Devadhaantu Insights – January 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.

Happy Reading!

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Thank You

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DIRECT TAX UPDATES

JANUARY 2021

Direct tax updates (1/8)

Status of private discretionary trust is akin to an Individual and not an AOP[1]

Assessee being a private discretionary trust had received the amount of Rs.25 Crores as voluntary contribution from 6 group companies of Shriram Group which was credited to its balance sheet under the nomenclature "addition to corpus". Upon assessment under section 144A of the ITA, addition was made u/s 2(24)(via) of the ITA for the amount received by assessee under the head ' Income from other sources' considering the sum of money as benefit or perquisite, treating Trust as Individual since beneficiaries of the Trust are also Individuals. Order of JCIT was upheld by CIT(A), while on further appeal, same was passed in favour of Assessee.

On further appeal by revenue to Hon'ble Mumbai High Court, **it was held that Trust is representative assessee representing its beneficiaries and accordingly, it should be taxed as an 'Individual' only**. Further it was reiterated that contribution received by the Trust from the companies is to be assessed under the head 'Income from Other Sources'. Mumbai High Court reiterated meaning of AOP as an association of person joining in an action, with a common purpose or for a common action. In the instant case, as none of the beneficiaries or Trustees have come together for a common purpose, it can not be construed to mean an AOP. Trustee are representative of the beneficiaries and income of the trust is required to be taxed in the like manner and to the same extent as it would be in respect of the beneficiaries. In the instant case, all the beneficiaries are individuals, therefore income of trust needs to be assessed in same manner like an individual only. Further its was held that status shown by the assessee in the return of income is irrelevant as the Income Tax Rules, 1962 only prescribes the forms and this cannot in any manner control the operation of the provisions of the ITA.

1 CIT vs Shriram Ownership Trust (T.C.A. No. 242 of 2018)

Direct tax updates (2/8)

Issuance of bonus shares does not attract gift tax provisions[1]

Assessee was under receipt of bonus shares in lieu of his holding in a private limited company. Tax authority levied tax with respect to the FMV of the bonus shares under the gift tax provisions, basis that the taxpayer received shares without paying any consideration.

Upon further appeal by assessee, first appellate authority passed order in favour of assessee on the ground that issuance of bonus shares is mere conversion of reserves into capital and therefore, the gift tax provisions are not application. Upon further appeal by tax department, Hon'ble Bangalore Tribunal passed order in favour of assessee rejecting revenue's plea.

Aggrieved by order of Tribunal, upon further filling appeal to Karanataka Hon'ble High Court, **it was held that gift tax provisions are not applicable on issuance of bonus shares. High Court reiterated that issuance of bonus shares merely involves capitalization of existing reserves as it does not involve any inflow of funds or increase in capital structure of the company.** It was stated that bonus shares do not enrich the shareholder and the value of the bonus shares gets offset by the sacrifice suffered by the shareholder in the value of original shares. As there is no flow of money, and it remains intact with company, no benefit is received by shareholders and accordingly, in the absense of transfer of shares, gift tax provisions are not attracted .

1 AO vs Dr. Ranjan Pai [TS-692-HC-2020 (KAR)]

Direct tax updates (3/8)

Gift of shares, held as stock-in-trade, by an assessee company could not be taxed as business income; Such gifts cannot be part of family arrangement as Company can not be a member of a family[1]

Assessee Company engaged in the financing of goods, material, movable/immovable properties and trading of shares, securities, stocks and debentures. Assessee Company had gifted shares held as stock-in-trade to 4 different newly formed Companies as a part of family realignment. AO disregarded the gifts as voluntary and under family arrangement, and taxed the fair market value of shares as business income in the hands of assessee company. CIT(A) upheld the order of AO.

Upon further appeal to ITAT, **it was held that gift of shares, as authorised by Articles of association and approved by shareholders and board of directors of an assessee company could not be taxed in the absence of accrual of any consideration in the hands of assessee company being donor of shares. However, argument of assessee company that gift was made under family arrangement was rejected stating that company is a separate juridical entity but it cannot be a member of family.**

