KATALYST ADVISORS

Katalyst Kaleidoscope

September 2024: Tax and Regulatory Insights

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A. Income Tax Highlights

1. Delhi HC: TRC sufficient evidence of beneficial ownership to claim Mauritius DTAA benefits[1]

An entity based in Mauritius, being a pooling vehicle comprising of investors across jurisdictions, claimed nil withholding tax on capital gains on its sale of investments in India based on the India-Mauritius DTAA, which protects investments from Mauritius into India before 2017 from being taxed in India. The Authority for Advance Rulings ("AAR") rejected such claim on the basis of alleged abuse of the tax treaty to avoid tax.

On appeal, the Delhi High Court disagreed with AAR's position, stating that a tax residency certificate is sacrosanct to avail benefits of a DTAA, as it constitutes certification of a bona fide entity having beneficial ownership to pursue a legitimate business purpose. Further, the 'beneficial ownership' test is relevant only in instances where the taxpayer holds shares as an assignee and / or there is a contractual obligation to pass on the income to another person. The Delhi High Court observed that merely because the parent entity may exercise shareholder influence over its subsidiary in Mauritius and draws dividend does not result in a lack of economic substance of such subsidiary. Further, creation of new investment pathways ought not be halted by skepticism or mistrust except on the basis of well-established parameters.

Katalyst comment:

i. *The genesis of the capital gains of the India-Mauritius treaty was in the context of the fact that India's foreign exchange reserve was abysmally low; it was always intended (and reiterated by CBDT circulars and indeed, the Supreme Court judgement in Azadi Bachao Andolan case[2]) that a TRC would suffice to avail the benefit of the capital gains clause of India Mauritius treaty. In relation to investments made on or after April 1, 2017, the benefit has already been withdrawn.*

ii. *The judgement is based on facts, which indicate a strong substance for being in Mauritius. The larger issue is that even if it were not to be so, in the context of what is stated in (i) above, this litigation is completely unnecessary and has caused substantial loss of credibility for India as a country.*

[1]Tiger Global International III Holdings v AAR (IT) & Ors, Delhi High Court [W.P.(C) 6764/2020 & CM APPL. 23479/2020] dated August 28, 2024

[2] Union of India v. Azadi Bachao Andolan [263 ITR 706 (SC)] dated October 7, 2003

2. Ahmedabad ITAT: Sole trust created by will and having only individual beneficiaries not liable to tax at maximum marginal rate[3]

The assessee-trust was the only trust declared by a person's will, which came into effect on their death; all beneficiaries of the trust were individuals. The Revenue brought the income of the trust to tax at the maximum marginal rate and did not allow any deductions against such income, contending that the shares of the beneficiaries is not defined.

The Ahmedabad ITAT ruled in favor of the appellant and held that as per Section 164(1) of the Income Tax Act, the income of a trust declared by will shall be charged to tax as per the normal slab rates, and deductions against such income shall also be available, given that the trust is the only trust declared by will.

3. Hyderabad ITAT: Revaluation of assets credited to partners' capital considered as transfer[4]

A partnership firm held immovable property in the form of land, which underwent an upward revaluation, shortly after the introduction of new partners to the firm. The said revaluation amount was credited to the capital accounts of all the partners of the firm.

The Hyderabad ITAT placed reliance on the case of Mansukh Dyeing[5], where, post admission of new partners in a firm, revaluation of assets was undertaken and revaluation amount was credited to all the partners of the firm; the Supreme Court held that said credit was, in effect, a distribution of increased value of assets to partners and could be considered as a 'transfer'.

The ITAT, referring to the above judgement, held that the revaluation of the land held by the firm and crediting the amount of said revaluation to the partners' capital account is a 'transfer' and any profit or gain arising from the transfer needs to be taxed in the hands of the assessee firm.

It was further observed by the Tribunal that, in terms of the quantum, the full value of consideration for the purposes of computing capital gains will be the fair market value as on the date of the 'transfer', which cannot be the value recorded by the assessee in the books of account for the purpose of revaluation because the basis of arriving at such value is not ascertainable. Accordingly, guideline value fixed by stamp duty authorities would be considered as the full value of consideration.

