Devadhaantu Insights – July 2020

Dear Reader,

Greetings!

We are happy to present the Devadhaantu Insights highlighting important legislative updates in direct taxes and regulatory updates in SEBI 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.

Happy Reading!

Devadhaantu Advisors

Thank You

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DIRECT TAX UPDATES

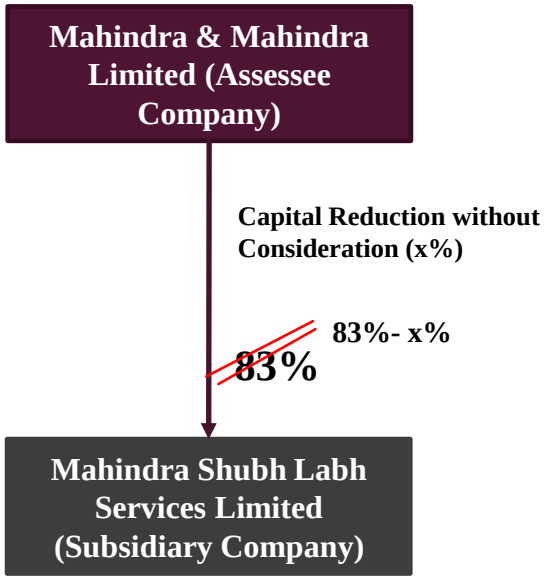
JULY 2020

Direct tax updates (1/6)

Rejection of claim of capital loss upon capital reduction without consideration[1]

Mahindra and Mahindra Limited ('the assessee') had a subsidiary viz. Mahindra Shubh Labh Services Limited in which it held around 83% stake. Pursuant to an order of the Bombay High Court, the capital of Mahindra Shubh Labh Services Ltd was reduced and the assessee received no consideration for the cancelled shares held by it. The assessee claimed a long term capital loss arising from the cancellation of shares held by it. The assessee, after placing reliance on various judicial precedents, contended that, reduction of capital tantamounts to transfer u/s 2(47) of the Income Tax Act ("ITA"). This was rejected by the tax authority on the basis of the Special Bench decision in the case of Bennett Coleman & Co. Ltd[2].

The Tribunal observed that the facts in the case of Bennett Coleman & Co. Ltd. and that of the taxpayer are similar as in both the cases there was an absence of consideration against the cancellation of shares. Further, the Tribunal distinguished the decision of Bangalore Co-ordinate Bench in the case of Jupiter Capital[3], on which the assessee had placed reliance, on the basis that cash consideration was paid to the shareholder pursuant to capital reduction in the said case. In view of the above, the Tribunal held that the Special Bench decision should squarely apply to the facts of the instant case and thus, upheld the order of the tax authority and rejected the claim of long-term capital loss on reduction of capital.



1 Mahindra and Mahindra Limited [TS-296-ITAT-2020(Mum)]
2 Bennett Coleman & Co. Ltd. [2011] 12 ITR(T) 97 (Mumbai)
3 Jupiter Capital Pvt. Ltd., in ITA No.445/Bang/2018 dt. November 29, 2018

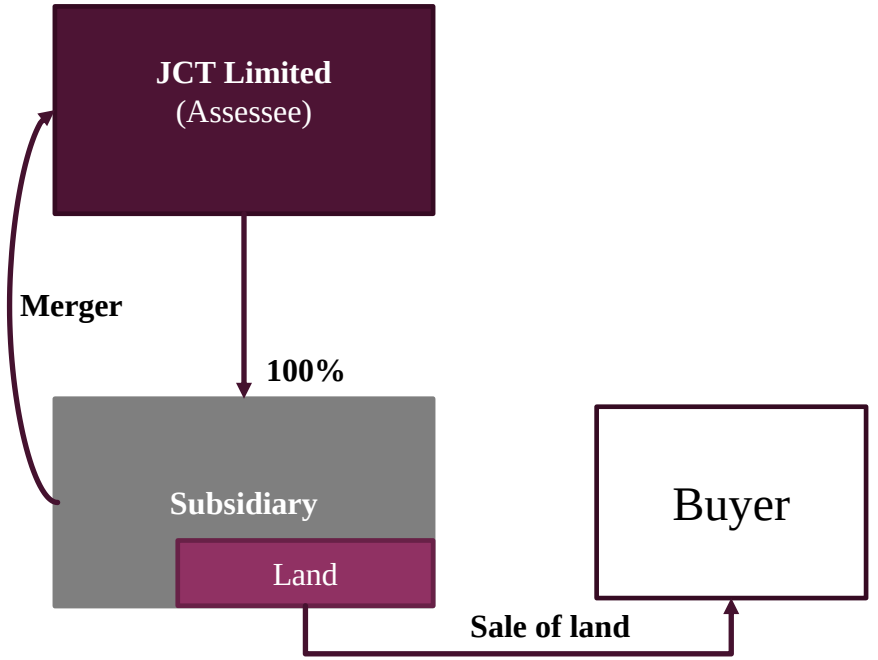
Direct tax updates (2/6)

