Devadhaantu Insights – February 2021

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. 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

FEBRUARY 2021

Direct tax updates (1/8)

Stamp duty valuation under section 50C does not apply to the sale of 'rights in land' [1]

Assessee, an Individual, running a proprietary concern had entered into an unregistered agreement with M/s Namaste Exports Ltd for purchase of land. The assessee paid 80% of the consideration, but neither the possession of the land nor a Power of Attorney was executed in favour of assessee. Later on, the land was sold by Namaste Exports Ltd. with assessee's consent. Assessee was mere a consenting witness to the transaction. The circle rate of plot as per stamp duty rate was far more but the assessee opted for showing the capital gain by adopting the sale consideration as per sale deed and supported it by a market value certification from registered valuer.

During assessment proceedings, section 50C was invoked with respect to sale of land and computation of capital gains was made in the hands of the assessee. Assessee submitted that Section 50C merely refers to Land and Building and not immovable property and that rights held for specific performance cannot be equated with land as it is merely a right to sue under the agreement for sale.

Based on assessee's submission, Karnataka HC reconfirmed the assessee's contention and stated **that provisions of section 50C will not be applicable while computing the capital gain on transfer of leasehold rights in land and plot as section 50C uses the word 'land' instead of the term 'immovable property'.** Further it remarked that wherever the legislature intended to expand the meaning of land to include rights/ interests in land, it had included it specifically in sections such as in section 35(1)(a), section 54G(1), section 54GA(1) and section 269UA(d). It was also stated that it is a settled rule of statutory interpretation with regard to taxing statute that a taxpayer cannot be taxed without clear words for that purpose and every act of parliament has to be read as per its natural construction of words.

[1] V S Chandrashekar ITA No. 70 of 2015

Direct tax updates (2/8)

Stamp duty valuation under section 50C does not apply to the sale of letter of Intent (rights to possess land) [1]

Assessee had purchased land in AY 2005-06, which was compulsorily acquired by GMADA. In lieu of this acquisition, the assessee was allotted three residential plots in Mohali by way of a letter of intent (LOI). During the AY 2015-16, assessee offered capital gains on transfer of LOI in respect of those three residential plots. The Income Tax Authorities taxed the transfer as capital gain after applying stamp duty valuation under section 50C.

The Tribunal held that "Two major and relevant takeaways from section 50C are that it is a deeming provision and applicable to transfer of land and /or building. Being a deeming provision, it is settled law, it can be applied only in the situation specifically given and cannot go beyond the explicit mandate of the section. What is to be adjudicated therefore is whether LOI qualifies as Land and/or Building in terms of the said section."

The Tribunal perused the contents of LOI and observed that the compensation for land acquired is by way of "developed" residential/commercial land. Further, the Tribunal stated that "the LOI's did not confer ownership of specific developed plot of land. They only state allotment of area of residential plot without mentioning specific plot number. The specific allotment is to be done by draw of lots as stated in the land pooling policy of the government. The LOI's therefore confer only a right to own developed land of specific area, to be developed and also to be identified at a future point in time, they do not confer owner ship of specific land in present. Strictly speaking therefore LOI's cannot be equated with land."

Therefore, the Tribunal concluded **that LOI is only a right to possess plot of land and not land itself and therefore the provisions of section 50C are inapplicable to the present case.**

1 Raminder Singh [TS-55-ITAT-2021(CHANDI)]

Direct tax updates (3/8)

Compensation received for cancellation of Letter of Intent(rights to possess plot of land) liable to tax as Capital Gains

The assessee had entered into an agreement through a LOI with a builder-company by depositing a sum for acquiring shares in the company which would enable him to occupy/ possess the flat upon construction. Subsequently, the LOI was cancelled as the builder did not obtain permits for construction and assessee received refund of the deposit as well as compensation for an opportunity lost. The assessee treated the difference between the indexed cost of acquisition and the aggregate of refund and compensation as capital loss. The Income Tax Authorities rejected assessee's stand and treated the compensation amount as Income from Other Sources.

