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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DIRECT TAX UPDATES

MAY 2020

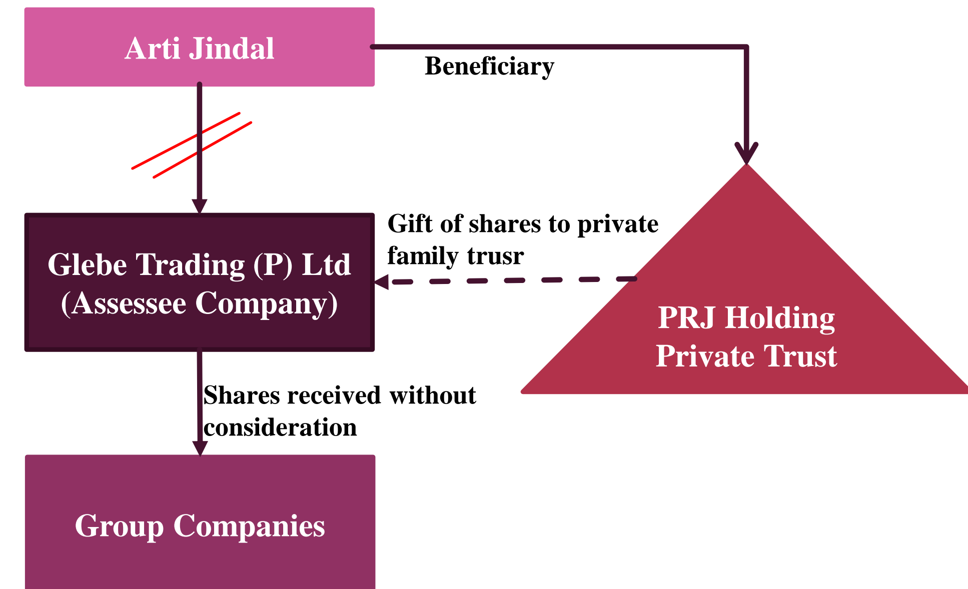
Direct tax updates (1/6)

Transfer of shares pursuant to family realignment cannot be termed as gift/ benefit/ perquisite and cannot be taxed in the hands of shareholders of the recipient company

The assessee, an investment company, had received shares of a few group companies without paying consideration as a part of internal family realignment. Pursuant to such transfer, shares of the recipient assessee company were gifted by the shareholder to a private trust.

The AO held that the receipt of shares by recipient company pursuant to internal family realignment amongst family members could not be regarded as a valid gift, considered it as a sham and void transaction and without making any additions in the hands of the recipient assessee company, taxed the receipt of shares in the hands of the shareholder of assessee company under section 2(24)(iv) of the Act.

Based on the MOU submitted by the assessee company, Delhi ITAT observed that it was clearly a family arrangement and internal family realignment and therefore, the transfer cannot be termed as gift/ benefit or perquisite. The ITAT also observed that the tax officer cannot hold the transaction as sham by lifting the corporate veil, without providing any cogent reasons, and without appreciating that the beneficiary (i.e. shareholder of assessee company) never obtained any benefit from this transaction at any time. The ITAT thus concluded that the tax officer's observations pertaining to section 2(24)(iv) of the Act were without any jurisdiction and he had overstepped the provisions of the ITA by commenting on the taxability in the hands of a shareholder of recipient assessee company.



1 Glebe Trading (P) Ltd vs ITO [2020] (116 taxmann.com 866 (Delhi Trib.)

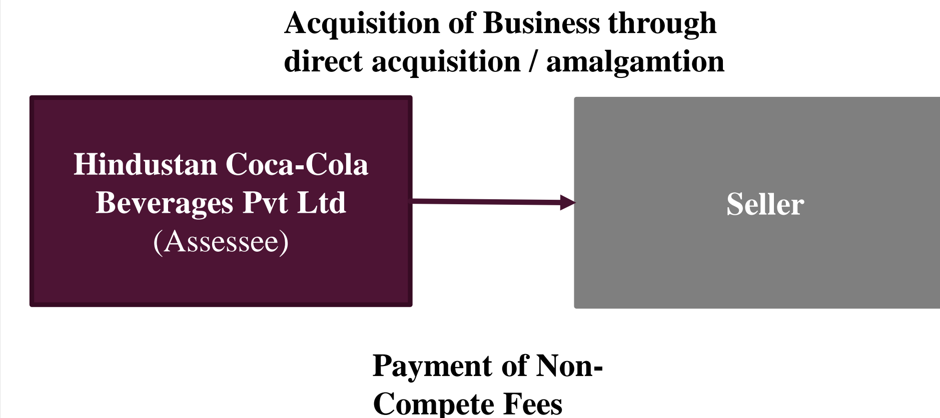
Direct tax updates (2/6)

