Devadhaantu Insights – August 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!

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Thank You

Contact@devadhaantu.in

www.devadhaantu.in

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DIRECT TAX UPDATES

AUGUST 2020

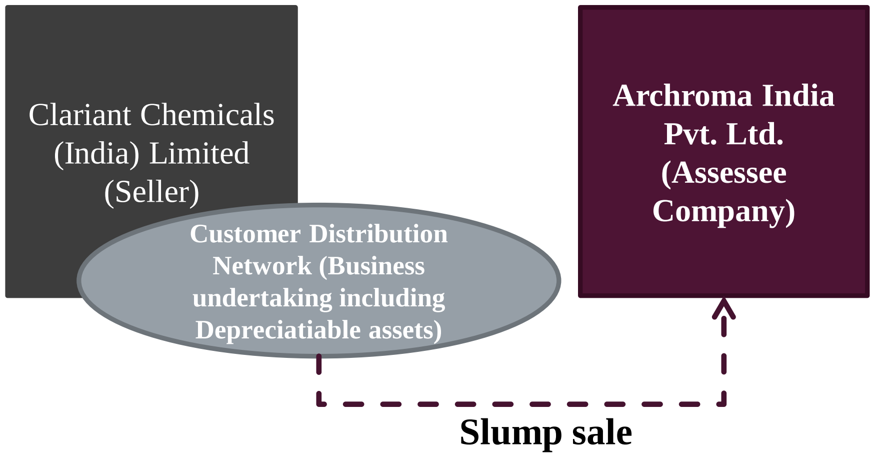
Direct tax updates (1/6)

Depreciation claim on assets received pursuant to slump sale restricted basis WDV in the hands of seller; Depreciation on excess consideration, being Goodwill, allowed to be claimed

Assessee had entered into a Business Transfer Agreement ('BTA') for purchase of a business undertaking by way of slump sale. Based on valuation report, assets were recorded at their fair value by following purchase price allocation and accordingly, such fair value was considered as the cost of acquisition for claiming depreciation under Income Tax Act, 1961 ('ITA').

AO held that acquisition by way of slump sale falls within the ambit of succession u/s 170(1) of the ITA and disallowed the depreciation claim based on the fair value the assets acquired by invoking the sixth proviso (Erstwhile 5th Proviso) to section 32(1). Pursuant to this, aggregate depreciation claim made by assessee and transferor needed to be bifurcated on the basis of days of usage such that aggregate depreciation claim would not be in excess had transfer not taken place.

The Tribunal confirmed the above disallowance of depreciation claim basis fair market value of the assets by holding that succession provisions covered u/s 170 of the ITA is applicable to transfer of assets and since the assets were acquired as a part of business undertaking by way of slump sale, following the principle of the Noscitur a sociis; However, the Tribunal upheld the alternative claim of the assessee and allowed depreciation claim on goodwill, being the difference between the fair value of such assets and the tax WDV in the hands of Seller. This enabled assessee to claim higher depreciation.



1 Archroma India Pvt. Ltd (ITA Nos. 306/Mum/2019 and 6919/Mum/2018 and C.O. No. 07/Mum/2020)

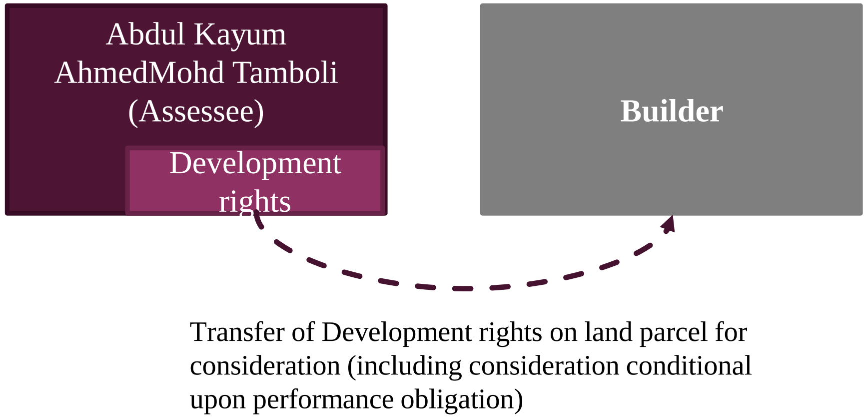
Direct tax updates (2/6)

Transfer of development rights held as 'Business Asset', to be taxed as Business Income; Tax deferral allowed on any consideration that is conditional on the performance obligation on seller

The assessee is a civil contractor and he had transferred certain development rights in a land parcel to a builder. As per the terms of the Agreement, the assessee had handed over the development rights for a consideration and part payment was received by him.