GAAR Provisions cannot be applied retrospectively

Pursuant to a scheme of amalgamation approved by the regional High Courts, the assessee's wholly owned subsidiary amalgamated with the assessee. Between the appointed date and approval date of the aforesaid Scheme, the subsidiary had sold a piece of land and made a long-term capital gain. Post effective date of amalgamation, the said long term capital gain was set off against the unabsorbed depreciation of the assessee company, being Amalgamated Company.

The CIT(A) was of the view that the entire amalgamation was a colourable device to avoid payment of tax. The entire transaction should be looked through, solely on the substance, rather than the form through lifting of piercing the corporate veil. While acknowledging the fact that GAAR provisions were not yet applicable, it was held that the merger was done to avoid capital gains tax on sale of land by setting off the gains with brought forward losses of the assessee.

The Tribunal held that the income of the amalgamating company would be transferred to the amalgamated company pursuant to the Court approval of the scheme and therefore, by virtue of section 72 and section 74 of the ITA, the loss of the amalgamated company should be eligible for set off of against the income of the amalgamating company. The Tribunal also held that the conclusion of the CIT(A) that the merger in question, approved by the High Court is a mere sham without any factual or legal base. Further, the Tribunal opined that invoking GAAR provisions, when they were not applicable, was bad in law. Thus, the Tribunal directed the AO to grant benefit of set off of carry forward losses in respect of the said capital gains.



1. Appointed Date of Merger of Subsidiary with Assessee
2. Sale of Land by Subsidiary
3. Approval of merger by regional high courts
4. Set off of Long term Capital Gains against Unabsorbed Depreciation

[1] JCT Limited [TS-323-ITAT-2020(Kol)]

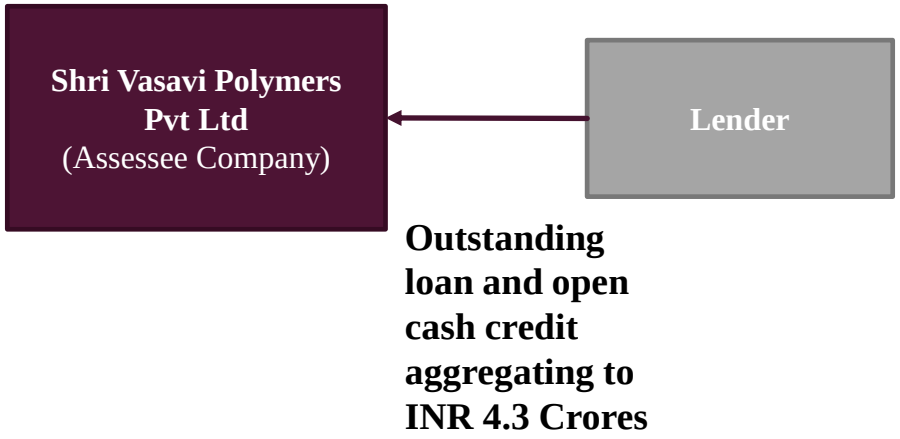
Direct tax updates (3/6)

Waiver of principle amount of working capital loan upon settlement cannot be taxed as income u/s 41(1) of the ITA [1]

In the given case, the assessee had an outstanding loan and an open cash credit for a sum of INR 4.3 crores which included the interest subsidy as well as the working capital loan. The interest of INR 0.43 crores was added back to income and taxed under the ITA. However, the sum of INR 1.7 crores which represent the waiver of working capital loan was added as income u/s 41(1). On appeal by assessee, the CIT(A), relying on various decisions, and specifically basis the decision of the Apex Court in the case of Mahindra and Mahindra[2] upheld the views of the assessee.