The assessee contended before the Tribunal that the agreement with which the flats were booked created a right in favour of the assessee in the immovable property and which upon cancellation would entitle the assessee to receive compensation along with the money already paid as deposits, for surrender of that rights in immovable property. The Income Tax Authorities on the other hand, contended that LOI cannot be said to be an agreement as the provisions of Maharashtra Ownership Flats (Regulation of the promotion of construction, sale, management and transfer) Act, 1963 (MOFA) was not followed by the assessee. The Tribunal observed that LOI executed by the assessee was as good as agreement to sell in all respects and held that it created a right in property in favour of the assessee. The Tribunal further held that provisions of MOFA cannot regulate the taxability of income. Placing Reliance on Bombay HC ruling in Vijay Flexible Containers[2], and co-ordinate bench ruling in Ashwin S.Bhalekar[3] held that right to obtain conveyance of immovable property fell within the expression 'property of any kind' and relinquishment of right in the property amounts to transfer of property.

1 Shri Shailendra Bhandari [TS-45-ITAT-2021(Mum)] 2 Vijay Flexible Containers [[TS-3-HC-1989(BOM)] 3 Ashwin S.Bhalekar [TS-303-ITAT-2019(Mum)]

Direct tax updates (4/8)

Income from sale of strategic investment into foreign subsidiaries' shares is taxable as LTCG if held as Investment [1]

The assessee company had sold certain shares held in its subsidiary which were incorporated in British Virgin Islands, disclosed as investment in the financial statements of the assessee and the purpose of the assessee's business was not trading in shares.

The assessee contended that the purpose of setting up of the subsidiary was to consolidate its investment in various operating companies and not to trade in the shares of subsidiary. The Income Tax Authorities contended that the transfer price of shares exceeded the cost price and treated the income from sale of such shares as business income.

Karnataka ITAT had rejected Income tax authorities contention and while citing CBDT Circular No. 4/2007 held that no single test is conclusive and it is the cumulative effect of all relevant factors which will be taken into consideration in reaching a conclusion as regards the nature of share. The Tribunal also referred to Circular No. 6 / 2016 wherein emphasis is given on treatment done by the assessee in the books for determining treatment of income from sale of shares. The admitted position with regard to treatment in the books of accounts is that the shares have been treated as investment and not as stock-in-trade. In the light of the facts of the cases and circulars mentioned, it was held that the income on sale of shares has to be regarded as LTCG and not business income in the hands of assessee.

1 United Spirits Limited [TS-68-ITAT-2021(Bang)]

Direct tax updates (5/8)

Capital loss arising on forfeiture of money paid against share warrants allowed

Assessee Company filed its return of income for subject AY declaring a short term capital loss arising from the upfront amount for part payment against warrants of Indiabulls Power Limited. The assessee company explained that the company conveyed its unwillingness to the Indiabulls Power Limited to exercise the warrants. Consequently, the upfront amount paid by the company towards part payment against the said warrants was forfeited and the same was charged to the statement of profit and loss account as loss on share warrants and claimed in the return of income. AO held that the assessee company was a conduit for transfer of the amount to the credit in the books of Indiabulls Power Limited as a capital receipt. Accordingly, he held that it is a colourable device created to camouflage the credit of the amount to Indiabulls Power Limited as a capital receipt to avoid the application of section 68 and disallowed the STCL claimed.

The Delhi Tribunal acknowledged the AO's contention believing that act of transfer of sum was to avoid tax for which assessee company was one of the layers used by the Indiabulls Group. However, considering that assessee company is not the beneficiary but the real beneficiary of such receipt of sum is Indiabulls Power Limited, needs to be held liable to tax, in light of the fact that India Bulls Power Limited had gone further into restructuring and Scheme of amalgamation. Placing reliance on Delhi HC ruling in Chand Ratan Bagri (supra), the Tribunal held that forfeiture of the convertible warrant had resulted in extinguishment of the right of the assessee and thus constituted transfer under section 2(47) and accordingly, had allowed the claim of Short Term Capital Loss.