Non-Compete fees is a capital expenditure and not eligible for depreciation claim[1]

The Assessee is a Beverages Company and had paid non-comepete fees for acquisition of running business of Bottlers through direct acquisition / amalgamation. The non-compete fee was paid to the bottlers for not disclosing the confidential information relating to the business and for not competing in similar line of business in their respective territories for a period of five years. The assessee followed practice of charging amounts to P&L A/c on a pro-rata basis to be fully written off over the period of benefit.

The AO observed that the assessee by virtue of non-compete fee, together with consideration for the purchase of the business, had acquired new business and the said payments were thus for the purpose of acquiring income generating business undertaking. The depreciation claimed on the said expenditure being capital was also denied by the AO, placing reliance on Hon'ble Delhi High Court in Sharp Business System[2]. CIT(A) upheld the order of AO.

On further Appeal, assessee submitted that expenditure towards non-compete fees did not resulted in creation of enduring asset as the scope of agreement was limited to particular territory and that the bottelers were free to carry on business and were in fact carrying on business in other territories; Also depreciation must also be allowed on non-compete fees in the nature of capital expenditure, intangible and thus warrants depreciation on same. Delhi ITAT, basis decision of High Court in Sharp Business System upheld the order of CIT(A) and stated that the payment of non-compete fees is capital in nature not elegible for depreciation claim.



[1] Hindustan Coca-Cola Beverages Pvt Ltd v. DCIT (ITA No. 2699/Del/2015)

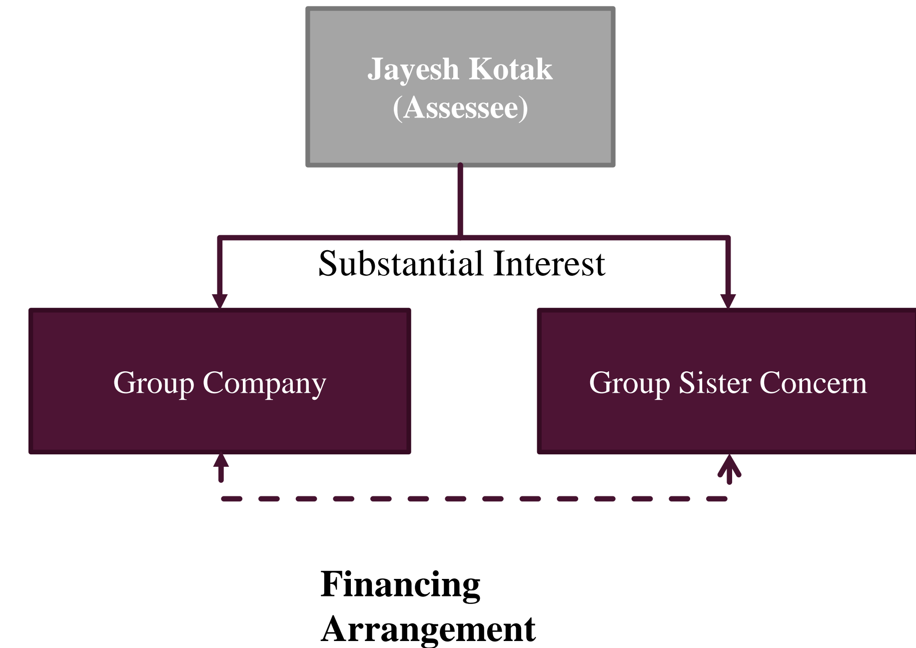
[2] Sharp Business System vs CIT [2012] 211 taxman 576 (Del.)