1 Manjula Finance Ltd vs ITO [ITA No. 3727/DEL/2018]

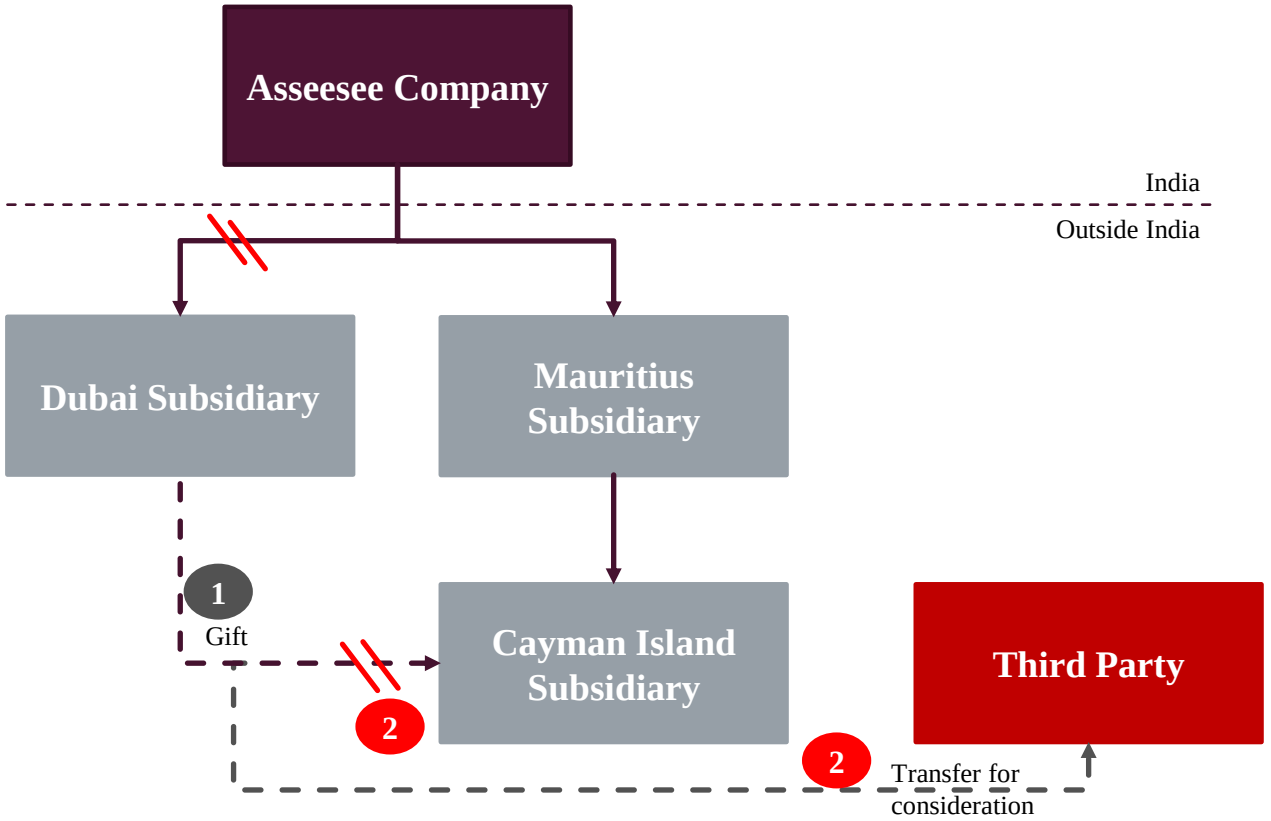
Direct tax updates (4/8)

Transfer of a wholly owned subsidiary to another wholly owned subsidiary followed by immediate sale to third party not considered as 'Gift' and held taxable transaction[1]

Assessee gifted (by way of transfer) its wholly owned subsidiary incorporated in Mauritius 4 years ago to another newly incorporated step down wholly owned subsidiary incorporated in Cayman Islands. Within just 4 days of such gift, 27.17% stake in such WOS at Mauritius was further transferred to third party for a consideration by WOS at Cayman Islands.

Madras High Court held that the transaction of transfer was not merely a gift to subsidiary company under section 47(iii) of the ITA. **The High Court observed that since a step-down subsidiary was created by assessee in a tax haven to act as a conduit to escape rigour of Indian Tax Laws and sole intention of assessee was for corporate re-structuring, transaction was in fact transfer of capital asset by assessee to its subsidiary and the same would be liable to tax under section 45.**

Transaction flow for transfer of subsidiary through newly incorporated step-down subsidiary