On further appeal to the Tribunal, the assessee contended that the amount waived by the bank was relating to working capital loan which is not covered u/s 41(1) of the ITA. The interest debited to Profit and loss a/c had already been disallowed and therefore, there was no trading liability claimed by the assessee. Hence, there was no case for taxing the waiver of working capital u/s 41(1) of the ITA. The Tribunal upheld the view of the CIT(A) and held that the what the assessee had received was remission of liability which was in the form of cash or money and the difference amount of principal which was settled by onetime payment was never debited to Profit & Loss account.

Therefore, the decision of Apex Court is squarely applicable in the instant case.



1 Shri Vasavi Polymers (P.) Ltd [2020] 117 taxmann.com 236 (Visakhapatnam - Trib.)

2 Mahindra & Mahindra (93 taxmann.com 32 (SC))

Direct tax updates (4/6)

Income arising on sale of shares held as capital asset (converted from stock) as STCG and not business income [1]

The assessee was an NBFC company engaged in the business of investing in shares and securities. However, owing to a decision of the Board of Directors, the assessee company stopped its trading activities and the investments in shares and securities, classified as stock in trade, under the portfolio management scheme were converted to investments/ capital asset. On assessment, the AO held that mere interchange of heads in books of accounts did not alter the nature of transaction and the transactions of the assessee fall within the ambit of business income and not short-term capital gain.

The High Court observed that the conversion of stock into capital asset could not have attracted any tax liability since there was no provision to tax the same at the time of such conversion. Further, the High Court held that income arising from sale of shares held as capital asset after their conversion from stock-in-trade should be treated as capital gains (relying on several High Court decisions).

Memorandum of Understanding ("MoU") for data exchange signed between CBDT and SEBI [CBDT Press Release dates July 8, 2020]

A formal Memorandum of Understanding ("MOU") was signed between the Central Board of Direct Taxes (CBDT) and the Securities and Exchange Board of India (SEBI) for data exchange between the two organizations.

The MoU will facilitate the sharing of data and information between SEBI and CBDT on an automatic and regular basis. In addition to regular exchange of data, SEBI and CBDT will also exchange with each other, on request and suo moto basis, any information available in their respective databases, for the purpose of carrying out their functions under various laws.

The MoU comes into force from the date it was signed and is an ongoing initiative of CBDT and SEBI, who are already collaborating through various existing mechanisms. A Data Exchange Steering Group has also been constituted for the initiative, which will meet periodically to review the data exchange status and take steps to further improve the effectiveness of the data sharing mechanism.

1 Kemfin Services Pvt. Ltd(TS-284-HC-2020(KAR))

Direct tax updates (5/6)

CBDT amends Rule 11UAC and Rule 11UAD of the Income Tax Rules, 1962 ("IT Rules") relating to valuation of certain assets, one of them being shares of specified companies [1]

Section 56(2)(x) of the ITA provides that where any person receives any property (including shares of a company) for a consideration less than its fair market value (computed as per the prescribed method), the fair value as exceeding the consideration would be taxable in the hands of the person receiving such property. Clause (XI) of proviso to Section 56(2)(x) of the ITA read with Rule 11UAC of the IT Rules, provides for prescribed class of persons to whom the provisions of Section 56(2)(x) of the ITA would not apply.

The Central Board of Direct Taxes (CBDT) vide a notification has replaced the Rule 11UAC of the IT Rules. As per the revised Rule 11UAC, effective from fiscal year 2019-20, the provisions of Section 56(2)(x) of the ITA would not apply to receipt of unquoted shares by shareholders, received pursuant to resolution plan approved by NCLT u/s 241/242 of Companies Act 2013 (dealing with oppression and mismanagement).