Direct tax updates (3/6)

Intercompany financing arrangement between group sister concern not liable to deemed dividend provisions as no benefit is received by shareholder

In the present case, the assessee was a shareholder in a company holding substantial interest (27%) which advanced unsecured loans to its sister concerns, wherein the assessee held substantial interest as well. The issue of taxability of such loan transaction came up at the time of re-assessment and the tax officer contended that since the assessee had substantial interest in both entities, he would have derived a benefit from the said transaction and was therefore, liable to tax under section 2(22)(e) of the Act.

The High Court observed that there is no provision in section 2(22)(e) of the Act to tax deemed dividends in the hands of the shareholder if the amount has not been received by the assessee shareholder. The High Court further observed that the loan would entail no direct benefit in the hands of the assessee and that mere holding substantial interest in each of the three companies would not render the said sum as deemed dividend under the applicable provisions. Moreover, even though the assessee is a shareholder of the lendee companies, he has not received any sums from the lendee companies. Therefore, in the absence of any benefit having been received by the assessee- petitioner, there was no obligation cast upon him to disclose such transactions and the said sum was not to be taxed as deemed dividend.



[1] Jayesh T Kotak [TS-206-HC-2020(GUJ)]

Direct tax updates (4/6)

Issue of Waiver of loan by Government of Maharashtra upheld by Mumbai Tribunal for non-applicability of tax provisions

Assessee had received loan from the Government of Maharashtra and same was waived, pursuant to which assessee was no longer required to repay the loan amount. The Assessing Officer held that an amount of Rs. 114.98 crores covered by the loan given by the Government of Maharashtra is taxable under Sections 28(iv) and 41(1) of the Act. Accordingly, the said amount was treated as income of the assessee for the year under consideration and added back to the total income of the assessee.

Basis the decision of Hon'ble Bombay High Court in Mahindra & Mahindra Ltd[2], the CIT(A) accepted the contention of the assessee that the onus of establishing that the receipts were chargeable to tax was on the Assessing Officer and held that the aforesaid decision in Mahindra and Mahindra Ltd (supra) squarely applies to the facts of the present case; the entire sum represented principal amount payable to the Government of Maharashtra and no part thereof comprised of waiver of any interest liability. Accordingly, the CIT(A) held that the sum in question was not chargeable to tax either under Section 41(1) of the Act or under Section 28(iv) of the Act.

On further appeal by revenue, Mumbai ITAT upheld the order of CIT(A) and stated that,
(1) Prima facie, section 28(iv) covers the benefit that arises to the assessee from the business / profession which has to be in some other form rather than in the shape of money. Since remission of loan is in the form of money, the very first condition of Section 28(iv) of the IT Act is not satisfied in the present case;
(2) For applicability of Section 41(1) of the ITA, Mumbai ITAT stated as under (i) it is a sine qua non that there should be an allowance or deduction claimed by the assessee in any assessment for any year in respect of loss, expenditure or trading liability incurred by the assessee; Reason being that an assessee can not does not get away with a double benefit. (ii) Although assessee was paying interest @ 6%, no deductible claim was made by assessee u/s 36(1)(iii) of the ITA. (iii) Amortisation benefit (in the nature of depreciation) was claimed by the Assessee, which was on machinery purchased by assessee from the loan money. (iv) Purchase of machinery was not debited to trading account or P/L account and accordingly, no extra claim was made by assessee. (v) By making distinguish between trading liability and other liability, ITAT held that the instant case involved cessation of liability other than trading liability.

1 Principal Commissioner of Income Tax v. SICOM Ltd. [2020] 116 taxmann.com 410 (Mum HC)

2 Mahindra & Mahindra Ltd v. CIT [2003] 261 ITR 501 (Mum HC)

Direct tax updates (5/6)

CBDT issues clarification with respect to determination of residential status for FY 2019-20[1]

Owing to the lockdown introduced for addressing Covid-19 in India, a number of individuals visiting India with the intention of leaving after a particular duration, thus ensuring that they maintain their status as a non-resident or a not ordinary resident during FY 2019-20, have been unable to return to their respective home countries.