The assessee offered net sale consideration (after deducting relatable expense) for tax as business income. However, the AO held that since the assessee parted with development rights and possession of land was also given to the developer, the same fell within the definition of 'transfer' within the scope of section 2(47) of the IT Act and taxed the entire sale consideration upfront in the year of transfer restating it as Capital Gains.

The Tribunal observed that since the assessee had considered its income as business income, therefore, the provisions of transfer as specified under section 2(47)(v) of the IT Act would not be applicable as the same is applicable only in case of a capital asset held by an assessee and not business assets. Further, in view of fact that in terms of agreement only part income accrued to assessee and since the balance consideration was a conditional receipt which would accrue only in subsequent years in event of assessee performing certain contractual obligations, entire amount of sale consideration could not be brought to tax in assessment year in question.



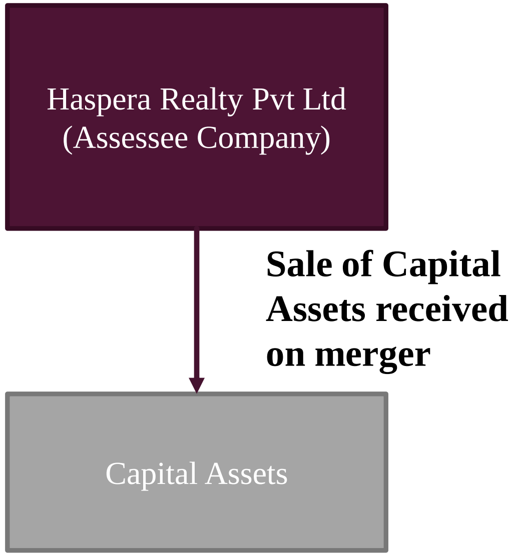
[1] ITO v. Abdul Kayum AhmedMohd. Tamboli [2020] 117.taxmann.com 637 (Mumbai – Trib)

Direct tax updates (3/6)

Rejection of recharacterization of capital reserve arising out of amalgamation as revaluation reserve to be added back to book profits for MAT computation[1]

In the given case, pursuant to scheme of amalgamation, five companies (related to the assessee) amalgamated with the assessee. All assets and liabilities (including shares in a company) were transferred to the assessee upon merger with effect from the appointed date; Aforesaid shares were recorded at their fair values in the books of assessee by following ‘purchase method’ of accounting for merger recordal under AS-14. Further, the difference between the fair value of assets and liabilities taken over upon merger by the amalgamated company, was recorded as capital reserve by the amalgamated company. Subsequent to merger, the assessee sold part of aforesaid shares (received upon merger) on a recognised stock exchange and claimed the long-term capital gains tax exemption under erstwhile section 10(38) of the ITA. In the books of account, since the shares were transferred at their fair value, the resultant gain was credited as part of ‘Other Income – profit on sale of equity shares’ which was considered in the book profits under MAT.

The AO disregarded the treatment adopted upon merger by assessee in the books of accounts and considered the difference arising on account of revaluation as revaluation reserve instead of capital reserve on the ground that merger was carried out with the intent of evading tax on book profit. On appeal, the Delhi Tribunal rejected the AO’s re-characterization by holding that revaluation reserve is created when an entity revalues its own assets, already acquired and recorded in its books at certain values while in the instant case, the assessee had not revalued its existing asset but only recorded fair values of assets and liabilities acquired pursuant to Scheme as its cost of acquisition.



While calculating Book Profit for the purposes of MAT liability, difference between Actual cost and fair value of capital asset (upon merger) recorded as Capital Reserve and not to be routed through profit and loss account as Revaluation reserve

1 Haspera Realty Pvt Ltd vs DCIT (ITA No. 764/Del/2020)

Direct tax updates (4/6)

Addition made in the hands of sole beneficiary of an Offshore Family Trust for the funds held Swiss bank account of Cayman Islands based underlying company of such a family trust [1] (1/2)

Based on a 'base note' received by investigating wing as a part of Swiss Leaks, the income-tax department re-opened the assessment of Mrs. Renu Tharani ('the Assessee') for the Assessment Year 2005-06. Base note revealed that the assessee was the sole 'discretionary' beneficiary of a 'Tharani Family Trust' which has an underlying company based in Cayman Islands and which operated the HSBC Geneva bank Account.

AO added an income of INR 196 Crs as undisclosed income u/s 69 of the Income Tax Act, 1961 ('the ITA') which was the peak balance held in the HSBC bank account and as income which had escaped assessment.