1 Redington (India) Ltd. [2020] 122 taxmann.com 136 (Madras) dated 10 December 2020

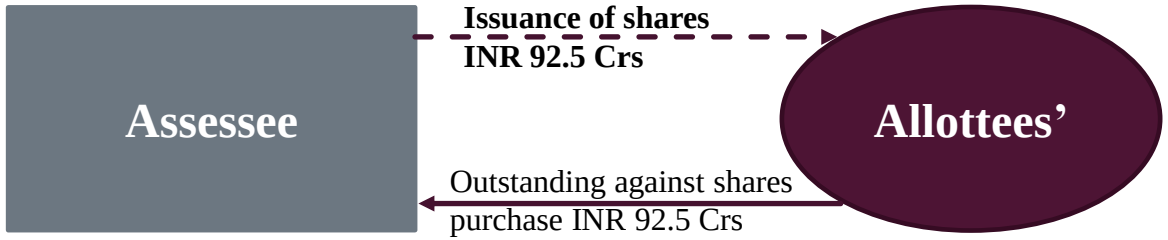
Direct tax updates (5/8)

Issuance of shares against book adjustment not an unexplained cash credit u/s 68[1]

Assessee Company had issued share capital worth INR 92.5 crores at premium to various companies. Such Companies had sold shares of other companies to Assessee and consideration towards such shares was outstanding in the books of Assessee Company. Assessee Company issued shares in lieu of such outstanding amount in the books of Assessee Company. Revenue made an addition of INR 92.5 Crs as unexplained cash credit u/s 68.

Kolkata ITAT acknowledge the fact that there was no real inflow of cash involved in the transaction and only adjustment by way of journal entries. Relying on decision of High Court in case of Jatia Investment Co., ITAT held **that addition u/s 68 was not invocable as issuance of shares was made by way of adjustment through journal entries and no cash flow was involved.**

Allotment of shares against outstanding liability



1 M/s Josan Deposits & Advances Pvt Ltd I.T.A. No. 2096/Kol/2017 dated 3 December 2020

Direct tax updates (6/8)

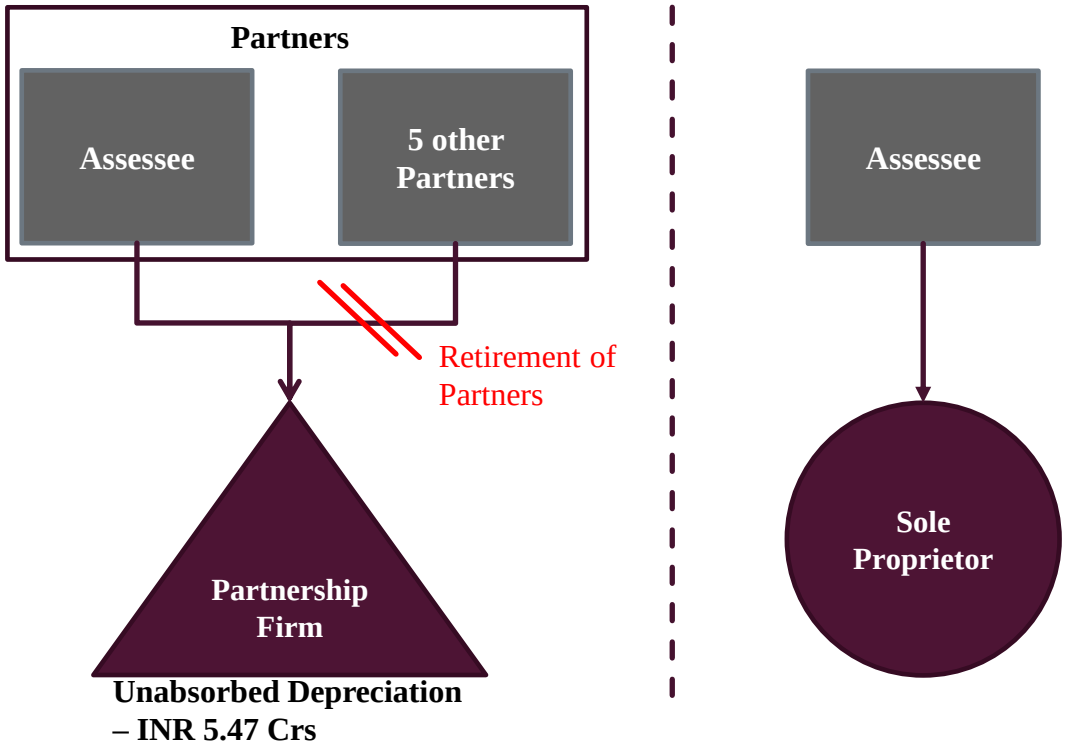
Unabsorbed depreciation of dissolved firm allowable to successor proprietorship[1]

Assessee was partner in a partnership firm, alongwith 5 other partners, who retired from the firm leaving capital assets of the firm undistributed. As a result, Partnership firm was dissolved and business of the firm was succeeded by the assessee in his individual capacity.