So that such individuals do not get characterised as "resident" under section 6 of the Income Tax Act, 1961 ('Act') due to the inevitable prolonged stay, CBDT has issued the following clarification for the purpose of determining residential status for FY 2019-20 under section 6 of the Act in case of individuals who came to India for a visit before 22 March 2020:

- **If quarantined:** If the individual is quarantined in India on or after 1 March 2020, period of his stay from the date of his quarantine to 31 March 2020 (or up to his date of departure in case he departed on an evacuation flight on or before 31 March 2020) shall be excluded;
- **If not quarantined:** In any other case, the individual's period of stay in India from 22 March 2020 to 31 March 2020 (or up to his date of departure in case he departed on an evacuation flight on or before 31 March 2020) shall be excluded;

Devadhaantu Comments:

This is a much-welcome and rational clarification, and considering the extension of lockdown beyond 31 March 2020 into the next year i.e. FY 2020-21, CBDT is expected to issue a similar circular for that year once the flight operations are resumed. However, international flights resumption from India is one of such an aspect. In addition, the intended destination country also needs to open its borders. Hence, logically, the exclusion of the number of days stay in India should factor that aspect in, whilst issuing the order for calculation of the number of days stay in India.

[1] CBDT Circular No. 11 of 2020 dt. May 8,2020

Direct tax updates (6/6)

Derecognition of the principle of mutuality; denial of exemption on 'surplus' franchisee advertising contributions[1]

The judgement revolves around the doctrine of mutuality which emphasizes on the fact an amount received from oneself cannot be construed as income and hence, not taxable. The Assessee-company was incorporated by Yum Restaurants India Pvt. Ltd ("YRIPL") as its fully owned subsidiary after having obtained the necessary requisite approvals.

The said approvals were sought so as to economize the cost of advertising and promotion for all the francisees of YRIPL as per their needs and were subject to certain conditions as regards functioning of assessee, whereby it was obligated to operate on a non-profit basis on principles of mutuality.

However, the assessee-company undertook a commercial venture wherein contributions were accepted both from members as well as non-members. Moreover, one member YRIPL was vested with a myriad set of powers to control functioning and interests of other members (franchisees), even to their detriment.

Basis the above, the Apex Court held that such an integration could not be termed as a case of ordinary social association devoid of commerciality. Revenue Authorities were justified in refusing to acknowledge assessee as a mutual concern and denying it any exemption from taxability.

Devadhaantu Comments:

The essence of the principle of mutuality lies in the commonality of the contributors and the participants who are also the beneficiaries. The contributors to the common fund must be entitled to participate in the surplus and the participators in the surplus are contributors to the common fund. This principle thus postulates that no amount of surplus or profit can arise when one undertakes a transaction which oneself. Hence, the Apex Court has denied the benefits that would arise in case the principle of mutuality was applicable to the assessee.

[1] CBDT Circular No. 11 of 2020 dt. May 8,2020

RBI REGULATORY UPDATES

MAY 2020

RBI Regulatory updates (1/3)

The Ministry of Finance further amends the Foreign Exchange Management (Non-debt Instruments) Rules, 2019[1] (1/2)

Ministry of Finance notified Foreign Exchange Management (Non-debt Instruments) (Second Amendment) Rules 2020, giving effect as under:

a. Acquisition through renunciation of rights

Prior to this amendment, any non-resident could have subscribed to renounced shares (i.e. renounced either by a non-resident or a resident) at a price determined by the company (in case of a listed company) or at a price not less than the price offered to residents (in case of an unlisted company). A non-resident can now subscribe to renounced shares in a rights issue, which have been renounced by a resident in its favor, subject to the pricing guidelines prescribed. This differential pricing shall lead to a separate price in a single rights issue for renounced shares intended to be subscribed by a non-resident, so far as unlisted companies are concerned.

b. Sourcing Norms under Single Brand Retail Trade ("SBRT")

Prior to the amendment, the sourcing norms applicable to SBRT transactions, shall not be applicable up to 3 years from commencement of the business i.e. opening of the first store in cases of products having 'state-of-art' and 'cutting-edge' technology. SBRT entities are permitted to undertake retail trading through e-commerce. As per the amendment, this exemption of sourcing requirements is now available for up to 3 years from the commencement of business i.e. opening of the first store or start of online retail, whichever is earlier.

c. Sectoral Cap for Insurance Sector and related conditions

The amendment also notified the government's budget proposal to permit up to 100% FDI in insurance intermediaries under the automatic route, which was earlier capped at 49%.The government has also prescribed certain conditions related to ownership & control of an Indian insurance company by resident Indian entities and operational aspects of insurance intermediaries such as prior IRDAI approval for repatriating dividend, no payments to the foreign group or promoter or subsidiary or interconnected or associate entities beyond the limits prescribed by IRDAI.

