# Direct Tax updates

**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

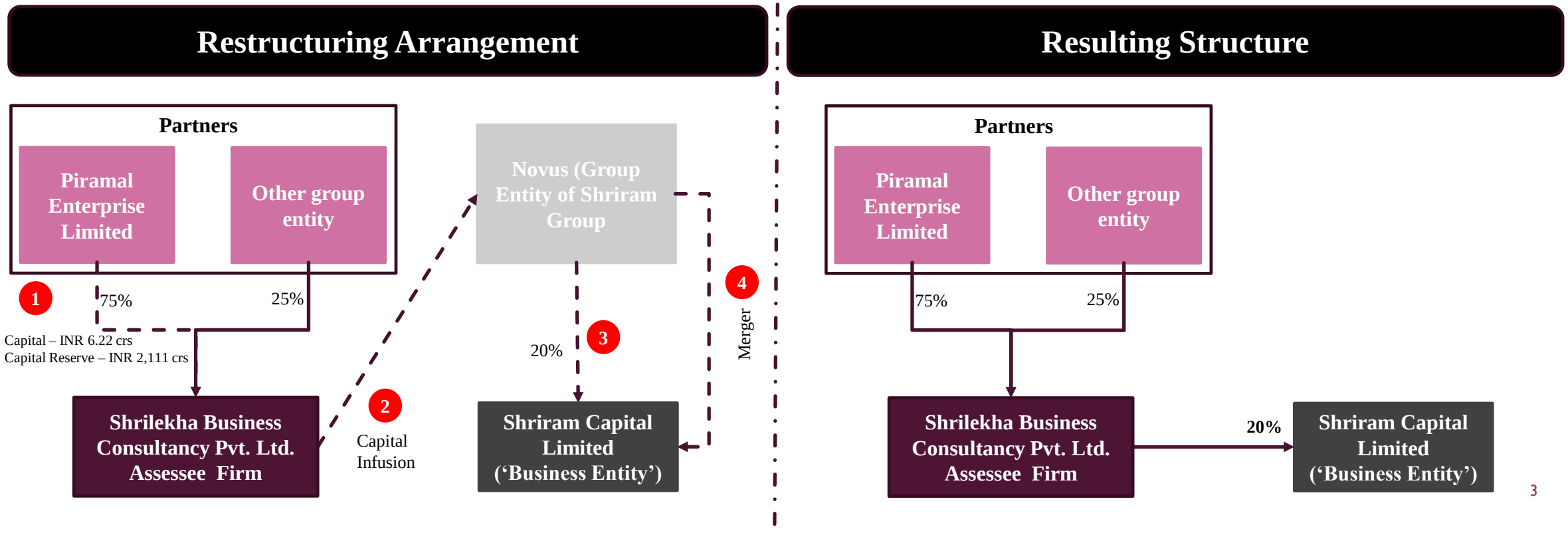
## NOVEMBER 2020

# Direct tax updates (1/4)

## Acquisition of a business entity through an investment vehicle under business restructuring mechanism, not a colourable device[1] (1/2)

In FY 2014-15, Assessee Firm was incorporated with an intention to make an acquisition of the business entity. It received INR 6.22 Crs towards partners contribution and INR 2,111 crs towards capital reserve from its partner intending to acquire such business entity.

Thus, acquisition was made in the business entity through a group entity of business entity which was then merged with the business entity itself.




[1] ITO vs M/s. Shrilekha Business Consultancy Pvt. Ltd. ITA No.1371/Hyd/2018 & ITA No.1041/Hyd/2019

# Direct tax updates (1/4)

## Acquisition of a business entity through an investment vehicle under business restructuring mechanism, not a colourable device (2/2)