[3]Pashiben Prajapati Family Trust (DISC) v CIT(A), Ahmedabad ITAT [ITA No. 305/Ahd/2024] dated August 16, 2024
[4] Shree Estates v ITO, Hyderabad ITAT [IT Appeal No. 469 (Hyd.) of 2023] dated July 31, 2024
[5] CIT v Mansukh Dyeing and Printing Mills, Supreme Court [Civil Appeal Nos. 8258 and 8259 OF 2022] dated November 22, 2024

Katalyst comment:

Prior to the Finance Act, 2021, 'transfer' of a 'capital asset' by way of distribution of capital assets on the dissolution of a firm 'or otherwise' was considered under the purview of capital gains. The term 'or otherwise' has often been considered in a broad sense, as seen in the case of Mansukh Dyeing, to include any form of reconstitution of the firm, even when the asset continues to remain the property of the firm; given that there is no asset monetization at the stage of revaluation, this seems strange and is bound to create practical issues, including cash flow to pay the tax.

4. Bangalore ITAT: Deemed dividend not attracted in absence of actual payment[6]

The assessee in this case was the director of an Indian company, where such Indian company held investment in another investee company, which was rendered non-recoverable; to compensate for the same, another party transferred certain shares held by them to the assessee without consideration. The Revenue considered this transfer as deemed dividend, contending that the assessee was benefited by the investment made by the Indian company.

The ITAT however, on appeal, observed that indirect benefits to shareholders or directors are not covered under the purview of the provisions dealing with deemed dividend; it further held that a transaction cannot be considered as deemed dividend in absence of movement of funds from the Indian company to the assessee.

5. Delhi ITAT: Transfer of shares does not amount to transfer of business[7]

A foreign seller company held 51% of an Indian company, which it sold in entirety to the buyer entity already holding the balance 49%; the seller company duly paid taxes on its long-term capital gains at the rate applicable on transfer of shares. The Assessing Officer, however, concluded that by way of transfer of shares, the seller company had transferred the entire business with assets and goodwill, and hence, required payment of tax at a higher rate.

The Delhi ITAT on appeal observed that the settled proposition of the law is that the shareholding of a person does not determine the rights qua the assets of a company. The shareholding of a person in a company, however big, does not vest any rights in the shareholder with regard to the assets or even liabilities of the company which is a separate and distinct legal entity from its shareholders and members. The ITAT ruled in favour of the assessee and concluded the transaction to be sale of shares, and not business.

[6] Sri Haris Kalandan Mohammed v DCIT, Bangalore ITAT [ITA No.878/Bang/2024] dated August 9, 2024
[7] Firestone Industrial Products INC United States v ACIT, Delhi ITAT [IT APPEAL NO. 1066/DELHI OF 2023] dated June 5, 2024

Katalyst Comment:

It is surprising that such issues are litigated by the tax department and judicial precedents are emerging where one would have thought that an issue of this nature should not arise at all.

6. Income Tax Return Statistics for the F.Y. 2022-23 [8]

The Income Tax Department has published statistics based on the income tax returns filed for the financial year F.Y. 2022-23. Some highlights are as follows:

- Status wise distribution of returns filed (amounts in INR Crores):

Status	No. of Returns Filed	% of Total Returns	Gross Total Income	% of Total Income	Aggregate Tax Liability	% of Total Tax
Individual	7,54,61,286	94.67	61,77,989	60.25	6,77,351	44.12
HUF	12,78,502	1.60	66,587	0.65	6,641	0.43
Firm	15,71,284	1.97	2,85,777	2.79	91,602	5.97
AOP/BOI	1,19,020	0.15	87,706	0.86	14,316	0.93
Companies	10,70,924	1.34	34,58,217	33.73	7,16,578	46.68
Others*	2,11,129	0.26	1,76,837	1.72	28,663	1.87
Total	**7,97,12,145**	**100**	**1,02,53,113**	**100**	**15,35,151**	**100**

* Others include trusts, cooperative society, LLP, local authority and artificial juridical person

- Returns filed based on income bracket for all types of assessees (amounts in INR Crores)

Range of Income	No. of returns	% of Total Returns	Sum of Gross Total Income	% of Total Income
Up to 5 lakhs	3,87,58,545	48.62	13,19,216	12.87
5 lakhs to 10 lakhs	2,79,36,822	35.05	18,73,514	18.27
10 lakhs to 25 lakhs	1,01,23,268	12.70	14,74,836	14.38
25 lakhs to 50 lakhs	19,53,619	2.45	6,63,297	6.47
50 lakhs to 1 crore	589762	0.74	4,01,373	3.91
More than 1 crore	3,50,129	0.44	45,20,874	44.09
Total	**7,97,12,145**	**100**	**1,02,53,113**	**100**

[8] Income Tax Department – Income Tax Return Statistics Assessment Year 2023-24 Version 1 June 2024

- Range of taxes paid by companies (amounts in INR Crores)