1 MINISTRY OF FINANCE (Department of Economic Affairs) NOTIFICATION S.O. 1374(E), April 27, 2020

RBI Regulatory updates (1/3)

The Ministry of Finance further amends the Foreign Exchange Management (Non-debt Instruments) Rules, 2019 (2/2)

d. Disinvestment by Foreign Portfolio Investors (“FPIs”):

In case of breach of the prescribed limit for FPIs, they have an option of divesting their excess holdings within 5 trading days from the date of the settlement of trades causing the breach. If the FPI chooses not to divest, then its entire investment in the Indian company is considered as a Foreign Direct Investment (“FDI”) and such FPI and its investor group is not permitted to make any further portfolio investments in the Indian company. Such breach is not considered as a contravention of the NDI Rules during the time taken to follow the said procedure. The Amendment has introduced an additional condition i.e., the divestment of holdings by the FPI and the reclassification of FPI investment as FDI will be subject to further conditions, if any, specified by SEBI and the Reserve Bank of India in this regard.

RBI Regulatory updates (2/3)

The Ministry of Finance Non – Debt Instrument Rules to curb opportunistic takeovers[1]

In order to curb the opportunistic takeovers/acquisitions of Indian companies due to the current COVID-19 pandemic, the Foreign Exchange Management (Non-debt Instruments) Rules, 2019 have been amended to include the following:

- an entity of a country, which shares land border with India or the beneficial owner of an investment into India who is situated in or is a citizen of any such country, shall invest only with the Government approval;
- A citizen of Pakistan or an entity incorporated in Pakistan shall invest only under the Government route, in sectors or activities other than defence, space, atomic energy and such other sectors or activities prohibited for foreign investment;
- In the event of the transfer of ownership of any existing or future FDI in an entity in India, directly or indirectly, resulting in the beneficial ownership falling within the restriction or purview of the above restrictions, such subsequent change in beneficial ownership shall also require government approval.

Devadhaantu comments:

The earlier FDI policy provided country specific restrictions only with respect to Pakistan and Bangladesh. The scope of restrictions has now been extended as described above. Various statistical surveys suggest that, various start-ups in India are funded by Chinese funds and the above-mentioned restriction would only further dent the capital-deficiency in the country. Also, while Hong Kong is a part of China, it has been classified as a separate country by the Indian Government for FDI reporting purposes. To avoid unintended impact on FDI inflows from Hong Kong, the Ministry should issue an appropriate clarification on the matter.

1 MINISTRY OF FINANCE (Department of Economic Affairs) NOTIFICATION S.O. 1278(E), April 22, 2020

RBI Regulatory updates (3/3)

RBI issues Governors' Statement in response to the Covid 19 Crisis[1] (1/2)

Basis the continuing assessment of the macro economic situation and financial market conditions, the RBI proposes to take the measures in the areas such as,

(i) Maintaining adequate liquidity;
(ii) Facilitate and incentivise bank credit flows;
(iii) Ease finanacial stress;
(iv) Enable the normal functioning of markets.

The table below captures the detailed insights of the various measures suggested in the Governors' Statement. These have been broadly categorized into two broad baskets i.e. liquidity management and regulatory measures. Some key measures have been elaborated as below:

Sr. No.	Suggested Measures	Implications
Liquidity Management		
1	Targeted Long Term Operations (TLTRO) 2.0	It has been decided to conduct targeted long-term repo operations (TLTRO 2.0) for an aggregate amount of INR 50,000 crore, to begin with, in tranches of appropriate sizes.
2	Refinancing Facilities for All India Financial Institutions	In the wake of the ongoing pandemic, it has been decided to provide special refinance facilities for a total amount of INR 50,000 Crores to various financial institutions such as NABARD, SIDBI and NHB to facilitate them to meet sectoral credits.
3	Liquidity Adjustment Facility: Fixed Rate Reverse Repo Rate	In order to deploy the excess liquidity with the commercial banks towards more productive sectors in the economy; it has been decided to reduce the fixed rate reverse repo rate under the liquidity adjustment facility by 25 basis points from 4% to 3.75%