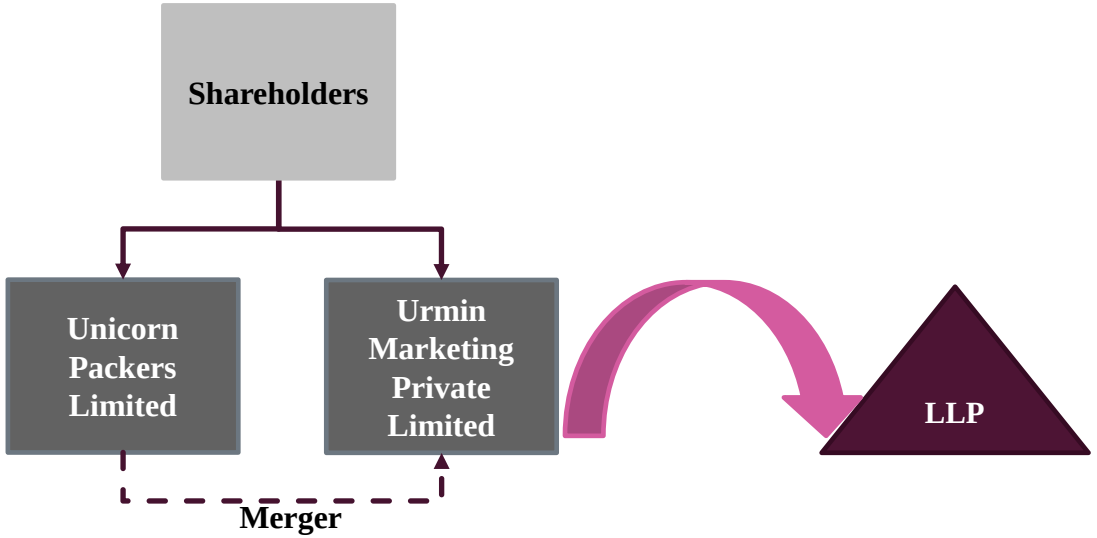
| AO's contentions | Assessee's submission and Revenue's order |
|---|---|
| AO was of the opinion that an additional INR 2,111 crs brought in by Partner was towards acquisition of business entity and business entity as a whole ought to have paid tax on this sale. Restructuring as above is a mechanism to avoid taxes on the sale of transaction. | In reply to same, assessee made submission that other investors in the target business entity had imposed conditions, per which the allotment of shares could not be made to any shareholders other than existing shareholders and / or group companies. In order to comply with the conditions, restructuring arrangement was made in the above manner, which Hyderabad ITAT had accepted and held that transaction was not colourable devise. |
| AO also argued that INR 2,111 crs invested in the assessee firm towards capital reserve, was without any consideration and therefore sought to tax the same u/s 56(1) of the ITA and alternatively, u/s 56(2)(via) of the ITA. | Hon'ble Hyderabad ITAT held that the receipt of capital contribution from partner is capital receipt and therefore can not be brought to tax u/s 56(1). Also, Section 56(2)(via) of the ITA can not be applicable in the present case merely because assessee firm used the consideration to invest in Novus on same day. |

# Direct tax updates (2/4)

## Goodwill arising on amalgamation of group companies allowable[1] (1/2)

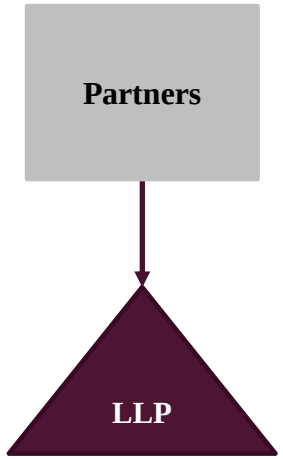
Unicorn Packers Limited ('UPL') got amalgamated into the assessee Urmin Marketing Pvt Ltd w.e.f. 1st April 2014, under a Scheme of Amalgamation approved by the High Court, for a consideration of INR 555 Cr. As the consideration exceeded the net book value of assets of the amalgamating company by INR 486 Cr, the assessee claimed the difference to be goodwill and amortised the same @ 25%. The revenue was of the opinion that goodwill generated was a colorable device and disallowed the depreciation claimed.

## Structure flow




| | |
|---|---|
| Consideration on Amalgamation – | INR 555 Crs |
| Less: Net Assets – | INR 486 Crs |
| Goodwill – | INR 69 Crs |

## Resulting Structure




Partners Capital – INR 555 Crs
Net Assets – INR 486 Crs
Goodwill – INR 69 Crs



[1] Urmin Marketing P.Ltd. v DCIT (ITA.No.1806/Ahd/2019)

# Direct tax updates (2/4)

## Goodwill arising on amalgamation of group companies allowable (2/2)

AO, in regard to goodwill on amalgamation, held that, as no depreciation on goodwill would have been allowed to the amalgamating company had amalgamation not taken place, hence, depreciation should not be allowed to the amalgamated Company. Given the fact pattern that the assesse had amalgamated into a group company (which was subsequently converted into a LLP), the AO's contention was that the exercise resulted in higher capital accounts in the books of the LLP without any corresponding inflow, and that goodwill was created to avoid tax. Additionally, even the valuation report was questioned by the AO.