1 Azalea International Pvt Ltd [TS-69-ITAT-2021(DEL)]

Direct tax updates (6/8)

Option price received annually by the assessee from its British JV partner as a minimum guarantee for mandatory first sale of shares upon relaxation of FDI norms in the insurance sector is a capital receipt[1]

Assessee entered into a JV as CUG Life Insurance Co Private Limited which was renamed as Aviva Life Insurance Co Private Limited to carry out the insurance business with CUIH in 74:26 shareholdings. The JV agreement provided for annual payment of option price at 20% of the subscription price by CUIH to Assessee against the right of first refusal at the time of sale of shares by Assessee in the wake of relaxation in FDI policy in insurance sector.

The assessee treated the option money as capital receipt whereas the Income Tax Authorities, relying on Mumbai ITAT ruling in Mahindra Telecommunications Investment Private Limited[2], sought to tax it in the year of receipt as a revenue receipt. The Tribunal extensively distinguished the Mumbai ITAT ruling and held that neither the frequency of receipt, the manner in which it is dealt with in the books of account, nor how the money is utilized is determinative of its character of tax purpose and classified the option price as advance capital receipt, supplements by referring to JV's dividend policy which prohibits adjustment of dividend received by the assessee against option price.

Further, Tribunal applied the principle of consistency and held that income tax authorities, for eight assessment years, have never taxed the option money so received as revenue income and it cannot change its stand on the same transaction in different assessment years. Therefore, the Tribunal held that "option money received by the assessee is capital receipt which requires an adjustment only at the time of transfer of the shares by Assessee to CUIH while working out resultant capital gain".

1 Dabur Invest Corp [TS-63-ITAT-2021(DEL)]

2 Mahindra Telecommunications Investment Private Limited [TS-296-ITAT-2016(Mum)]

Direct tax updates (7/8)

Concessionaire rights' on BOT basis eligible for claiming depreciation as intangible asset in the hands of infrastructure company

Assessee had entered into a concessionaire agreement with the National Highway Authority of India [‘NHAI’] on build, operate and transfer ‘BOT’ basis. It thereafter incurred the expenditure on the corresponding road project(s) and raised the impugned identical depreciation deduction claim. The Income tax authorities relied on the CBDT’s Circular on treatment of expenditure incurred in Build-Own-Transfer (BOT) agreements and contended that the cost of the expenditure incurred on the road/highways project is to be amortized over the complete duration of the agreement only and assessee is neither the owner of the road project, nor acquired any commercial or business rights for its exclusive usage to claim depreciation.

The ITAT observed that concession agreement has resulted in the NHAI granting concessionary rights to reconstruct, operate and maintain the corresponding national highway project and upheld the assessee’s stand qua its claim that it has been holding the concessionaire rights in the nature of license to collect road toll of an intangible asset under section 32(1) and that it would be entitled to depreciation thereon. The Tribunal held that “we see no material on record which would indicate that anybody other than the assessee is entitled to dilute its rights to construct, operate the project in lieu of the toll collections right for the specified agreement period and the assessee’s right to collect toll would form an exclusive right in the nature of license eligible to be treated as an intangible asset”. The Tribunal further distinguished Bombay HC ruling in North Karnataka Expressways Ltd.[2] which followed SC ruling in Mysore Minerals Ltd.[3] as it dealt with assessee’s self-proclaimed beneficial ownership on the concerned road project.

1 Godhra Expressways Private Ltd1 TS-65-ITAT-2021(HYD)
2. North Karnataka Expressway Ltd. Vs. CIT10(2015) 272 ITR 145 (Bom)
3 Mysore Minerals Limited [TS-18-SC-1999-O]

Direct tax updates (8/8)

Compensation for pre-closure of contract manufacturing agreement is capital receipt [1]

The facts were that the assessee had entered into a contract manufacturing agreement with Dr. Reddy's Laboratories Ltd. for manufacturing of drugs as per the specification provided by the principals, but the know-how required for manufacturing of drugs was not possessed by the assessee. Subsequently, Dr. Reddy's terminated the contract before completion of the 10 years' contract period and made a compensation payment to the assessee. The assessee treated the compensation as Capital Receipt, whereas the Income Tax Authorities considered the said receipt to be in the nature of non-compete fee and taxed the compensation under section 28(va)(a).

