Devadhaantu Insights – October 2021

Dear Reader,

Greetings!

We are happy to present the Devadhaantu Insights highlighting important legislative updates in direct taxes and regulatory updates in SEBI, IBC, FEMA and Corporate laws.

We hope that we are able to provide an insight into various updates that you would find to be informative as well as useful. For any deeper discussion as to how the updates covered in this document could affect your transactions, please do not hesitate to contact Devadhaantu.

Happy Reading!
Devadhaantu Advisors

Thank You

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DIRECT TAX UPDATES

OCTOBER 2021

Direct tax updates (1/6)

Opting a tax effective structuring option which is legally permissible is not colorable device'[1]

Venus Infrastructure & Developers (P) Ltd ('the Assessee Company') is engaged in the business of construction and development of real estate. The Assessee Company sold shares of a company called ARGHPL and incurred a long-term capital loss in AY 2012-13.

Revenue contended that the Assessee Company owned only one immovable property as asset and held that the Assessee Company used colourable device by resorting to sale of shares resulting in long term capital loss, instead of sale of property, which would have resulted in short term capital gains.

As the matter went to the consideration of Income Tax Appellate Tribunal, Ahmedabad Bench ('ITAT, Ahmedabad Bench'), it was noted that the term colourable device means "transactions which appear to be authentic on the face but in actuality they are false". ITAT, Ahmedabad bench drew support from the Hon'ble Ahmedabad High Court ruling in the case of Banyan Berry wherein it was held that "every Act which results in tax deduction, exemption of tax or not attracting tax authorized by law cannot be treated as a device of tax avoidance and the real question to be asked is whether the act of the assessee falls in the category of a colourable device, a dubious method or subterfuge which the judicial process may not accord approval."

The ITAT, Ahmedabad Bench held that the Assessee Company chose one of the two legally permissible options which it deemed to be the most tax effective or viable and mere holding period of 34 months for land cannot be a criterion to hold the transaction as a colourable device as Assessee Company could easily postpone the transaction by 2 months to avoid the possible hassles of the income tax proceedings.

1 Venus Infrastructure & Developers (P) Ltd [TS-906-ITAT-2021(Ahd)]

Direct tax updates (2/6)

No reduction in Written Down Value (“WDV”) of assets upon waiver of loan[1]

Shapers India Private Limited (‘the Assessee Company’) had purchased plant & machinery from Sermo Sable (“SS”) in FY 2002-03 on a credit basis. SS waived off the outstanding sums payable by the Assessee Company in FY 2005-06 (AY 2006-07) and accordingly, the Assessee Company wrote back the amount payable and created Capital Reserve in its books of account in that year for an equal amount.

During the reassessment proceeding of FY 2010-11 (AY 2011-12), the Assessing Officer (“AO”) disallowed the depreciation claim on the loan written back which was transferred by the Assessee Company to the Capital reserve account in FY 2005-06.

As the matter went to Income Tax Appellate Tribunal, Pune bench (‘ITAT, Pune bench’), it was observed that the cost as is relatable to any subsidy or grant or reimbursement should have been excluded from the actual cost of the asset in the Assessment Year in which the subsidy or grant was received. Further, ITAT, Pune bench added that “once the assessment for the AY 2006-07 got concluded with such gross value of the asset, the stage for altering the actual cost/ WDV on account of the loan waiver got over. The AO got denuded of the power to reduce the amount of depreciation after so many years in the AY 2011-12.”

Accordingly, the ITAT, Pune bench held that **the waiver of loan in the earlier year has no impact either on the actual cost under section 43(1) of the IT Act or WDV of block of asset under section 43(6) of the IT Act for the year under consideration i.e. AY 2011-12.**

1 Shapers India Private Limited v. DCIT [2021] 130 taxmann.com 409 (Pune Tribunal)

Direct tax updates (3/6)

Anti-abuse provisions u/s 56(2)(vii) of the ITA is not applicable for rights issue of shares[1]

Rajeev Ratanlal Tulshyan ('the Assessee') was a director and major shareholder in Kennington Fabrics Private Limited ('KFPL'). During AY 2014-15, KFPL allotted INR 3.95 Cr shares at a face value of Re.1/- each in the rights issue. The revenue took the view that there was disproportionate allotment of shares and alleged that this was less than FMV as per Section 56(2)(vii) of the ITA (currently Section 56(2)(x)) read with Rule 11U & 11UA and the difference between FMV and the consideration paid was taxable.