The Hon'ble Tribunal held that **the restriction on depreciation is only in relation to assets that existed prior to amalgamation, and cannot be applied to goodwill generated on amalgamation and therefore, rejected the applicability of the proviso to the assessee's case; the Tribunal also rejected the AO's questioning of the valuation report on the grounds of lack of technical expertise of the tax department in this area.**

The Hon'ble ITAT **ruled in favour of the assessee also on the ground that the Scheme was approved by the Hon'ble High Court of Gujarat, after inviting comments from the Income Tax Department. No replies were received from the department within the stipulated period and therefore, it was assumed that the Income Tax Authorities have no objections on the scheme and the scheme was approved. Subsequent objections by the tax authorities after having given their approval by way of no objection, is not desirable. As goodwill is a depreciable asset per CIT vs Smifs Securities Ltd[2], ITAT allowed the claim of the assessee for depreciation on goodwill.**



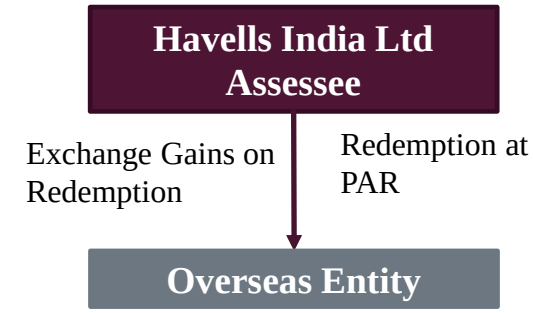
[2] CIT vs Smifs Securities Ltd 348 ITR 302

# Direct tax updates (3/4)

## Exchange Gain on Redemption of shares at Par, held not taxable1

The assessee, purchased shares in foreign subsidiary in Euros in AY 2008-09 by remitting funds from India and redeemed the said shares at par value. On repatriation of redemption proceeds an exchange gain was generated on conversion of Euros to INR.

### Structure




The Assessing Officer opined that the exchange gain arose on sale or redemption of shares and the same was taxable as capital gain under Sec. 45 being the charging section for capital gains.

The Hon'ble Delhi Tribunal held that investment made by the assessee was made in Euro and redemption of such shares was also made in Euro. Thus, actual profit or loss on sale/redemption of such shares have to necessarily be computed in Euro only and thereafter, converted to INR for the purposes of Section 45 of the Act. In other words, the cost of acquisition of shares and consideration received thereon should necessarily be considered in Euro and the resultant gain/loss thereon should thereafter be converted into INR at the prevailing market rate. In the present case, the net gain/loss on redemption of shares was Nil, i.e. no gain on transfer of shares, since the shares were redeemed at par value and thereby, there was no capital gains taxable under Section 45 of the Act.

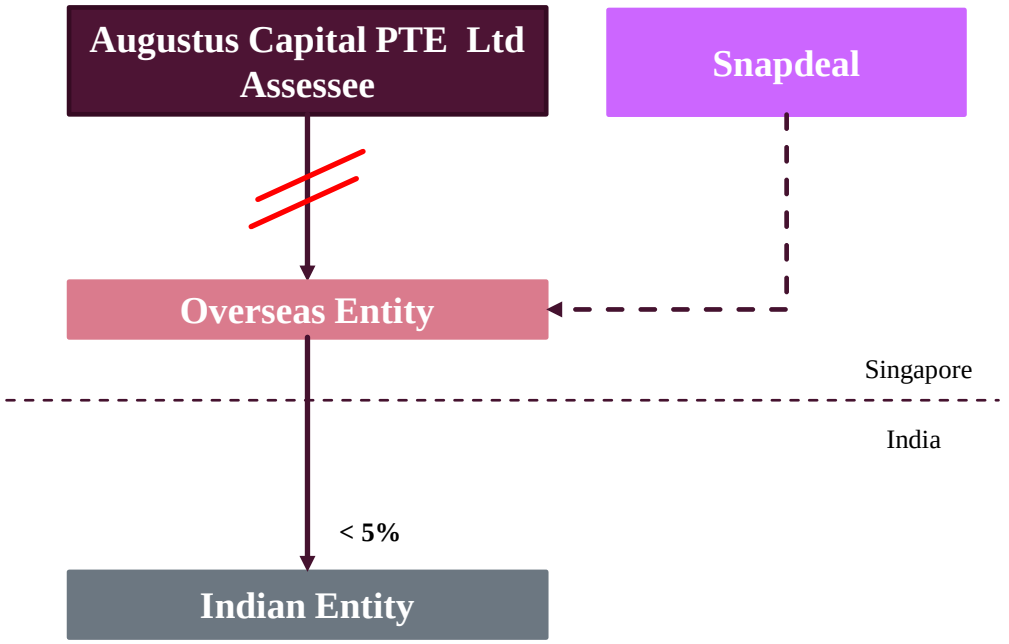
The said contention is also supported by Rule 115, which provides that income chargeable under capital gains should be converted at rate provided thereunder. The inference that follows is that, for conversion of capital gains from foreign currency to INR, the gain calculated in foreign currency should be converted to INR at applicable exchange rate. Thus, the gain was held as non-taxable.