The Tribunal observed that due to the termination of contract, the assessee company has incurred huge loss in the form of investments made for manufacturing facilities as well as loss of profit from the business for which Dr. Reddy's Laboratories Ltd. had compensated the assessee for such loss. It stated that, "when the assessee is not having necessary know-how for manufacturing of drugs, the amount paid for termination of contract cannot be brought to tax as non-compete fee for not using any know-how, patent, copyright."

Further, the Tribunal held that compensation is for loss of source of income and for relinquishing his right to file law suit for breach of contract. The Tribunal relied on Bombay HC ruling in Parle Soft Drinks (Bangalore) P.Ltd., which further reaffirmed by Supreme Court, and concluded that "compensation received for termination of manufacturing agreement is in the nature of capital receipt for loss of investment in business or loss of profit from business".

1 Sai Mirra Innopharm Private Limited [TS-64-ITAT-2021(CHNY)]

2. Parle Soft Drinks (Bangalore) P.Ltd [TS-5420-SC-2018-O]

SEBI REGULATORY UPDATES

FEBRUARY 2021

SEBI Regulatory updates (1/2)

Amendment in the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018

SEBI has amended the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018 (ICDR Regulations) to provide as under:

a) Further Public Offer: Amongst other, the requirement of minimum promoters' contribution shall not be applicable in the following situation - where the equity shares of the issuer are frequently traded on a stock exchange for a period of at least 3 years immediately preceding the reference date, and:

  i. the issuer has redressed at least 95% of the complaints received from the investors till the end of the quarter immediately preceding the month of the reference date; and
  ii. the issuer has been in compliance with the LODR for a minimum period of 3 years immediately preceding the reference date.

b) Preferential Issue: As per the extant norms, the equity shares issued on a preferential basis, pursuant to any resolution of stressed assets under a framework specified by the RBI or a resolution plan approved by the Tribunal, under the IBC, shall be locked-in for a period of one year from the trading approval. As per the amendment, the lock-in provision shall not be applicable to the specified securities to the extent to achieve 10% public shareholding.

SEBI Regulatory updates (2/2)

SAT quashes SEBI order debarring Non- Executive Independent Director from accessing the Securities Market for a period of 5 years citing reasons as absent involvement in fraudulent GDR issue

SEBI passed an order debarring the Appellant from accessing the Securities market for 5 years in light of fraudulent issue of GDRs by MPS Infotecnics Ltd, where appellant was holding position of non-executive independent director.

The appellant filed appeal with the Hon'ble Securities Exchanges Tribunal (SAT) against the above SEBI order. SEBI had issued a show cause notice to various noticees, including the appellant, alleging violation of the SEBI (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Market) Regulations, 2003 (PFUTP) on the grounds that

a) the GDR proceeds were diverted, and concealing and suppressing such material facts was in violation of the provisions of SEBI Act and PFUTP Regulations;
b) since the Appellant was a signatory to the resolution to open a bank account for receiving the subscription money in respect of GDR, he was responsible and equally guilty of the aforesaid violation.

The appellant had argued that he was a Non-Executive Independent Director in the Company and was not involved in the day-to-day affairs of the management of the Company, and was only involved in policy decisions and the resolution that he signed was only for opening of bank account and could not be stretched for giving GDR proceeds as a loan to a third party who did not exist on the date when resolution was passed.

SAT relied on its decision in Adi Cooper to hold that the concept of fraud emerging through the said resolution signed by the appellant did not arise, as the said third party was nowhere in the picture as on resolution date. Further, SAT also remarked that there was no finding given by SEBI that the appellant was involved in the day-to-day affairs and management of the Company and therefore allowed the said appeal.

