if any, shall be aggregated and held by the trust and the trust shall sell such shares in the market, at such price, within a period of 90 days from the date of allotment of shares, as per the draft scheme submitted to SEBI.
- Listed entity to submit to stock exchange, a report from its Audit Committee and the Independent Directors certifying that it has compensated all the eligible shareholders within 7 days of compensating the shareholders.

2. SEBI consultation paper for review of certain aspects of public issue framework under ICDR Regulations

SEBI has issued a Consultation Paper on review of certain aspects of public issue framework under SEBI ICDR Regulations and has invited public comments on proposals by November 30, 2021.

The Consultation Paper makes recommendations on 4 aspects: (i) objects of the issue – where object is to make future acquisition / strategic investment without identifying specific targets, (ii) conditions for Offer for Sale (OFS) by significant shareholders, (iii) lock-in of shares for Anchor Investors and (iv) monitoring of General Corporate Purpose (GCP) amount.

The Paper proposes to prescribe a combined limit of up to 35% of fresh issue size for deployment on IPO objects of inorganic growth initiatives and GCP, where the intended acquisition/ strategic investment is unidentified in the objects of the offer; however, such limits shall not apply if the object has been identified and suitable specific disclosures about such acquisitions / investments are made at the time of filing of offer document. It further suggests that for IPOs of companies where there are no identifiable promoters, divestment of stake by significant shareholders (holding >20%) be capped at 50% of their pre-issue holding for draft offer documents, and that for such significant shareholders who are selling through OFS in IPO, their remaining post issue shareholding should be locked-in for 6 months from the date of allotment in IPO.

In relation to shares allotted to Anchor Investors are locked in for a period of 30 days from the date of allotment, it also suggests that there may be a need to review the said lock-in period as a longer lock-in for Anchor Investors will provide more confidence to other investors.

3. SEBI notifies amendment to RPT definition under LODR Regulations[9]

SEBI has made the following amendments to the LODR Regulations pertaining to Related Party Transactions (RPTs):

Existing Regulations	Amendments	Remarks
First proviso to Reg. 2(1)(zb) i.e. definition of "related party" – Any person or entity, *inter alia*, holding 20% or more of shareholding in the listed entity was deemed to be a related party.	From April 1, 2023 onwards, any person or any entity, *inter alia*, holding equity shares of **10%**, either directly or on a beneficial interest basis, **at any time, during the immediate preceding financial year,** shall be deemed to be a related party.	The threshold for including entities as related party is being broadened by reducing the threshold of shareholding to 10% from April 1, 2023.
Reg. 2(1)(zc) i.e. definition of "related party transaction" – Related party transaction was defined to mean transfer of resources, services or obligations **between a listed entity and a related party.**	It will now include transactions between: (i) a listed entity **or any of its subsidiaries** on one hand and **a related party of** the listed entity or **any of its subsidiaries** on the other hand; or (ii) a listed entity **or any of its subsidiaries** on one hand, **and any other person or entity** on the other hand, **the purpose and effect of which is to benefit a related party of the listed entity or any of its subsidiaries**, with effect from April 1, 2023; However, some transactions have been specifically excluded (subject	RPT definition is being broad-based by including transactions between subsidiaries of listed entities and their related parties. This shall further be broadened from April 1, 2023 by including transactions with any person, if it results in benefitting a related party of the listed company or its subsidiaries; its subjective dimensions are a source of controversy.

[9] Notification No. SEBI/LAD-NRO/GN/2021/55 dated November 9, 2021

Existing Regulations	Amendments	Remarks
	to disclosures), such as issue of specified securities on a preferential basis, corporate actions which are uniformly applicable/ offered to all shareholders, acceptance of fixed deposits by banks/ NBFCs.	
Explanation to Reg. 23(1) i.e. material related party transaction – RPT was considered material if the transaction(s) exceeds 10% of the annual consolidated turnover of the listed entity.	RPT shall now be considered material if the transaction(s) **exceeds INR 1,000 crore or 10%** of the annual consolidated turnover of the listed entity, **whichever is lower**.	Additional monetary threshold is inserted for qualifying a transaction as RPT, thereby providing relief to smaller transactions/ entities.
Reg. 23(2) i.e. Audit committee approval – All related party transactions require prior approval of the audit committee.	In addition to RPTs, any **material modifications** shall require prior approval of the audit committee. It is also provided that RPT where only subsidiary of the listed company is a party shall require audit committee approval only if the value exceeds 10% of consolidated turnover (10% of standalone turnover, from April 1, 2023).	Any material modifications to RPTs, and not only initial transactions, shall require audit committee approval
Reg. 23(4) i.e. approval of shareholders – All material related party transactions shall require approval of the shareholders through resolution.	In addition to material RPTs, any **subsequent material modification** shall require **prior** approval of the shareholders through resolution.	It is specified that **prior** approval of shareholders shall be required, not only for material RPTs but also for material modifications.
Reg. 23(5) i.e. carve out from audit committee approval/	The carve out from audit committee and shareholder	Transactions between wholly owned

