Devadhaantu Insights – April 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

APRIL 2020

Direct tax updates (1/4)

Brought forward business loss be set off against income from dividend received pursuant to investment made in subsidiary companies under joint venture agreement (Strategic investment)

Assessee Company is engaged in the promotion of industries in TamilNadu by making investment in various companies as well as having joint ventures thereon. The amounts invested in those companies were by way of investment in shares for which the resultant income would be in the form of dividend till the time of holding of those shares. The said dividend income according to the assessee was to be reflected under the head 'income from business' and exemption, if any, provided U/s.10 of the Act should be claimed thereon.

AO had adjusted the brought forward business loss against the taxable income which pertained to income from other sources after set off of current year business loss. The Ld.CIT observed that brought forward business loss could be set-off only against business income of the assessee and since, in the opinion of the Ld.CIT, there was no business income for the assessee during the year under consideration, he held that the order passed by the Ld.AO is erroneous and prejudicial to the interest of the Revenue by allowing the set-off of brought forward loss.

As per submission made by assessee, referance was made to the agreement entered into with various industries wherein it is very clear that the assessee does not merely make investment in the said companies, but also participates in the day to day management in the affairs of the said company. Further, reference was made to the decisions of the highest authority[2] which hold that notwithstanding the statutory requirement that the computation of the dividend income had to be under the head "other sources", still the income could be treated as business income for all other purposes. Accordingly, based on ruling in favour of the assessee in previous assessment years, the Department argued that although the first investment in the various entities partakes the character of investment in various sectors through the investee companies, the subsequent investment does not qualify as the same and hence, income from subsequent investment in same investees should be considered as dividend income, and that findings of previous decisions cannot be applied in favour of the assessee perpetually.

The Hon'ble ITAT in this regard accepted the assessee's contention that the subsequent investment was made to ensure continuity of controlling stake in the investee companies, and does not change the character of the investments made. Therefore, it ruled in favour of the assessee and allowed dividends from all investments including subsequent investments, to be taxed as business income. As a result, brought forward business losses could be set of against this dividend income.

[1] M/s Tamilnadu Industrial Development Corporation Limited vs ACIT [ITA No. 1181/chny/2008] - [Chennai ITAI]

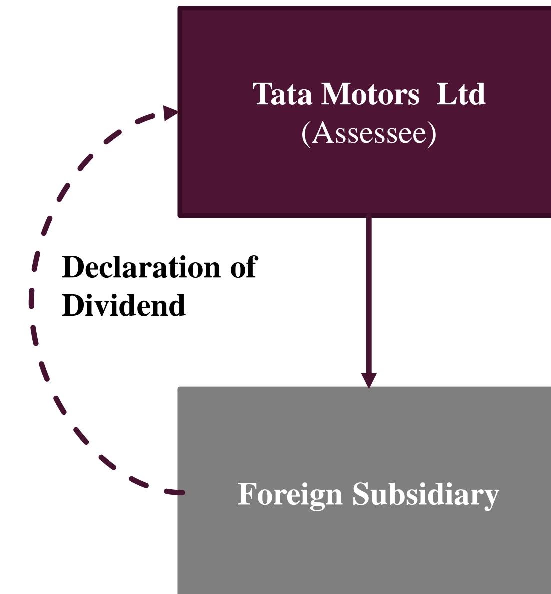
[2] Commissioner of Income-tax v. Cocanada Radhaswami Bank Ltd. and Commissioner of Income-tax v. Chugandas & Co.

Direct tax updates (2/4)

Setoff of business loss against dividend from foreign subsidiary is allowed to be set-off [1]

Assessee had incurred business loss in the year under consideration and same had been set-off against the dividend income received from the specified foreign companies.
The AO contended that the dividend received is required to be taxed separately @ 15% under Section 115BBD, and that set-off of business loss is not available against the same.

ITAT allowed the assessee's appeal stating that, in the absence of any positive income after set-off of loss from one head of income against another head of income u/s. 71 of the Act, the chargeability provision as per section 115BBD of the Act fails to apply; Section 115BBD(2) of the Act which begins with non-obstante clause restricts allowability of only 'expenditure' or 'allowance' and thus, in the absence of any express provision for restriction on allowability of 'loss', the said business loss of current year is allowable to be set-off against such foreign dividend income as per provisions of section 71 of the Act;
The law is quite clear and no adjustment can be made separately for section 115BBD and the provisions of section 70 and 71 of the Act are applicable in the assessee's case. Therefore, the taxable income should be determined in accordance with section 70 and 71 first and then any tax has to be determined subsequently.
Accordingly, set off of business loss against dividend income is allowed.