1 LSI-933-SAT-2020(MUM)

CORPORATE LAW UPDATES

FEBRUARY 2021

Corporate Law - Regulatory updates (1/3)

Ministry of Corporate Affairs ("MCA") notified Companies (Amendment) Act, 2020 w.e.f. January 22, 2021 (1/2)

MCA has notified amendment proposed in Companies Act 2013 with the objective of decriminalization of various minor offences, which was introduced via Companies (Amendment) Act, 2020. The bill had received presidential assent and was notified in the official gazette on September 28, 2020. Key highlights of the new provisions in Companies (Amendment) Act, 2020 are as under:

Definition of Listed Companies:

The Amendment Act inserted a proviso to section 2(52) which empowered MCA in consultation with Securities and Exchanges Board of India (SEBI) to prescribe such class of companies which will be excluded from the definition of listed companies. MCA further amended the Companies (Specification of definitions details) Rules, 2014 on February 19, 2021 and excluded following class of companies from the definition of Listed Companies:

a) Public companies which have listed only their non-convertible debt (NCDs) securities or non-convertible redeemable preference shares (NCPRS) or both issued on private placement basis.

b) Private companies which have listed their non-convertible debt securities (NCDs) on private placement basis on a recognized stock exchange.

c) Public companies whose equity shares are listed only on a stock exchange in a foreign jurisdiction or any other prescribed jurisdiction permitted under the Amendment Act. (Foreign Listing)

De-criminalization of minor offences:

By way of the Amendment, MCA removes criminal punishment such as imprisonment for over 46 offences under the Act, in addition to reducing, modifying and omitting the fines/penalties for contravention of provisions in relation to buyback of securities, disclosure of interest by directors, financial statements and Boards' report, formation of companies with charitable objects, disqualification of directors, variation of shareholder rights, transfer of securities, alteration of share capital and reduction of share capital, etc.

Corporate Law - Regulatory updates (1/3)

Ministry of Corporate Affairs ("MCA") notified Companies (Amendment) Act, 2020 w.e.f. January 22, 2021 (2/2)

Foreign listing:

Pursuant to the addition of a new sub-section to section 23 of the Act, certain classes of public companies incorporated in India, as may be prescribed by the Central Government, are permitted to issue securities for listing on stock exchanges in permissible foreign jurisdiction, without requiring compulsory listing in India. The Central Government is also empowered to exempt such class of public companies from complying with certain provisions of the Act, namely, provisions relating to private placement and public offer of securities, beneficial ownership, share capital and debentures or punishment for failure to distribute dividend, by way of issuing a notification, which has to be placed before both the Houses of Parliament.

Exemption to NBFCs:

Under the Act, a banking company is exempted from filing the resolutions passed to grant loans or give guarantee or provide security in respect of loans in the ordinary course of its business, with the registrar. The Amendment extends such exemption to a registered non-banking finance company and a housing finance company.

Remuneration of Independent Directors:

Prior to the Amendment, in case of inadequate profits, only executive directors/managing director of a company were entitled to receive remuneration subject to limits prescribed in the Act. The Amendment seeks to align the aforesaid provisions to independent directors/non-executive directors to the effect that in case a company has no profits or its profits are inadequate, then non- executive directors, including an independent director, will be entitled to receive remuneration up to the extent permissible under the Act.

Financial Results of Certain unlisted Companies:

MCA may require specified unlisted companies to prepare / file financial results on periodical basis.

Corporate Law - Regulatory updates (2/3)

MCA extended certain provisions of the Companies Act 2013 to Limited Liability Partnership w.e.f. February 18, 2021

Key highlights of the notification are as follows:

Disclosures by Significant Beneficial Owners:
Section 90 provides that every 'significant beneficial owner' is required to make a declaration to the company, specifying the nature of his interest and other particulars, in the prescribed manner. This sections have been extended to Significant Beneficial Owners of LLPs. MCA will prescribe rules for determining who will be the SBO and manner in which disclosures are required to be made.