1 Havells India Ltd [TS-580-ITAT-2020(DEL)]

# Direct tax updates (4/4)

## Exemption from applicability of retrospective applicability of indirect transfer tax to an overseas investor holding shares in another overseas company which in turn held shares another Indian Company [1]

### Structure




Augustus Capital PTE Ltd ('the assessee'), a Singaporean company off-loaded its investment in another Singaporean company which held shares in an Indian company to Snapdeal in AY 2015-16. The Assessing Officer applied the provisions of Sec. 9(1)(i) which seeks to tax sale of shares of a foreign company, where the underlying asset is shares of an Indian Company. The assessee argued that Explanation 7 to the said section would apply retrospectively in the instant case, even though it was made applicable from 1st April 2016, as other provisions and circulars with regards to taxation of underlying sale of shares of an Indian company were applicable retrospectively. Explanation 7 carves out such indirect transfers where the foreign company holds neither rights of management or control in the Indian company nor voting power or share capital exceeding 5%. The Hon'ble Tribunal upheld the retrospective application of the carve out and held the sale to be non-taxable.



[1] Augustus Capital PTE Ltd (ITA No. 8084/DEL/2018)

# CORPORATE LAW UPDATES

## NOVEMBER 2020

# Corporate Law updates

## Dismissal of petition filed for redemption of preference shares by issuance of equity shares

Accuspeed Engineering Services Pvt Ltd ('the Petitioner') sought to redeem preference shares out of proceeds of issue of equity shares by way of filling petition under the provisions of the Companies Act, 2013 for scheme of arrangement with National Company Law Tribunal ('NCLT').

Section 55(3) of the Companies Act, 2013 which deals with provisions related to redemption of preference shares, provides that, in case a Company is unable to redeem preference shares or pay dividend on such shares in accordance with terms of the issue, it may, with the consent of the holders of 75% in value of such preference shares and with the approval of the Tribunal on a petition, issue further redeemable preference shares, thereby redeeming the previously issued shares.

NCLT observed that, the Registrar of Companies in its report mentioned that, redemption of preference shares out of the proceeds of issue of equity does not fall within the provisions of Section 55(3) of the Companies Act. On this basis, the Petition was dismissed by NCLT.



1 Accuspeed Engineering Services Pvt Ltd SR.No.1469/2019

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

**NOVEMBER 2020**

# SEBI Regulatory updates (1/2)

## Amendments to Listing Obligations and Disclosure Regulations

SEBI has issued the SEBI (Listing Obligations and Disclosure Requirements) (Third Amendment) Regulations, 2020.

The key changes are summarized below:

- Regulation 54(1) has been amended requiring the listed entity to maintain either 100% asset cover or asset cover as per the terms of offer document/ Information Memorandum and/or Debenture Trust Deed, sufficient to discharge the principal amount at all times for the non-convertible debt securities issued;
- The exemption from maintenance of asset cover in case of unsecured debt securities issued by regulated financial sector entities has been scrapped;
- Companies shall be required to forward, inter-alia, all covenants of the NCD issue and a half-yearly compliance certificate regarding maintenance of asset cover, etc. to the Debenture Trustee;
- A company having its equity shares or convertible securities listed shall be required to make disclosure of initiation of forensic audit along with reasons and entity initiating the forensic audit. Further, final forensic audit report (other than for forensic audit initiated by regulatory / enforcement agencies) along with comments of the management, if any shall also be submitted to the stock exchange.

# SEBI Regulatory updates (2/2)

## Amendments to circular on Scheme of Arrangement

SEBI has now issued a circular, in furtherance to SEBI Circular dated March 10, 2017, bringing about certain amendments to the later. The new circular has several dimensions and the key ones with respect to the schemes of arrangement are as under:

1. The new circular requires for a report from the Committee of Independent Directors recommending that the draft Scheme is not detrimental to the shareholders of the listed entity. Earlier there was no such requirement;

2. The Audit Committee will now have to take into consideration the following additional parameters before issuing their report on the draft scheme of arrangement:
   - Need for merger/demerger/amalgamation/Arrangement;
   - Rationale of the Scheme;
   - Synergies of business of entities involved in scheme;
   - Impact of the Scheme on the shareholders;
   - Cost benefit analysis of the Scheme;

3. The valuation report now needs to be issued by a ‘registered valuer’ as specified in S. 247 of the Companies Act, 2013 and applicable rules;

4. The Stock exchanges are required to analyze the documents pertaining to the Schemes of Arrangement in greater detail. The requirement of an Observation letter has been done away with. The Stock Exchanges need to issue a No Objection Letter basis which the SEBI shall issue a Comment Letter once a no objection letter has been provided by the stock exchanges;

5. The dual criterion has been done away with, and the benchmark is linked to 20% of the ‘value’ of the undertaking as per the last audited balance sheet [Reference to Section 180(1)(i) has been replaced by reference to Section 180(1)(ii)].