AO disallowed the set off of brought forward depreciation of INR 5.47 Crs stating that no provisions allows carry forward of unabsorbed depreciation of a dissolved firm to an Individual.

Relying on the Supreme Court Decision in case of A. Dharma Reddy[2] and Madras High Court Decision in case of N. Krishnammal[3], Hynderabad ITAT in the instant case held that the assessee continued the business of the firm as a successor-in-buisness, in his individual capacity. **Accordingly, unabsorbed depreciation of current year in the year of succession is allowed to be set off against the income of individual successor.**

Succession of firm into sole proprietorship



1 Yerram Venkata Subba Reddy (ITA No. 1119/Hyd./2018) dated 4 November 2020
2 A.Dharma Reddy (1969) 73 ITR 751 dated 19 February 1969
3 N. Krishnammal 147 ITR 431 dated 3 August 1982

Direct tax updates (7/8)

Discount on ESOP issuance is allowable business expense u/s 37 [1]

Assessee Company floated Trust for the purposes of issuance of ESOP for its employees under Employee Stock Option Plans Scheme. Under the Scheme, shares of the Assessee Company were transferred to Trust at face value. Employees were given option to buy shares within stipulated timeframe. The difference between market price and allotment price was claimed as deduction u/s 37.

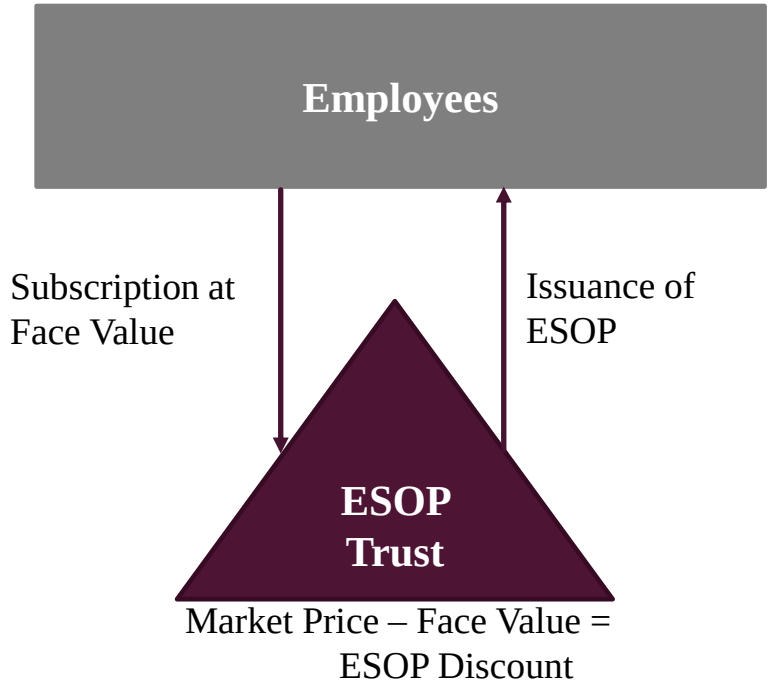
Karnataka High Court reaffirmed the principle laid down by other high court and held that discount on issue of ESOP is deductible expenditure u/s 37 on following grounds:

a. For claiming business expenditure, there is no requirement of pay out of expenditure in cash;

b. Discount on issuance of ESOP is not contingent Liability but is an ascertained liability

c. The term 'Expenditure' also includes 'Loss'.

Employee ESOP Trust



1 M/s Biocon Ltd ITA.No.653 of 2013 dated 11 November 2020

Direct tax updates (8/8)

CBDT introduced faceless penalty [1]

The Central Board for Direct taxes (CBDT), has notified the "Faceless Penalty Scheme" for conducting penalty proceedings under the Income-tax Act, 1961 (Act) in a faceless manner. The said scheme is alignment with the Faceless Assessment Scheme and the Faceless Appeal Scheme.

The said Scheme lays down the procedure for conducting penalty proceedings in a virtual manner without any physical interaction between the tax payer and the Income-tax Department.