Range of Income	No. of returns	% of Total Returns	Sum of Gross Total Income	% of Total Income
Up to 25 lakhs	9,90,930	92.53	14,095	1.97
25 lakhs to 1 crore	44,623	4.17	22,504	3.14
1 crore to 5 crores	23,761	2.22	52,009	7.26
5 crores to 25 crores	8,547	0.80	91,194	12.73
25 crores to 50 crores	1,444	0.13	50,896	7.10
50 crores to 100 crores	774	0.07	54,283	7.58
More than 100 crores	845	0.08	4,31,596	60.23
Total	**10,70,924**	**100**	**7,16,578**	**100**

Katalyst Comments:

- *Only 1.34% of the tax payers are companies, yet accounting for nearly half of the aggregate tax liability; individuals and companies together account for almost 90% of the aggregate tax liability.*

- *Approximately 80% of individuals filing returns earned an income of only up to INR 10 lakhs in the year, pointing out the amount of disproportionate effort for small individual tax payers; 44% of the income is concentrated amongst 0.44% of individuals who earned more than INR 1 crore.*

- *Almost 90% companies earned an income of only up to INR 25 lakhs; whereas, 60% of the income is concentrated amongst 845 companies earning more than INR 100 crores.*

B. Corporate Law Highlights

1. Competition Law: Amendments in provisions related to combinations

Several changes have been notified in the provisions regulating the competition laws in India by the Ministry of Corporate Affairs as well as the Competition Commission of India to ensure anti-competitive practices in negotiated settlements with businesses, regulating mergers and acquisitions based on deal value and other aspects of merger regulation. These amendments are applicable with effect from September 10, 2024, including transactions which have not yet been closed as on such date, even if the transaction had been entered into and signed.

Key highlights are as follows:

- Deal-value threshold[9]: This seeks to capture combinations exceeding value of INR 20 billion under the purview of the Competition Act, provided that the target company has substantial business operations in India, irrespective of the value of assets or turnover. Substantial business operations will be established based on prescribed thresholds linked to digital services provided to users in India, gross merchandise value and turnover[10].

- Minimum value of assets or turnover[11]: The de-minimis exemption allows companies to avoid prior approval for combinations depending upon the value of assets or turnover. Post the amendment, acquisition, control, merger or amalgamation does not constitute a combination if the value of the assets of the Indian target company is below INR 4.5 billion, or value of turnover is below INR 12.5 billion.

- Exempted combinations[12]: Several categories of combinations have been notified which, on satisfying specified criteria, would not be required to be reported under the Competition Act. These include acquisitions in the ordinary course of business, intra-group acquisitions, acquisition of up to a percent of holding, etc.

- Inbound fast-track merger[13]: Where a foreign holding company is merging into its Indian wholly-owned subsidiary, both companies shall obtain the prior approval of RBI, and, the Indian company can opt for the fast-track merger route by making an application to the Regional Director, instead of the National Company Law Tribunal.

- Criteria for notice of combination[14]: Conditions have been established under which entities involved in a combination can notify the Competition Commission of India if the parties to a combination, their group entities and affiliates do not produce similar, identical or substitutable products or services, or engaged in different levels of the supply chain. 'Parties to the combination' as well as 'affiliates' has been defined.

Katalyst Comment:

These amendments further define the criteria under which combinations – such as acquisitions, mergers and amalgamations – must be notified to the Competition Commission of India, potentially requiring its prior approval.

[9] Ministry of Corporate Affairs Notification Nos. S.O. 3846(E), G.S.R. 548(E), G.S.R. 549(E) and G.S.R. 547(E) dated September 9, 2024
[10] The Competition Commission of India (Combinations) Regulations, 2024 dated September 9, 2024
[11] Competition (Minimum Value of Assets or Turnover) Rules, 2024 dated September 9, 2024
[12] Competition (Criteria for Exemption of Combinations) Rules, 2024 dated September 10, 2024
[13] Companies (Compromises, Arrangements and Amalgamations) Amendment Rules, 2024, dated September 9, 2024
[14] Competition (Criteria of Combination) Rules, 2024, dated September 9, 2024

2. MCA: AGM / EGM can be conducted virtually till September 30, 2025[15]

The Ministry of Corporate Affairs has allowed companies to conduct annual general meetings due in the year 2024 and 2025 (i.e., for the F.Y. 2023-24 and 2024-25) and extra-ordinary general meetings virtually through video conference or other audio visual means on or before September 30, 2025. Further, companies can also transact items through postal ballot till September 30, 2025. The circular has clarified that this shall not be construed as an extension in statutory time for holding annual general meetings.