As the matter went to the Income Tax Appellate Tribunal, Mumbai bench, ('ITAT, Mumbai bench'), it was observed that this disproportionate allotment of shares as deemed by tax authorities was a fallacy as they overlooked that there were two right offers during the year and the right issue was offered, on both occasions, to existing shareholders in the ratio of 7:8 on first occasion and 5:8 on the second occasion and since Assessee subscribed his entitlement but the other shareholders did not, Assessee's overall holding increased at year-end and accordingly there was disproportionate allotment of rights issue pursuant to which assessee's holding ratio increased beyond proportionate holding.

The ITAT, Mumbai bench relied on coordinate bench ruling in Sudhir Menon HUF wherein it was held that if there was no disproportionate allotment, there is no scope for any property being received by them on the said allotment of shares and held that there being only an apportionment of the value of their existing holding over a larger number of shares and Section 56(2)(vii)(c) would not get attracted.

The ITAT, Mumbai bench noted that in the aforesaid ruling it was held that Section 56(2)(vii) does not apply to bonafide business transactions and referred to CBDT Circular No.1/2011 which states that "the intention was not to tax transactions carried out in the normal course of business or trade, the profit of which are taxable under the specific head of income" and held that since the rights issue was carried out in normal course of business, Section 56(2)(vii) of the ITA does not apply.

1 Rajeev Ratanlal Tulshyan [TS-950-ITAT-2021(Mum)]

Direct tax updates (4/6)

Assessment proceedings on non-existent entity held as invalid[1]

Suzlon Global Services Limited ('SGSL' or 'the Assessee') acquired a division of its holding company under slump sale for INR 2,000 Cr., whereby excess purchase consideration of INR 1,922.92 Cr. was treated as goodwill on which Assessee claimed depreciation from AY 2014-15 onwards. Subsequently, the Assessee was amalgamated with Suzlon Structures Ltd. ('SSL') with effect from March 31, 2016. Upon the amalgamation, SSL recorded a goodwill of INR 1,427.90 Cr.

Pursuant to the amalgamation, SGSL claimed the depreciation on the Goodwill up to March 30, 2016 which were transferred to SSL, and SSL claimed depreciation on Goodwill acquired from SGSL only for a day for FY 2015-16. AO completed the assessment under section 143(3) of the ITA.

Principle CIT sought revision of assessment u/s 263 of the ITA as he contended that Assessee was not eligible for claiming depreciation on goodwill arising out of amalgamation on account of section 32 and 43(6) of the ITA. Aggrieved by the order of CIT, Assessee challenged the validity of the assessment u/s 263 of the ITA with the Income Tax Appellate Tribunal, Ahmedabad bench ('Ahmedabad ITAT') as the Assessee was merged with SSL and ceased to exist.

With regards to the validity of assessment framed on erstwhile entity, the Ahmedabad ITAT relies on the Supreme Court ruling in Maruti Suzuki[2] and Gujarat High Court ruling in Kaizen Products[3] and held that the assessment to be invalid as it was made in the name of the non-existent company and that it could not be made subject to revision u/s 263 of the ITA.

1 Suzlon Global Services Limited [TS-935-ITAT-2021(Ahd)]
2 Hon'ble Supreme Court in PCIT v Maruti Suzuki India Limited [Civil Appeal No 5409 of 2019]
3 Hon'ble Gujarat High Court in case of Pr. CIT vs. Kaizen Products (P.) Ltd. [2018] 406 ITR 311 (Delhi)

Direct tax updates (5/6)

Notification of new rules for implementing the amendments made by the Taxation Laws (Amendment) Act, 2021 for taxing indirect transfers of Indian assets retrospectively[1]

The Taxation Laws (Amendment) Act, 2021 ('2021 Act'), inter-alia, amended the Income-tax Act, 1961 ('the ITA') to provide that no tax demand shall be raised in future based on the amendment to section 9 of the ITA made vide Finance Act, 2012 for any offshore indirect transfer of Indian assets if the transaction was undertaken before the presidential assent i.e., May 28, 2012.