The said Scheme leverages on the developments in technology, and aims to live up to the Honourable Prime Minister's vision of improving transparency, efficiency, and accountability in tax administration.

1 Notification No. 3 of 2021 dated January 12, 2021

SEBI REGULATORY UPDATES

JANUARY 2021

SEBI Regulatory updates

SEBI in its board meeting (PR No. 61/2020 dated 16 December 2020), has taken several decisions including following:

Eligibility and condition	Existing Regulation	Relaxation	Condition
Listed Companies going for further issuance of equity shares and / or Convertible Equity instruments	• Minimum public shareholding of 20% of proposed issue size or 20% of post issue capital • Lock –in Requirement of 3 years for minimum contribution and 1 year for contribution over and above minimum contribution	**No such conditions would be applicable for issue of equity and / or convertible equity instrument**	**Shares of the issuing company shall be frequently traded on the stock exchange**
Listed Companies Going through Corporate Insolvency Resolution Process	In case, if public shareholding falls below 10%, such listed companies are required to bring back the public shareholding to atleast 10% within 18 months, to 25% within 36 months	Such companies will be mandated to have at least 5% public holding (as against no minimum requirement at present), and the shareholding should go up to 10% within 12 months and to 25% within 36 months	**NA**

SEBI Regulatory updates

Single login e-voting facility for demat account holders [SEBI/HO/CFD/CMD/CIR/P/2020/242 dated 9 December 2020]

At present, there are multiple e-voting service providers ('ESPs') providing e-voting facility to listed entities which necessitates registration on various ESPs and maintenance of multiple user IDs and passwords by shareholders. Further, SEBI observed that the participation by the public non-institutional shareholders / retail shareholders is at negligible level.

In the context of the above, SEBI, vide circular dated 9 December 2020, proposed new mechanism to facilitate e-voting to all the demat account holders, by way of a single login credential, through their demat accounts / websites of Depositories / Depository Participants.

Under Phase I, shareholders can **directly register with depositories wherein they would be able to access the e-voting page of various ESPs through the websites of the depositories without further authentication by ESPs**. Alternatively, demat account holders will have the option of accessing various ESP portals directly from their demat accounts. After this, they would be routed to the webpage of the respective depositories from their demat accounts, which in turn would enable access to the e-voting portals of various ESPs without further authentication.

Under Phase II, in order to further enhance the convenience and security of the e-voting system, the depository will have to **validate the demat account holder through a One Time Password (OTP) verification process**.

CORPORATE LAW UPDATES

JANUARY 2021

Corporate Law - Regulatory updates

Amendment for Corporate Social Responsibility obligation by Company (1/3)
MCA notification S.O. 324(E) dated 22 January 2021 & MCA notification G.S.R. 40(E) dated 22 January 2021 ("the Amendment Rule")

The Ministry of Corporate Affairs ("MCA") has amended Corporate Social Responsibility ("CSR") legislation ("Amendment Rule") w.e.f January 22, 2021, summary of which is as under:

Defined 'Ongoing Project':

As per Section 135(5) of the Companies Act, 2013, a Company is required to ensure that it spends 2% of the average net profit of immediately preceding previous 3 financial years towards CSR expenditure. For the effectiveness and better utility of the CSR provisions companies are allowed to utilize CSR spent on the ongoing projects. Flexibility has been given to companies to transfer unspent CSR amount into a special bank account opened with any scheduled bank within 30 days of the end of the financial year in which such amount remains unspent. Such balance in the Unspent CSR account is required to be utilized by the company within 3 years of transfer into such account.

Amendment Rule has **defined such Ongoing Project to mean "A multi-year project undertaken by a Company in fulfilment of its CSR obligation having timelines up to 3 years and shall include such project that was initially not approved as a multi-year project but whose duration has been extended beyond 1 year by the board based on reasonable justification".**

Requirement of transfer of Unspent CSR Amount into 'Specified Fund':

Amendment Rule requires **additional requirement of transferring the unspent CSR amount into Specified Fund** under Schedule VII of the Companies Act 2013 **within period of 6 months of the expiry of financial year**. Such requirement is applicable only in case if such unspent amount does not relate to any ongoing project. Additionally disclosure in the Board of Directors report would also be required to be made.