Existing Regulations	Amendments	Remarks
shareholder approval – Audit committee and shareholder approvals were not required for transactions **between a holding company and its wholly owned subsidiary** whose accounts are consolidated with such holding company and placed before the shareholders at the general meeting for approval.	approval is also extended to **transactions between two wholly-owned subsidiaries** of the listed holding company, whose accounts are consolidated with such holding company and placed before the shareholders at the general meeting for approval.	subsidiaries of a listed company should also not require audit committee and shareholder approvals.
Reg. 23(9) i.e. disclosures – Disclosures were required to be made **30 days** from the date of publication of standalone and consolidated financial results for the half year.	Disclosures should now be made **within 15 days** from the date of publication of standalone and consolidated financial results every 6 months. However, from April 1, 2023, such disclosures shall be made **on the date of publication** of standalone and consolidated financial results every 6 months**.**	The time period within which the disclosures are to be made has been reduced to 15 days (eventually to the same day) from publishing the financials.

4. SEBI prescribes information to be submitted to audit committee and shareholders for approval of RPTs[10]

In continuation of the amendments made to the SEBI LODR Regulations vide Circular dated November 9, 2021 (as discussed above), SEBI has made available the format for disclosure of the RPTs to stock exchanges.

Further, it has also prescribed the information that should be submitted by to the audit committee and the shareholders for the approval of proposed RPT. Some key information

[10] SEBI/HO/CFD/CMD1/CIR/P/2021/662 dated November 22, 2021

includes details of source of funds if the transaction relates to loan or inter-corporate deposits, advances, or investments; applicable terms; purpose for which the funds will be utilized; justification for why the RPT is in interest of the listed entity; copy of the valuation report, if any; etc.

D. RBI/ Foreign Exchange Laws

1. RBI allows FPIs to invest in debt securities issued by InvITs and REITs[11]

It has been decided to permit Foreign Portfolio Investors (FPIs) to invest in debt securities issued by InvITs and REITs. This change is in accordance with the announcement made in the Union Budget 2021-22 that debt financing of InvITs and REITs by FPIs will be enabled by making suitable amendments in the relevant legislations.

FPIs can acquire debt securities issued by InvITs and REITs under the Medium-Term Framework (MTF) or the Voluntary Retention Route (VRR) and such investments shall be reckoned within the limits and shall be subject to terms and conditions for investments by FPIs in debt securities under the respective regulations of MTF and VRR.

Consequential amendments to Foreign Exchange Management (Debt Instruments) Regulations, 2019 have been notified[12] on October 13, 2021, whereby debt securities issued by InvITs and REITs have been inserted in the list of debt instruments which FPIs are permitted to purchase on repatriation basis under Schedule I of Foreign Exchange Management (Debt Instruments) Regulations, 2019.

2. Government increases the FDI cap in Telecom sector[13]

The Central Government has increased the cap for Foreign Direct Investment (FDI) in Telecom sector to 100% under automatic route. Previously, the FDI in Telecom sector was permitted upto 49% under automatic route and beyond 49% through Government approval route.

E. Goods and Service Tax Highlights

[11] RBI/2021-22/120 A.P. (DIR Series) Circular No. 16, dt November 8, 2021
[12] No. FEMA.396(1)/2021-RB., dt October 13, 2021
[13] DPIIT FDI Policy Section, Press Note No. 4 (2021 Series), dt October 6, 2021

1. Apex Court disallowed the GST refund of Rs. 923 crores by way of rectification of GSTR-3B return to Bharti Airtel

The Apex court[14] has rejected the GST refund of Rs. 923 crores granted by the Delhi High Court and held that directions of Delhi High court allowing rectification of monthly GSTR-3B returns for the period between July 2017 to September 2017 cannot be sustained and corrections to past returns can be made only in the month in which the error is identified. The Apex court also held that the GST portal was only facilitator to feed or retrieve information and it is not the primary source of determining ITC availability and consequent tax liability. It was also observed that discharging tax liability through ITC utilization or cash is a matter of choice, which once exercised, could not be revised.

***Katalyst Comments**:*

It is pertinent to note that the hon'ble Apex Court has held that it is the tax payer's obligation to self-assess its tax liability and report the same through proper maintenance of accounts and records accurately shall subsist regardless of the online system. Also, these obligations were also present in pre-GST regime as well. Since the Apex court has held that the GSTR 2A is the mere add on facility provided by the GST portal, absence of any invoices in GSTR-2A (mismatch) should not be the sole reason to deny the ITC and henceforth, GST authority should allow the ITC availed on account of mis-match in GSTR-2A. Further, the hon'ble Apex court did not consider the fact that section 16(2)(aa) of the CGST Act which provides that irrespective of the credit that appears in the purchase register, one may only avail the credit that matches with GSTR 2A.