The assessee, during the course of re-assessment proceedings, raised several objections as under:

- She was a non-resident under section 6(1) of the ITA and thus any income outside India was not liable to be taxed as per provisions of section 9(1) of the ITA;
- She had not maintained any bank account with HSBC Bank, Geneva and also is not the owner of the said bank account;
- Instead, the account was maintained by GWU Investments Limited, a Cayman Island based company and an underlying company of Tharani Family Trust for which the assessee was the beneficial owner;
- Letter from HSBC Bank confirming the fact that no payment was made to her either as a beneficiary or as a beneficial owner by GWU Investments Limited.

However, the Mumbai Tribunal confirmed the addition by holding that the reopening of the assessment and the addition to the total income are valid on the following observations-

- The assessee had not disclosed Swiss account details in her return of income;

[1] Renu T Tharani v. DCIT [2020] 117 taxmann.com 804 (Mumbai - Trib.)

Direct tax updates (4/6)

Addition made in the hands of sole beneficiary of an Offshore Family Trust for the funds held Swiss bank account of Cayman Islands based underlying company of such a family trust (2/2)

- The Tribunal observed that within a short time of information about the bank account coming into the possession of the AO,
  i. the account was closed;
  ii. the underlying company was closed as its name was struck off from Registrar of Companies, Cayman Islands;
  iii. whatever assets were held in this bank account were transferred back to GMW Investments Ltd, a company in Cayman Islands- a tax haven where it is almost impossible to find out about beneficial owners of a corporate entity; and
  iv. the Tharani Family Trust stood terminated;
- Further, the Tribunal noted that in response to specific request from AO, the assessee had declined to sign 'consent waiver' (i.e. enforcing privacy under the Swiss secrecy and data protection laws) and the effect of not signing was depriving the AO to seek relevant information from the bank in respect of assessee's account;
- Referring to the information received and the inability to furnish a Trust Deed or relevant documents, the Tribunal asserted that the assessee is a beneficiary and a beneficial owner of GMU Investments Ltd, a Cayman Islands entity.

Direct tax updates (5/6)

SC holds Project Office not carrying out core business would not constitute a Permanent Establishment in India [1]

Samsung Heavy Industries Co. Ltd (‘the assessee’), a Korean Company, was awarded a turnkey project in India for which it had set up a Project Office (‘PO’) which served as a co-ordination and a communication channel. The issue raised in this case was whether such PO was a mere liaison office or was involved in the core activity of execution of the project itself as a Permanent Establishment (‘PE’) of the assessee in India under Article 5(1) of India-Korea DTAA.

After a detailed examination of all the documents, the Supreme Court (‘SC’) held that the PO carried out activities that were preparatory and auxiliary in nature and did not constitute a fixed place PE of the assessee in India.

The key observations are as follows:

- The condition precedent for applicability of Article 5(1) of the DTAA and ascertainment of a PE is that it should be an establishment through which the business of an enterprise is wholly or partly carried out. Profits of the foreign enterprise are taxable only where the said enterprise carries on its core business through a PE;

- The PO of the assessee was established to execute delivery documents in connection with the contract and the fact that no expenditure relating to the turnkey project was incurred would elucidate that non-core functions were only carried out;

- Further, since only two people were working in the PO, neither of whom were qualified to perform any core activity, it was held that the PO was merely an auxiliary office to act as a liaison between assessee and ONGC.

[1] Director of Income-tax v. Samsung Heavy Industries Co. Ltd [2020] 117 taxmann.com 870 (SC)

Direct tax updates (6/6)

Memorandum of Understanding ('MoU') signed by CBDT with MSME and CBIC respectively

- A MoU is signed between CBDT and the Ministry of Micro, Small and Medium Enterprises, Government of India ('MSME') which will facilitate seamless sharing of certain Income-tax Return related information by Income-tax Department to MSME.
- Further, CBDT has also entered in a MOU with the Central Board of Indirect Taxes and Customs ('CBIC') which will facilitate sharing of data and information on an automatic and regular basis. In addition to regular exchange of data, CBDT and CBIC will also exchange (on request and spontaneous basis) any information available in their respective databases which may have utility for the other organisation.

PAN exemption for Non-residents investing in IFSC based Cat-I and Cat-II AIFs

CBDT has inserted Rule 114AAB, notified vide the Income-tax (19th Amendment) Rules 2020 to exempt all non-residents (including foreign companies) who have, during a previous year, made investment in an alternative investment fund (AIF) located in IFSC and is registered as a Category I AIF or Category II AIF, from the mandatory requirement of obtaining PAN from the income tax authorities, if the following conditions are met:

- Non-Resident does not earn any income in India, other than the income from investment in IFSC based Category I AIFs or Category II AIFs, during the previous year;
- Any income tax due on income of Non-Resident has been deducted at source and remitted to the Central Government by such IFSC based Category I AIF or Category II AIF, in accordance with section 194LBB of the ITA; and
- Non-Resident furnishes the requisite details and documents (such as contact details and address of the Non-Resident, declaration of residence of such Non-Resident outside India, and the tax identification number or unique identification number allocated to such Non-Resident in its country of residence) to such IFSC Category I AIF or Category II AIFs.