Disqualification of Directors, Number of Directorship and Vacation of Office by Director:
Section 164 provides criteria for a person who will be disqualified from being a director in a company, section 165 prohibits a person (individual) from becoming director in more than 20 companies and section 167 provides the manner in which vacancy of a directors to be filled up. These provisions have been extended to LLPs. However, it is still unclear whether these provisions will be applicable to a 'partner' or a 'designated partner' of an LLP.

Other Provisions:
Powers of Registrar for making inspection or inquiry, appeals to NCLT for revival of companies and offences to be regarded as noncognizable, to LLPs. The manner in which these sections will be applicable to LLPs.

Corporate Law - Regulatory updates (3/3)

NCLAT allows appeal against order of NCLT for rejecting Scheme of Amalgamation having prospective Appointed Date

Scheme of Amalgamation was filled for merger of RHI India Pvt Ltd and RHI Clasil Pvt Ltd with and into Orient Refactories Limietd, a listed Company ('Scheme') with an Appointed Date as January 1, 2019. Board of all the companies involved in the Scheme had approved the Scheme on July 31, 2018 and valuation report for determining merger ratio was obtained on July 31, 2018. Scheme had filed Scheme of Amalgamation having Appointed Date as of past showing significant gap with its effective date.

NCLT rejected the scheme citing reason that due to the significant gap in the appointed date of the Scheme and the valuation date, the scheme is only benefitting few shareholders and contrary to public policy.

The National Company Law Appellate Tribunal (NCLAT) observed / held that no minority shareholders had come forward to oppose the Scheme neither objections were raised by SEBI or any regulatory authority. Further, NCLAT stated that "the commercial wisdom of the shareholders shall not be overlooked by the NCLT and the scheme cannot be said to be violative of public policy just on the ground that NCLT considered that the scheme appears to benefit only a few shareholders of Transferor Company without giving any reasonable finding."

NCLAT further held that "NCLT while passing the impugned order has overreached its scope of Judicial Intervention in determination of the Scheme of Amalgamation under section 230- 232." And referring to the MCA Circular clarifying that section 232(6) of the Act enables the companies in question to choose and state in the scheme an 'appointed date', NCLAT stated that NCLT shall not reject the Scheme solely on the ground that the appointed date and valuation date is different and directed the concerned Regional Director to monitor that the scheme is implemented according to the appointed date as specified in the scheme document.

1 RHI India Private Limited , RHI Clasil Private Limited and Orient Refractories Limited vs Union of India (Company Appeal no. 128/2020)

STAMP DUTY LAW UPDATES

FEBRUARY 2021

Corporate Law - Regulatory updates

Amendments in Maharashtra Stamp Act, 1958

The Maharashtra Government has by the Maharashtra Stamp (Amendment and Validation) Ordinance 2021 (Ordinance) amended the Maharashtra Stamp Act, 1958 (Maharashtra Stamp Act). The amendment are as follows:

Amendment to Section 5: The Ordinance has inserted the expression **'or transactions'** after 'several distinct matters' as appearing in section 5 of the Maharashtra Stamp Act. The Government desires to stamp the underlying transactions covered in the instruments instead of the instrument especially in the case of mortgage for multiple beneficiaries.

Amendment to Article 6 of Schedule I: The Ordinance has increased the stamp duty payable on an agreement relating to deposit of title deeds, pawn, pledge or hypothecation where the amount secured exceeds INR 5 lakh from '0.2%' to '0.3%' subject to the existing cap of INR 10 lakhs. Further, any instrument providing for additional security in the form of hypothecation or equitable mortgage shall be stamped for nominal amount of INR 500 if full stamp duty is paid on Primary security.

Amendment to Article 40(b) of Schedule I: The Ordinance has reduced the stamp duty on a mortgage deed (other than agreement specified in Article 6) where possession of the subject property is not given or agreed to be given from '0.5%' to '0.3%' subject to the existing cap of INR 10 lakhs.

Validation of Proceedings: Clause 4 of the Ordinance specifically validates any actions initiated under the existing section 5 and Articles 6 and 40 in Schedule I of the Maharashtra Stamp Act. Further, no suit is maintainable for refund of the stamp duty levied or collected.