[1] Tata Motors Ltd. [TS-166-ITAT-2020(Mum)] dated 6th March, 2020

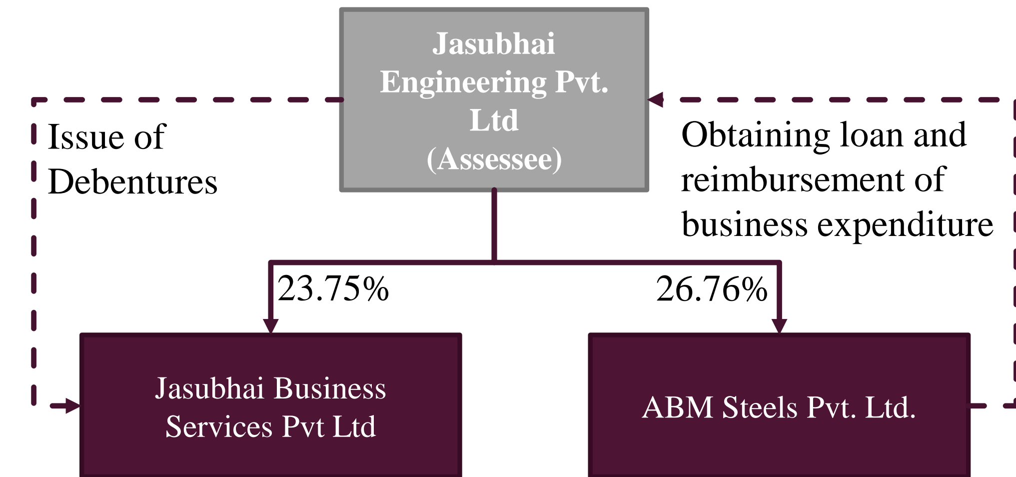
Direct tax updates (3/4)

Issue of Debentures cannot be subjected to invocation of deemed dividend provisions [1]

Assessee has beneficial shareholding in 2 companies and assessee has taken loan from one of such companies, having positive accumulated reserves in the books. Part of such loan was repaid by assessee and balance part of sum of money was towards reimbursement towards the purchase of machineries on behalf of assessee for business purpose. And also, assessee had received sum of money towards issue of double option debentures, issued by other such company. Considering the above facts, and also that both the companies are closely held, AO invoked the provision of section 2(22)(e) of the Act by relying on various case laws.

CIT (A) deleted the addition made by AO towards deemed dividend in relation to intercompany transaction in case of first associate company, however, retained the deemed dividend invocation towards second associate company.

On further appeal to ITAT, addition towards deemed dividend in case of first associate company in relation to intercorporate deposit was retained as assessee received some benefit out of the loan money even though same was repaid. Addition made towards reimbursement towards purchase of machinery was deleted as it construed business transaction. Addition made by AO towards issue of debentures was also deleted as provisions of deemed dividend are attracted only when loan and advances taken and direct issue of debenures cannot be equated with loan or advance.



[1] Jasubhai Engineering Pvt. Ltd [TS-167-ITAT-2020(Mum)], dated 6th March, 2020

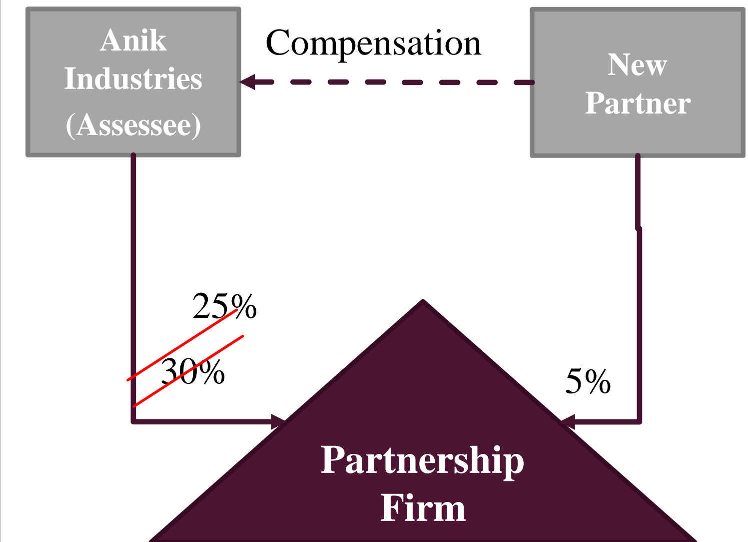
Direct tax updates (4/4)

Compensation received upon reconstitution of partnership interest cannot be considered as transfer of capital asset

Assessee had received compensation upon surrender of 5% of partnership interest, which AO brought to tax under the head Capital Gains. AO stated that at the time of reconstitution of the firm, one of the methods to compensate for the goodwill would be that new incoming partner agrees to make payment directly to the old partners without involving the firm. The said payment was nothing but consideration for intangible asset i.e. the loss of share of partner in the goodwill of the firm and accordingly liable to capital gains tax. CIT(A) confirmed the addition made by AO.