The 2021 Act also provides that the demand raised for offshore indirect transfer of Indian assets made before May 28, 2021 (including the validation of demand provided under Section 119 of the Finance Act 2012) shall be nullified on fulfillment of specified conditions such as withdrawal or furnishing of undertaking for withdrawal of pending litigation and furnishing of an undertaking to the effect that no claim for cost, damages, interest, etc. shall be filed and such other conditions are fulfilled as may be prescribed. The amount paid/collected in these cases shall be refunded, without any interest, on fulfillment of the said conditions.

In view of the above, CBDT has notified two new Rules vide Income-tax (31st Amendment) Rules, 2021 as under:

(i) Rule 11UE which provides for the specified conditions in order to be eligible to claim relief under 2021 Act which effectively require the declarant and all the interested parties to irrevocably withdraw, terminate or discontinue all claims, appeals etc.

(ii) Rule 11UF which provides the form and manner of furnishing the undertaking for withdrawal of pending litigation, claiming no cost, damages, etc.

1 Notification No. G.S.R 713(E) published in the Official Gazette on October 1, 2021

Direct tax updates (6/6)

Black Money Act: There cannot be simultaneous proceedings under Black Money Act and Income-tax Act on the same asset/ income; Revenue cannot collapse offshore trust structure by lifting the corporate veil [1] (1/2)

Assessee, an Indian national and tax-resident was served a notice u/s 10(1) of the Black Money Act ('BM Act') for AY 2016-17 alleging the Assessee to be a beneficial owner of foreign bank accounts and offshore entities and the beneficiary of foreign discretionary trusts. Assessee challenged the notice to be defective for being legally and factually untenable on following grounds:

a. There cannot be simultaneous proceedings on the same asset under ITA and BM Act; and

b. Assessee cannot be a beneficial owner of the foreign bank accounts of offshore entities and beneficiary of a foreign discretionary trust only because for the purpose of anti-money laundering laws, the Assessee had been declared as 'beneficial owner'.

The Tribunal held that the BM Act has an inbuilt bar "in as much as it has been provided that assets out of income assessed to income tax shall be excluded from the purview of undisclosed asset in Black Money Act. Hence, it is abundantly clear that as per the scheme of the act, there cannot be a simultaneous proceedings on the same asset/income under Income Tax Act, 1961 as well as Black Money Act".

Further, the Tribunal followed coordinate bench ruling in the wealth tax appeal for AYs 2007-08 to 2013-14 in Assessee's own case where the Assessee was held not liable for wealth-tax on funds lying in offshore bank accounts, financial interests in various companies, and properties held abroad despite the fact that for the purpose of anti-money laundering laws, the Assessee had been declared as 'beneficial owner' and that no investments were moved abroad from India by the settler or any beneficiaries.

1 Yashovardhan Birla [TS-393-ITAT-2021(Mum)-TP]

Direct tax updates (6/6)

Black Money Act: There cannot be simultaneous proceedings under Black Money Act and Income-tax Act on the same asset/ income; Revenue cannot collapse offshore trust structure by lifting the corporate veil (2/2)

The Tribunal held that Revenue as well as ITAT cannot shift stands under different proceedings that involve same facts and noted that Revenue, had not doubted the trust deed executed by Assessee's Uncle that forms the edifice of the assessment and therefore, by virtue of the doctrine of approbate and reprobate, CIT(A) could not have taken a different stance on the trust deed.

The Tribunal relied on SC ruling in Estate of HMM Vikramsinhji of Gondal where in the context of the discretionary trust and beneficiary, it was held that "discretionary trust gives beneficiary no right to any part of the income of the trust property but vests in the trustees a discretionary power to pay him, or apply for his benefit, such part of the income as they think fit. Beneficiary have no power to bind themselves for the future and has no more than a hope that the discretion will be exercised in his favour." Thus, Ld. Tribunal held that the ownership of the assets cannot be thrust upon the Assessee.

MINISTRY OF CORPORATE AFFAIRS (‘MCA’) UPDATES

OCTOBER 2021

MCA - Regulatory update

NCLAT rejected plea seeking modifications of order rejecting merger scheme and its partial enforcement [1] (1/2)

A composite scheme of arrangement was filed with NCLT, Mumbai bench and Chennai Bench. Scheme was filed for arrangement of merger and demerger between 9 petitioner companies and their shareholders as follows:

- Merger of Petitioner Companies 1 to 6 with Petitioner Company 9; and
- Demerger of business undertakings of Petitioner Companies 7 and 8 with and into Petitioner Company 9;

Petitioner Companies 3 to 6 and 9 were Private Companies and others were unlisted public companies. The scheme of Arrangement was approved by NCLT, Mumbai bench as well as by Chennai bench. However, certain shareholders of Petitioner Company 1 and Petitioner Company 2, filed an application with NCLAT whereby objection was raised against the Scheme and accordingly, Scheme was rejected by NCLAT.