3. SC: Notes to accounts form part of the balance sheet[16]

The Supreme Court upheld the ruling of the Patna High Court, where a bid submitted by a company was rejected on the grounds that the balance sheet filed for such purpose lacked explanatory notes.

The Apex Court held that as per the Companies Act, 2013, notes of accounts form part of the balance sheet. Balance sheets can only be understood by going into the factual narrations made in the explanatory notes to the accounts. When one speaks about Balance Sheet, it implicitly takes along with it the explanatory note.

4. New Delhi NCLAT: Modification to a scheme of amalgamation can be done at any stage without requirement of additional regulatory compliances[17]

Two Transferor companies sought to merge with the transferee company vide a scheme of amalgamation filed with the Hon'ble National Company Law Tribunal ("NCLT"). The boards of the transferor companies and the transferee company approved the merger by way of board resolutions, and the shareholders and creditors of the companies consented to the scheme by way of consent affidavits filed with the NCLT.

Subsequently, the share capital of the transferor companies underwent a change, which caused the companies to seek a minor modification in the scheme with respect to the share exchange ratio; this was supported by a report issued by a registered valuer and fresh consents provided by the shareholders of the transferor companies for the aforementioned amendment. The NCLT,

[15] Ministry of Corporate Affairs General Circular No. 09/2024 dated September 19, 2024
[16] State of Bihar v Ziqitza Health Care Ltd., Supreme Court [CIVIL APPEAL NOS. 4975 TO 4978 OF 2024] dated April 16, 2024
[17] One World Centre (P.) Ltd v FIM Holdco Ltd, New Delhi NCLAT [Company Appeal (AT) No. 169 of 2024] dated July 19, 2024

however, rejected the scheme of amalgamation in question, and directed the companies to make a fresh application owing to the modification in the scheme.

The Appellate Tribunal on appeal observed that a modification to a scheme can be made at any stage. The shareholders of the concerned companies consented to the change in the share swap ratio, and statutory authorities may file objections to the scheme, if any, during the proceedings; consents of the creditors are irrelevant, as they would not be impacted by the modification in share swap ratio. Accordingly, the NCLAT directed for the modification in the scheme to be accepted without fresh application to avoid time and monetary loss.

C. SEBI and Other Highlights

1. SEBI: Consultation paper on maintenance of record of mandatory communication by regulated entities[18]

Presently, SEBI regulations only mandate record-keeping for a limited class of communications, such as books of accounts, to serve as an audit trail.

SEBI has released a consultation paper on maintenance of record of all such communication which are mandated to be communicated under all respective governing regulations and circulars issued therein. SEBI also proposes a mandate retention of these records for a minimum of eight years, with the records to be produced to SEBI upon request.

2. SEBI: Draft circular on reporting format for research analysts and proxy advisers[19]

SEBI has released a draft circular proposing to specify a standardized reporting format in which research analysts and proxy advisers shall submit information on a half-yearly basis.

The following are some of the details required to be reported by research analysts:

- Number of clients, amount of aggregate fee collected and details of bank accounts used for receiving fees from clients;
- Social media handles;
- Details of advertisements issued;
- Public appearances made by the research analyst, its directors or analysts.

[18] SEBI Consultation Paper on Maintenance of Record of Mandatory Communication by Regulated Entities dated August 29, 2024
[19] SEBI Draft Circular for Public Comments on Periodic reporting format for Research Analysts and Proxy Advisers dated August 9, 2024

The following are some of the details required to be reported by proxy advisers:

- Details of bank accounts used for receiving fees from clients and total amount of fees received;
- Social media handles;
- Details of advertisements issued;
- Number of agenda items of companies for which voting recommendations were provided in favour and against the proposal;
- Number of meetings / discussions held with listed companies during the reporting period in respect of reports issued / to be issued along with details of meetings.

3. SAT: Materiality of related party transactions[20]

In the Katalyst Kaleidoscope for the month of August 2024, a SEBI order in the case of Linde India Ltd was covered, wherein SEBI interpreted related party transactions ("RPT") broadly and directed to test the materiality of RPTs on the basis of aggregate value of transactions, irrespective of the number of contracts involved. Further, in this case, SEBI required a valuation exercise of the business foregone and received, including by way of geographic allocation in connection with the company's RPT, to be conducted by a valuer appointed by the National Stock Exchange.

The Securities Appellate Tribunal upheld the SEBI order for conducting a valuation exercise, concluding that halting the valuation would hinder Sebi's fact-finding process and emphasized that the exercise would not prejudice the company.

It seems that Linde India has now moved the Supreme Court challenging the SAT order.