Further, as per Section 50CA of the ITA, where the consideration received on transfer of unquoted shares, is less than its fair market value (computed as per the prescribed method), such fair value shall be deemed to be the full value of consideration received for the purpose of computing capital gains. The CBDT, vide its notification has inserted Rule 11UAD to the IT Rules pursuant to which the provisions of Section 50CA of the ITA would not apply in case of transfer of unquoted shares of a company, its subsidiary and the subsidiary of such subsidiary received pursuant to resolution plan approved by NCLT u/s 241/242 of Companies Act 2013 (dealing with oppression and mismanagement).

1 CBDT Notification No. G.S.R. 421(E) and 423(E) dt. June 29, 2020

Direct tax updates (6/6)

CBDT imposes due date for disposition of lower withholding tax applications u/s 197[1]

It was observed that a number of applications u/s 197 and section 206C(9) pertaining to obtaining nil tax deduction and lower rates of deduction in respect of withholding tax have been pending before the CBDT. In order to grant relief to the taxpayers in view of the ongoing pandemic, the CBDT has decided to dispose all pending applications as on June 30, 2020 up to August 31, 2020.

Also, all the fresh applications made to be disposed off by the CBDT within one month of the receipt of the application.

CBDT extends various compliance due dates[1]

The CBDT has further extended certain compliance timelines in view of the ongoing pandemic. The table below captures certain key compliances:

Sr. no.	Nature of Compliance	Earlier Due Date	Revised Due Date
1	Income Tax Return for FY 2019-20 • Corporate Assessee; • Non-Corporate Assessee	 October 31, 2020 July 31, 2020	 November 30, 2020 November 30, 2020
2	Date of furnishing Tax Audit Report	September 30, 2020	October 31, 2020
3	Date of furnishing declaration, passing of order, payment etc. under the Vivad se Vishwas Act (without any payment of additional tax)	June 30,2020	December 31,2020
4	Due date for investment for claiming roll-over benefit in respect of capital gains under sections 54 to 54GB		September 30,2020
5	Passing order or issuance of notice by authorities/ assessment/ re-assessment/ appeals and compliances under the Direct Tax Laws	December 31,2020	March 31, 2021

1 CBDT Notification No. G.S.R. 421(E) and 423(E) dt. June 29, 2020

CORPORATE LAW UPDATES

JULY 2020

Corporate Law updates

Objections of minority shareholders rejected for scheme of selective capital reduction as it doesn't fall under the purview of "arrangement"[1]

The Petitioner Company, a listed entity, had entered into a Scheme of Arrangement with its shareholders u/s 230-232 of the Companies Act, pursuant to the advice of the Bombay Stock Exchange for selective reduction of its share capital. The Scheme had been unanimously approved by the shareholders and creditors of the Petitioner Company. The Petitioner Company had decided on converting its partly paid up shares into fully paid up ones, on account of it being an investor friendly measure, rather than forfeiting those shares. This process was undertaken by merely passing a board resolution, as the petitioner, basis a legal opinion sought, believed the same would not tantamount to reduction of capital under the provisions of the Companies Act.

The request of the Petitioner to list these reduced shares was rejected by the Bombay Stock Exchange ("BSE") and this wasn't communicated to the Petitioner owing to a change of address. The Petitioner stated that being unaware of the decision of BSE of non-listing, the petitioner recognized share capital in its audited financial statement, annual returns and other documents, giving effect to the shareholding structure as effectuated by the abovementioned board resolution. It was only at a subsequent stage, when a change in the capital structure of the company was being contemplated, the refusal to list the aforesaid shares came to the knowledge of the Petitioner. Following this, and upon the advice of BSE Limited, the Petitioner approached the Hon'ble Bombay High Court for sanction of the present Scheme, which would subsequently result in the ratification of the above corporate action, subsequently transferred to this Bench. The Company then filed for a composite scheme of arrangement for ratifying the earlier capital reduction, reconstitution of the share capital and reconciliation with the share capital numbers. The Regional Director raised certain objections. However, the same were averred on the basis of being too technical and procedural in nature.