Appellant further appealed under Rule 11 of NCLAT Rules for partial enforcement of the scheme to the extent merger of Petitioner Companies 3 to 6 with Petitioner Company 9 arguing that no objections were received from Petitioner Companies 3 to 6 and 9 and such partial enforcement of the scheme can work out satisfactorily and in accordance with law.

In this matter, the NCLAT rejected the application for partial enforcement and remarked that "Rule 11 of NCLAT Rules gives Inherent Powers to pass such orders as may be necessary for meeting the ends of justice or to prevent abuse of the process of the Tribunal and further stated that this Tribunal can rectify any mistake apparent from the record and amend any order passed by it. However, what the Applicant, in effect, is seeking from this Tribunal is to reopen the whole Appeal and consider if the scheme can be partly enforced with regard to the Private Companies. This cannot be done relying on powers under Rule 11."

1 Rama Investment Company Pvt. Ltd. vs. Ankit Mittal. [LSI-830-NCLAT-2021(NDEL)]

MCA - Regulatory update

NCLAT rejected plea seeking modifications of order rejecting merger scheme and its partial enforcement (2/2)

The NCLAT held that the concerned order of this Tribunal sought to be modified/ clarified has dealt with the scheme as a whole which was proposed, challenged and even the Regional Director looked at the scheme as a composite scheme, thus, rejected the argument that the scheme should be segregated in the context of Private Limited vis-à-vis Public Limited Companies.

Further responding to appeal for exercising powers under section 231 of CA, Ld. Appellate Tribunal clarified that modification under Section 231 can be made only if the scheme is sanctioned and ruled that "When the scheme has been rejected, Section 231 cannot be relied upon to seek a modification".

NCLAT dismissed application seeking modification/ clarification of its judgment rejecting the Scheme of Amalgamation and Arrangement which had been approved by NCLT.

INSOLVENCY AND BANKRUPTCY BOARD OF INDIA (‘IBBI’) UPDATES

OCTOBER 2021

IBBI Regulatory updates (1/2)

NCLAT affirms NCLT order which held that default in payment of interest does not qualify as a 'financial debt' [1]

Nitin Rekhan ('the Appellant') had filled an appeal against the order of Delhi NCLT alleging Hightime Marketing Pvt Ltd of default in paying interest.

Delhi NCLAT affirmed order of Delhi NCLT dismissing Appellant's application for initiation of insolvency process against the Corporate Debtor ('Respondent') for default in payment of interest on grounds that default of payment of interest is not covered under the definition of 'financial debt' u/s 5(8) of IBC and the Appellant does not fall within the ambit of 'financial creditor'. Respondent received sum for issuing shares to him but since no shares could be allotted to the Appellant, Respondent refunded the principal amount, but no interest was paid on the principal amount as is required.

Appellant filed the application u/s 7 of IBC for default of payment of interest which was rejected Delhi NCLT on grounds that the Appellant is not covered under the definition of 'financial debt' and no financial contract has been produced by the Appellant in compliance of the provisions of IBC.

The NCLAT remarked that debt is a much bigger set of financial liabilities whereas 'financial debt' is only a subset of the overall set of debt. As per IBC provisions, 'financial debt' to mean a debt along with interest which is disbursed against the consideration for the time value of money, where money should necessarily be borrowed against the condition of time value of money.

The NCLAT dismissed the appeal holding that it was not persuaded by the contention of the Appellant that there was a time value of money attached with the deposits which was established through a prior contract and Appellant has not given any document or argument to show that the amount deposited by him was to be used by the Respondent for establishing or running his business.

1 Nitin Rekhan vs. Hightime Marketing Pvt. Ltd. [LSI-816-NCLAT-2021(NDEL)]

IBBI Regulatory updates (2/2)

IBBI amends CIRP regulations to restrict number of modifications to EOI and Resolution Plan[1]

IBBI amended Insolvency Resolution Process for Corporate Persons Regulations, 201617 (CIRP Regulations) w.e.f. September 30, 2021, with a view to ensure adherence to timeliness by addressing the delays in CIRP, and to maximize value in corporate insolvency proceedings.