On further appeal to ITAT, assessee submitted that compensation received by a partner from another partner for relinquishing rights in the partnership firm would be capital receipt and there would be no transfer of asset within the meaning of Sec.45(4) of the Act. The assessee reiterated that the rights of the existing partner was reduced and new right was created in favor of the existing partner, keeping partners ownership intact even with the change in the constitution of the firm.

ITAT ordered that relinquishment of partnership interests in favour of existing partner does not tantamount to capital gains as in the instant case it was only realignment of partnership interest and not transfer of interest to third party. During the subsistence of a partnership, a partner has a right to obtain a share in profits. On a dissolution of a partnership or upon retirement, a partner is entitled to a valuation of his share in the net assets of the partnership which remain after meeting the debts and liabilities. An amount paid to a partner upon retirement, after taking accounts and upon deduction of liabilities, does not involve an element of transfer of capital asset.



[1] M/s Anik Industries Limited vs DCIT [ITA No. 7189/mum/2014]

CORPORATE LAW UPDATES

APRIL 2020

Corporate Law updates

NCLAT set aside the order imposed by CCI in relation to disregarding de-minimis exemption in case of Target by covering Target's parent entity under its purview [1]

The given decision revolves around the applicability of the De Minimis Exemption which would not apply if the sales and assets of an entity would fall below a certain given threshold. The facts are Eli- a company based in the United States agreed to acquire the global animal health business of Novartis AG. With respect to the Indian leg of the transaction, the parties believed it to be covered under the then applicable de Minimis Exemption which applied to the acquisitions of enterprises whose sales in India were not more than INR 750 Crs or whose Indian assets valued not more than INR 250 Crs and hence the Competition Commission of India ("CCI") was not notified.

However, the CCI, issued a letter asking as to why the transaction was not notified to which Eli responded that the transaction was exempt under the de Minimis Exemption as the target business only had a turnover of INR 93 Crs and assets worth INR 36.2 Crs. However, the parties also decided voluntarily to notify the transaction to CCI.

The CCI further concluded, without citing any reasons, that the transaction was reportable. Although the CCI approved the transaction, it issued a show cause notice to Eli to show cause why it should not be penalized for not notifying the transaction in India. Eli again responded that the transaction was exempt under the de Minimis Exemption. Post which, the CCI imposed a penalty of INR 1 Crore by asserting that the thresholds of the de Minimis Exemption did not apply to the business being acquired i.e. the Animal Health Business but rather to the target's parent i.e. Novartis India Ltd, which was not covered by the de mimimis exemption. This decision was based solely on the ground that the parent was an incorporated entity that animal health business was a mere portion of the entire Indian operations of Novartis.

Aggrieved by the decision of the CCI, Eli approached the NCLAT in appeal contending that such an interpretation of the de Minimis Exemption by the CCI was wrong and it had incorrectly applied the thresholds to the target's parent company merely because the target was not incorporated. The NCLAT also clarified that for the purpose of calculation of assets and turnover what is being acquired is relevant, as the assets/turnover of what is left over with the sellers after the acquisition will have no role to play in the context of the business conducted by the purchaser post acquisition. Accordingly, the NCLAT held that since the turnover and assets attributable to the target was INR 93.9 Crores and INR 36.2 Crores respectively, the transaction was exempt under the de Minimis exemption and therefore was not required to be notified to the CCI.

[1] NCLAT New Delhi - TA (AT) (Competition) No. 03 of 2017 dt. March 12, 2020

Corporate Law updates

High Court of Madras holds that merely because shares were allotted on right basis to existing shareholders, it cannot be said that the rights issue converted into a public issue [1]

The Company allotted shares to existing shareholders on a right basis and many of the existing shareholders renounced their right in favour of others who were not shareholders. On that basis, the ROC alleged that since the right was renounced in favour of more than 50 persons, the rights issue has converted into a public issue and thereby, a prospectus is to be issued.

The Court held that the Company has no control on the right of renunciation by shareholders, which maybe in favour of any person including a third person (non-shareholder). It also referred to the clarification issued by MCA stating that right issue does not require issue of prospectus.

Thus, it was held that the rights issue continued to remain as such and no public issue related requirements applied in this case.

[1] Vikramjit Singh Oberoi vs Registrar of Companies [2020] 114 taxmann.com 512 (Madras)

OTHER REGULATORY UPDATES

APRIL 2020

Other Regulatory updates

NCLAT: CCI order imposing penalty on gun jumping set aside[1]

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