Further, one of the minority shareholders holding 15 shares objected that the given scheme did not qualify as an "arrangement" envisaged under section 230-232 of the Companies Act, 2013. In response to the said objection, the Petitioner's Counsel cited various judicial precedents that have observed that mergers and demergers are not the only components of a "scheme of arrangement" and that the term "arrangement" is of wide amplitude, although not defined in the Companies Act. The Counsel also stated that there was no impact on the shareholding of the existing public shareholders. Further, the objecting minority shareholder had very less number of shares, insufficient to raise any objection before the Tribunal. The Tribunal held that in order to find solutions to corporate problems, a scheme can take multiple hues and confirming it to set parameters would cause injustice to the petitioners and shareholders alike which was certainly not the intent of the lawmakers. Even if the Scheme purports to rectify and regularise the allotments already made by the Petitioner, there is no reason why the Scheme should not be treated as an "arrangement" between the company and its shareholders.

1 CP (CAA)/190/MB.I/2017 in the case of Kumaka Industries Limited dt. July 6,2020

SECURITIES AND EXCHANGE BOARD OF INDIA ('SEBI') UPDATES

JULY 2020

SEBI Regulatory updates

SEBI revises pricing guidelines for preferential issues[1]

The minimum price at which a listed company can undertake a preferential issue is determined by a formula set out in the ICDR Regulations factoring historical share prices prior to a relevant date. In case of listed companies whose shares are frequently traded, the formula specifies the minimum price per share to be the higher of, average of the weekly high and low of the volume weighted average price (VWAP), during preceding 26 weeks and 2 weeks.

As a result, although the securities market has seen a significant downtrend during the last few months, the price at which a preferential issue could be undertaken would invariably be at a premium over the prevailing market price.

Basis numerous representations, SEBI has decided to relax this requirement by providing an alternate formula for determining the pricing of preferential issues proposed to be undertaken between July 1, 2020 or the date when the amendment is notified, whichever is later, and December 31, 2020. As per this relaxation, the look back period of 26 weeks has been reduced to 12 weeks, thereby reducing the impact of the higher market prices preceding the downturn. In lieu of the pricing relaxations and in an effort to discourage short term investments, the applicable lock-in period has been set to 3 years.

1 Notification No. SEBI/LAD-NRO/GN/2020/21 dt. July 1, 2020

STAMP DUTY LAW UPDATES

JULY 2020

STAMP DUTY - Regulatory updates

Department of Economic Affairs ("DEA"): FAQs on Stamp Duty pertaining to securities released [1]

With the objective of bringing uniformity in the stamp duty levied on securities transactions across states, the DEA amended the Indian Stamp Act, 1899 (revised Act), through Finance Act, 2019, and the relevant Stamp Rules, 2019, were notified on December 10, 2019. The amendments have come into effect from July 1, 2020. The DEA has released a set of Frequently Asked Questions on the revised Act, providing clarifications on various issues ranging from the rationale for the amendments and the benefits arising therefrom to the procedure and manner of collection of the duty to applicability of stamp duty on mutual fund units and related issues. A few noteworthy clarifications are summarised as below:

- It is clarified that off-market transfers not involving consideration, for example transfer pursuant to gift or legacy transfer should not attract stamp duty since the amended provisions clearly indicate that stamp duty is to be collected on market value which is based on price or consideration involved;
- By the same logic, it has been clarified that since no consideration is involved in bonus issue, bonus shares will not attract stamp duty.

A brief snapshot of the applicable Stamp Duty Rates w.e.f. July 1, 2020 has been given in the table below:

Sr. No.	Instruments	Rate of Duty
1	Issue of Debentures	0.005%
2	Transfer and Re-Issue of Debentures	0.0001%
3	Issue of Security other than Debentures	0.005%
4	Transfer of security other than debenture on delivery basis	0.015%
5	Transfer of security other than debenture on non-delivery basis	0.003%