IBBI placed a cap on the number of times modifications may be made to invitation for expression of interest (EOI), and request for resolution plans, thereby specifying that such modifications shall not be made more than once. Alternatively, Resolution Professional, if envisaged in the request for resolution plan, may use a challenge mechanism to enable resolution applicants to improve their plans.

Further provided that the Committee of Creditors shall not consider any resolution plan received after the time as specified by the committee or received from a person who does not appear in the final list of prospective resolution applicants.

1 IBBI/2021-22/GN/REG078 dated September 30, 2021

SEBI REGULATORY UPDATES

OCTOBER 2021

SEBI Regulatory updates (1/2)

Securities Appellate Tribunal ('SAT') held that no acquisition of indirect control by Reliance Industries Limited over Network18[1] (1/2)

An application challenging the open offer price of Network18 was filled by Victor Fernandes ('the Appellant'), allegedly controlled indirectly by Reliance Industries Ltd. ('RIL') through Indian Media Trust ('IMT') and 6 other entities ('Holding Companies').

During the proceedings, SAT noted that,

- a Deed of Trust was executed for the sole beneficiary RIL under which IMT was floated, and the entity appointed as the Trustee was controlled by Mr. Raghav Bahl (Founder and former MD, Network18 Group).
- Mr. Bahl subsequently entered into a Single Unit Agreement ('SUA') on behalf of IMT as well as the holding companies, controlled by him and TV18, NW18, and as per the said SUA, the parties thereto were to act as largest Indian shareholders of NW18.
- Later, a Zero Coupon, Optionally & Fully Convertible Debentures Agreement ('ZOCD Agreement') was entered into between these holding companies and under the ZOCD Agreement, IMT agreed to invest the subscription amount into ZOCDs of the holding companies, which were required to utilize the funds for subscribing to the right issues of NW18 and TV18.

SEBI had held that the ZOCD Agreement read independently or combined with the SUA neither triggered any open offer, nor require any disclosure under Clause 36 of the Listing Agreement. Further stated that a reading of the ZOCD Agreement would show that it was merely an investment made by IMT in the concerned entities, and the control of the affairs of these entities, TV18, etc. remains with the holding companies.

1 Victor Fernandes and Anr. vs SEBI and Ors. [LSI-800-SAT-2021(MUM)]

SEBI Regulatory updates (1/2)

Securities Appellate Tribunal ('SAT') held that no acquisition of indirect control by Reliance Industries Limited over Network18 (2/2)

SAT affirmed SEBI's order rejecting Appellants' application challenging the open offer price of Network18,

- it was noted that as per the ZOCD Agreement, Mr. Bahl continued to be in control of TV18, NW18 etc. on behalf of the holding companies;
- IMT, RIL did not have any say in the management affairs of TV18, NW18;
- effectively, there was no change in control of NW18 as a result of the execution of the ZOCD Agreement
- conversion option was not exercised at any time before making the public announcement, the ZOCD Agreement itself did not entail any indirect control of IMT or RIL in NW18,

Therefore, no disclosure was required to be made.

SEBI Regulatory updates (2/2)

SEBI Informal Guidance: Inter-se transfer of locked-in shares between promoters is permissible subject to remaining locked-in period continuing with the transferee

Applicant submitted that Jammu & Kashmir Bank ('J & K Bank') issued and allotted commensurate equity shares on preferential allotment basis to the U. T of Jammu and Kashmir ('J&K Govt.') who is the promoter and majority shareholder in the Bank. The shares issued were to be locked-in for 3 years and the entire pre-preferential holding of the Govt was locked in for 6 months. J&K Govt. issued guidelines for apportionment of assets including transfer of 8.23% shareholding in the J&K Bank to the U.T. of Ladakh and for which applicant applied to SEBI for informal guidance.

SEBI has issued an Informal Guidance clarifying that the specified securities may be transferred among promoters or to a new promoter or persons in control of the issuer provided that the lock-in period of 3 years continues for the remaining period with the transferee and subject to the provisions of Takeover Regulations. After the transfer of such shares U.T of Ladakh would also be classified as Promoter of J&K Bank.

1 Informal Guidance sought by Jammu and Kashmir Bank Ltd.[LSI-842- SEBI-2021(MUM)]