2. Services by Shapoorji-Pallonji to SPV created under smart-city mission is taxable as composite supply of works contract service at 12%

The applicant is engaged in the business of providing construction service and provides works contract services to its clients including the Government. The Greater Vishakhapatnam Smart City Corporation Limited (GVSCCL) was set-up as a Special Purpose Vehicle (SPV) under Government of India's "Smart City Mission" whereby the SPVs shall plan, appraise, approve, release funds, implement, manage, operate, monitor, and evaluate the smart city development projects. The applicant has provided services to SPVs and w.r.t. applicability of GST rate for the supply of services, the Andhra Pradesh AAR[15] has held that

[14] UOI vs. Bharti Airtel Ltd. [TS-555-SC-2021-GST]
[15] In the matter of Shapoorji Pallonji & Company Pvt. Ltd. [TS-556-AAR(AP)-2021-GST]

those services of the applicant such as beautification of streets including Streetscape Design, Landscaping and Intersection Redesign in Visakhapatnam's Area Based Development provided to SPV is a 'composite supply of works contract', attracting 12% GST.

Katalyst Comments:

GVSCCL fits into the definition of 'Government entity' as per the GST Law. Further, the functions carried out by GVSCCL are the functions which are entrusted by the Central Government, State Government and Local Authority. Also, various services of the applicant fall within the ambit of composite supply of works contract services as per section 2(119) of the CGST Act and hence, GST is payable at 12% and not @ 18% as per notification no. 11/2017-CT(Rate) dated June 28, 2017.

3. Maharashtra AAR: recovery of an amount towards top-up and parental insurance premium is not 'supply of service'

Applicant has formulated a 'Health and Wellness Policy' wherein, the employees are given an option to opt for an additional insurance for themselves as well as for their partners. Further, the applicant has taken a separate Top-up insurance and Parental Insurance from the insurance company and initially pays entire premium along with taxes and then recovers the same from respective employees by way of deduction from their salary. In this regard, the Maharashtra AAR[16] has held that the activity undertaken by the applicant of providing Mediclaim insurance policy to employees and their parents is neither covered within the definition of 'supply' u/s 7 of the CGST Act nor it is covered under the definition of 'business' u/s 2(17) of the CGST Act and it does not amount of supply of service.

Katalyst comments:

A welcome ruling by the Maharashtra AAR. GST is not applicable on recovery of top-up insurance and parental insurance premium from employees as the company is not into the business of insurance and hence, the not covered within the definition of supply. Therefore, no GST is payable on recovery of the insurance premium from employees.

4. Punjab & Haryana High court orders to refund Rs. 108 Cr of CGST/SGST as the assessee rightly paid IGST at a later date

[16] In the matter of The Tata Power Company Limited [TS-595-AAR(MAH)-2021-GST]

For the period April 2018 to December 2018, the Assessee paid CGST and SGST of about Rs. 108 crores approximately, considering the transactions to be intra-state sales as complete break-up of transactions was not available. Later, the revenue required the Assessee to first make payment under the right head IGST and then pray for the refund. Post payment of IGST, the refund plea of the Assessee was rejected on the ground that phrase 'subsequently held' in Section 77 of the CGST Act could only apply in a case where an adjudicating authority had actually held whether a transaction was inter-state or intra-state. In this regard, the Punjab & Haryana[17] High Court held that once the Assessee had paid extra amount on asking of Revenue under the IGST, the liability of Revenue to refund an amount of Rs. 108 crores wrongly deposited under CGST & SGST couldn't be disputed.

Katalyst Comments:

Welcome decision of Punjab & Haryana High court. As the assessee has additionally paid Rs. 108 Cr under the correct head of 'IGST' on asking of the Revenue, he is rightly entitled for the refund u/s 77 of the CGST Act and the same should be granted without any dispute.

5. Key notifications – Applicable w.e.f. January 1, 2022

- Services by way of job-work in relation to dyeing or printing of the textile and textile products is liable to GST @ 12%[18] as against 5% earlier.

- Construction services as mentioned under sub -entry (iii), (vi), (vii), (ix) and (x) of sr no. 3 of notification no. 11/2017 provided to the Government authority or a Government entity is liable to GST @ 18%[19] as against 12% earlier.

- Pure services (excluding works contract service or other composite supplies involving supply of any goods) provided to Government authority or a Government entity by way of any activity in relation to any function entrusted to a Panchayat under article 243G of the Constitution or in relation to any function entrusted to a Municipality under article 243W of the Constitution is liable to GST @ 18%[20] as against NIL rate earlier.

[17] SBI Cards & Payment Services Ltd. vs. Union of India & Ors. [TS-557-HC(P&H)-2021-GST]
[18] Notification no. 15/2021-CT(Rate) dated November 18, 2021
[19] Notification no. 15/2021-CT(Rate) dated November 18, 2021
[20] Notification no. 16/2021-CT(Rate) dated November 18, 2021

Katalyst Kaleidoscope

November 2021: Tax and Regulatory Insights

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