Corporate Law - Regulatory updates

Amendment for Corporate Social Responsibility obligation by Company (2/3)
MCA notification S.O. 324(E) dated 22 January 2021 & MCA notification G.S.R. 40(E) dated 22 January 2021 ("the Amendment Rule")

Surplus from the CSR activities

Amendment Rule prescribes that **the surplus arising out of CSR activities shall be transferred to Unspent CSR Account and must be spent in pursuance of CSR policy** and annual action plan of the company or shall be transferred to Specified Fund within prescribed time line for each of the basic requirement.

Excess Expenditure incurred for CSR activities

Any excess amount spent for CSR activities can be set off against subsequent 3 financial year's requirement of CSR spent and a board resolution in respect of same shall be passed. However, such amount shall not be set off against surplus arising out of CSR Activities.

New Compliance framework for entities with whom companies undertake CSR activities

The Amendment Rule requires **implementing agencies that intend to undertake CSR activities to obtain registration by filing form CSR -1** electronically with Central Government w.e.f. April 1, 2021.

Impact assessment by Independent Agency

The Amendment Rule prescribes that the Companies having average CSR obligation of INR 10 Crs or more, in the immediately preceding financial years shall be required **to undertake impact assessment through an independent agency**, for their CSR project which have outlay of INR 1 Crs or more and have been completed not less than 1 year before undertaking the impact study.

Such impact assessment report shall be placed before the Board of Directors and shall be annexed to the annual report on CSR in the report of the Board of Director.

Expenditure incurred towards obtaining impact assessment report can be treated as CSR expenditure. However, such expenditure shall not exceed lower of (i) 5% of the total CSR expenditure for the that financial year; and (ii) INR 50 lakhs

Corporate Law - Regulatory updates

Amendment for Corporate Social Responsibility obligation by Company (3/3)
MCA notification S.O. 324(E) dated 22 January 2021 & MCA notification G.S.R. 40(E) dated 22 January 2021 ("the Amendment Rule")

Exclusions from CSR activities

Following activities shall not be regarded as CSR:

- activities supported by the companies **on sponsorship basis for deriving marketing benefits** for its products or services
- activities carried out **for fulfilment of any other statutory obligations** under any law in force in India
- activity undertaken by **company outside India except for training of Indian sports personnel representing any State or Union territory at national level or India at international level**

Limits on the Administrative Overhead:

Total administrative overhead towards CSR shall not exceed 5% of the total CSR expenditure of the company for the financial year.

Further, the term 'administrative overheads' has been expressly defined to mean the expenses incurred by a company for 'general management and administration' of CSR functions in the company. However, expenses directly incurred for the designing, implementation, monitoring, and evaluation of a particular CSR project or programme shall not be covered within the ambit of 'administrative overheads'.

Corporate Law - Regulatory updates

Procedure by Company, where 90% or more its shareholders acquires shares held by minority shareholders in such Company
MCA notification No. G.S.R. 79(E), dated December 17, 2020

MCA notified rules under Companies (Compromise, Arrangements and Amalgamations) Rules, 2016 enabling majority shareholders to acquire minority shareholding in the Company. Silent feature of procedures mentioned are list down hereunder:

Verification by Companies

Company shall verify the details of the minority shareholders holding shares in dematerialized form, within 2 weeks of transfer of consideration by acquirers being majority shareholder(s) into special bank account for their intension to acquire stake held by minority shareholder(s);

Notice to minority shareholders

Company shall send notice to minority shareholders by way of registered post or speed post or courier or email informing about cut-off date. Cut off date shall be only after 30 days of company sending above notice to minority shareholders

Publication in the Newspaper

Notice sent to minority shareholders shall be published in 2 widely circulated newspaper, one in English language and one in vernacular language in the district in which the registered office of the company is situated. Such notice shall also be published on the website of the company, if any.

Intimation of cut off date to Depository

Immediately after publication of notice in newspaper, Company shall intimate depository, informing cut-off date and following declarations shall be made:

- Corporate action is made u/s 236 of the Companies Act, 2013;
- Copy of notice sent to minority shareholders and newspaper clip;
- Declaration stating that minority shareholders shall be paid by company immediately after corporate action;
- Declaration that any disputes or complaints arising out of corporate act shall be sole responsibility of company

Transfer of payment to minority shareholders

Upon receipt of intimation from depository, company shall transfer consideration, after deduction of applicable stamp duty, in the name of minority shareholders

Intimation to transfer the shares in the name of Acquirer

Company shall intimate successful transfer of consideration to depository and depository shall transfer shares in the name of Acquirer