4. SEBI Order: Exemption from making open offer on transfer of shares of listed company by promoter family to private family trust[21]

The promoter of a listed company formed a private family trust to carry out internal reorganisation of promoters' control and shareholding to streamline the succession process; the trustees and beneficiaries being individual promoters, their immediate relatives or lineal descendants. Accordingly, the promoter transferred his shareholding, and the shareholding of his HUF, to the private trust, triggering an open offer under the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011.

[20] Linde India Limited v Securities and Exchange Board of India [Appeal No. 329 of 2024] dated May 22, 2024
[21] SEBI Order in the matter of proposed acquisition of shares and voting rights in Shakti Pumps (India) Limited [WTM/ASB/CFD/7/2024-25] dated September 10, 2024

SEBI noted that the proposed indirect acquisition would be a non-commercial transaction which would not affect or prejudice the interests of the public shareholders of the company in any manner as there will be no change in the public shareholding or the total equity shareholding of the company. Further, it will not involve any change in ownership, control and management. Accordingly, SEBI granted exemption from making an open offer of the shares of the listed entity.

Katalyst Comment:

The process of exemption for transfer of promoter shares to trust is subject to the conditions laid down in SEBI Master Circular dated February 16, 2023; one would hope that this process be made much more streamlined and faster, since practical experience has shown that it takes quite some back and forth, and a few months to get approval for such transfers.

5. IFSC: Listing regulations for recognized stock exchanges in IFSC[22]

The IFSCA has notified new regulations for listing of equity instruments (by both Indian and foreign entities), bonds and other permitted financial products on the stock exchanges in the IFSC. Some key highlights of these regulations in relation to listing of equity shares and convertible securities are as follows:

- Eligibility criteria: The entity shall have an operating revenue of at least USD 20 million in the last financial year or average over last three financial years; or, pre-tax profit of USD 1 million in the last financial year or average over the last three financial years; or, a post issue market capitalization of at least USD 25 million.

- Minimum public offer and post-issue public shareholding: For Indian companies, it continues to be 25% as per existing regulations; for foreign companies, minimum public shareholding shall be 10%.

- Lock-up: Pre-issue shareholding of promoters and controlling shareholders shall be locked up for a period of 180 days.

Apart from the above, the regulations also notify requirements at the time of listing of debt securities, continuing obligations and disclosure requirements for listed equity and debt and new definition of 'banking unit'.

[22] International Financial Services Centres Authority (Listing) Regulations, 2024, dated August 20, 2024

D. Goods and Service Tax Highlights

1. GST Council: Key takeaways from the 54th GST Council meeting[23]

The 54th GST Council meeting was held on September 9, 2024; key outcomes of the meeting are as follows:

- Procedure and conditions for waiver of interest or penalty for F.Y.2017-18 to F.Y.2019-20: The GST amnesty scheme, providing waiver of interest and penalty in non-fraud cases for the abovementioned years, would be notified with effect from November 1, 2024. Further, March 31, 2025, would be the due date for availing the benefits under this scheme.

- Clarification regarding regularisation of refund of IGST availed on export of goods[24]: Where inputs for goods were imported without payment of IGST and compensation cess, but these levies have been subsequently paid and bill of entry has been reassessed by jurisdictional customs authorities, then there would be no bar on availing refund on IGST paid on export of the goods.

- Advertising services: Advertising services provided to foreign clients are not performance-based services; thus, they can be considered as export of services. Further, if an Indian advertising company merely acts as an agent facilitating the provision of media space between a foreign client and a media owner, then it is considered an intermediary, and the place of supply would be the place of the advertising company, being India.

2. GST Adjudicating Authority: Arbitration settlement not liable to GST[25]

The Directorate General of GST Intelligence ("DGGI") had imposed GST on the $1.27 billion paid by Tata Sons to Docomo in 2017 to settle a dispute involving Tata Teleservices; the DGGI contended that since the payment was made on behalf of Tata Teleservices, it should be considered as a loan, being a service provided, from Tata Sons to the group company.

The Bombay High Court, on filing of a writ petition, upheld the levy imposed by the GST authorities; subsequently, Tata Sons approached the adjudicating authority, contending the payment made was as a part of arbitration settlement, and not for services. The adjudicating authority finally passed an order in the favour of Tata Sons, and held that no GST would be applicable on liquidated damages.

[23] GST Council Press Release on the 54th Meeting of the GST Council dated September 9, 2024
[24] CBIC Circular No. 233/27/2024-GST dated September 10, 2024
[25] Tata Sons v DGGI in GST Adjudicating Authority dated September 23, 2024