IFSC based Category I AIFs and Category II AIFs would be required to furnish a quarterly statement (in Form 49BA) capturing the aforementioned information received by it from Non-Resident investors, within 15 days from the end of the quarter. Additionally, the provisions of section 206AA (which provides for higher rate of withholding in the absence of PAN) would also not apply to payments made to a Non-Resident, pursuant to the exemption granted to it under Rule 114AAB.

CORPORATE LAW UPDATES

AUGUST 2020

Regulatory updates (1/2)

A memorandum of family settlement does not require registration and is binding on the parties[1]

In this case, the family members entered into a family settlement in the year 1970 settling a dispute regarding a property by entering into memorandum of family settlement, which was not registered. Family members had acted upon the memorandum of family arrangement. Later in 1988, one of the family members raised issues to retract from the memorandum, resulting in disputes between the family members. Thus, suit was filed by the other family member in possession of property for declaration contending that he was the owner in possession on strength of this settlement.

The issue before the SC was whether a memorandum of settlement required registration since by way of said document the interest in immovable property was transferred in favour of one of the family members.

Hon'ble SC noted that the HC not doubted the factual findings that there was not only univocal family arrangement between the parties in 1970, but it was even acted upon them without any exception. The SC relying on the judgement of Kale & Ors.[2] held that a distinction should be made between a document containing the terms and recitals of a family settlement and a mere memorandum of family settlement entered into. Thus, SC held that document executed in 1988 between the parties was merely a memorandum of settlement. A mere memorandum to family settlement prepared after the family arrangement had already been made either for the purpose of the record or for information of the court for making necessary mutation does not require registration.

It held that it is a settled legal position that when by virtue of a family settlement or arrangement, members of a family descending from a common ancestor or a near relation seek to sink their differences and disputes, settle and resolve their conflicting claims or disputed titles once and for all in order to buy peace of mind and bring about complete harmony and goodwill in the family, such arrangement ought to be governed by a special equity peculiar to them and would be enforced if honestly made. The object of such arrangement is to protect the family from long drawn litigation or perpetual strives which mark the unity and solidarity of the family between the various members of the family. Accordingly, a memorandum of family settlement does not require registration and is binding on the parties.

1 Ravinder Kaur Grewal & Ors. v. Manjit Kaur & Ors. [Civil Appeal no. 7764 of 2014 (SC)]
2 Kale & Ors. v. Deputy Director of Consolidation & Ors [3 (1976) 3 SCC 119]

Regulatory updates (2/2)

Ministry of Corporate Affairs ('MCA') has notified amendments to Indian Accounting Standards ('Ind AS')[1] (1/2)

The MCA, vide, Notification dated July 24, 2020 has issued Companies (Ind AS) Amendment Rules, 2020, containing amendments to certain Ind AS. Key amendments are as under:

Amendment in Ind AS 103 - Business Combinations

- **Definition of business**

i. The requirement of identifying a business combination has been substituted to provide that the assets acquired and liabilities assumed constitute a business. If the assets acquired are not a business, the reporting entity shall account for the transaction or other event as an asset acquisition.

ii. Further, it clarified that to be considered a business, an acquired set of activities and assets must include, at a minimum, an input and a substantive process that together significantly contribute to the ability to create outputs;

- **Incorporation of optional concentration test**

i. The amendment also added an "optional concentration test" that permits a simplified assessment of whether an acquired set of activities and assets is a business or not.

ii. The concentration test is met if substantially all of the fair value of the gross assets acquired is concentrated in a single identifiable asset or group of similar identifiable assets.

iii. An entity may elect to apply (or not apply), the test and may make such an election separately for each transaction or other event.

Regulatory updates (2/2)

Ministry of Corporate Affairs ('MCA') has notified amendments to Indian Accounting Standards ('Ind AS')[1] (2/2)

Amendment in Ind AS 107 and Ind AS 109 - Financial Instruments

- Modification in relation to specific hedge accounting requirements to provide relief to the potential effects of uncertainty caused by the interest rate benchmark (IBOR) reform.

Amendment in Ind AS 116 – Lessees

- Provides lessees with an exemption from assessing as to Covid-19 related rent concession is a lease modification. Further, if not a lease modification then requires the lessees to account for Covid-19 related rent concessions. Requires lessees to apply the exemption retrospectively in accordance with Ind AS 8 (Accounting Policies, Changes in Accounting Estimates and Errors), but not require them to restate prior period figures.