1 MINISTRY OF FINANCE (Department of Economic Affairs) NOTIFICATION S.O. 1278(E), April 22, 2020

RBI Regulatory updates (3/3)

RBI issues Governors' Statement in response to the Covid 19 Crisis (2/2)

Sr. No.	Suggested Measures	Implications
Regulatory Measures		
4	Asset Classification	• The Asset Classification norms have been put to a standstill in the moratorium period from March 1, 2020 to May 31, 2020. • Insofar as the risk built up in the bank balance sheets is concerned, a higher provision of 10 % on all such accounts under the standstill, spread over two quarters, i.e., March, 2020 and June, 2020 is suggested. These provisions can be adjusted later on against the provisioning requirements for actual slippages in such accounts.
5	Extention of Resolution Timeline	In the case of large accounts under default, Scheduled Commercial Banks, AIFIs, NBFC-ND-SIs and NBFC-D are currently required to hold an additional provision of 20 per cent if a resolution plan has not been implemented within 210 days from the date of such default. This has been further extended by 90 days.
6	NBFC Loans to Commercial Real Estate Projects	In respect of loans to commercial real estate projects delayed for reasons beyond the control of promoters can be extended by an additional one year, over and above the one-year extension permitted in normal course, without treating the same as restructuring. It has now been decided to extend a similar treatment to loans given by NBFCs to commercial real estate. This will provide relief to NBFCs as well as the real estate sector.

SEBI REGULATORY UPDATES

MAY 2020

SEBI Regulatory updates

SEBI provides for certain relaxations to Issue of Capital and Disclosure Requirements ("ICDR") Regulations, 2018 in respect of Rights Issue in the backdrop of Covid 19 [Press Release No 23/2020 dt. April 21, 2020]

In their bid to facilitate fund raising from capital markets in the backdrop of Covid-19, the SEBI has relaxed norms applicable to listed entities for raising funds. These are broadly categorized into three baskets which have been discussed below:

Rights Issue:

Fast Track Issuances:

- The eligibility requirement for average market capitalization of public shareholding of INR 250 Crs has been reduced INR 100 Crs.
- The requirement relating to period of listing of equity shares for at least 3 years has been reduced to listing for 18 months only.
- The conditions related to no audit qualifications for issuers' audited accounts has been replaced with the requirement to disclose the impact on audit qualifications on issuers financials.

Minimum Subscription: The threshold for a minimum subscription requirement has been reduced from 90% to 75% of the offer size subject to certain conditions.

Threshold for not filing Draft Letter of Offer with SEBI: The threshold for not filing a Draft Letter of Offer has been increased from INR 10 Crores to INR 25 Crores. It may be noted that these relaxations are applicable to rights issues that open on or before March 31, 2021.

Further, the SEBI vide another circular [SEBI/HO/CFD/DIL1/CIR/P/2020/66 dt. April 21, 2020] ,brought about certain other relaxations which are as follows:

Flexibility on Issue Size:

- If an Offer Document of an issuer is pending approval from SEBI, the issuer shall be permitted to reduce or increase the offer size by 50% of the estimated issue size (in lieu of the present limit of 20%) without filing a fresh offer document.
- This shall be applicable to all documents pending approval up to December 31, 2020 with respect to IPOs/FPOs/Rights issue.

Validity of SEBI Observations:

- The validity of observations on all public issues/rights issues to be extended by 6 months from the date of expiry for issuers whose observation has expired/shall expire between March 1, 2020 and September 30, 2020.

SEBI Regulatory updates

SEBI temporarily relaxes the cooling off period before a fresh issue subsequent to a buy-back [SEBI Circular No. SEBI/HO/CFD/DCR2/CIR/P/2020/69 dt. April 23, 2020]

Considering the developments relating to the COVID-19 pandemic, and in order to facilitate the grappling demands of funds by the corporates, SEBI has temporarily relaxed the restriction on companies that do not permit them to raise further capital for a period of one year from the expiry of a buyback, except in discharge of their subsisting obligations. The period of one year has now been reduced to 6 months.

SEBI relaxes actions against non-compliance with minimum public shareholding ("MPS") requirement during the period March 1, 2020 to August 31, 2020 [SEBI/HO/CFD/CMD1/CIR/P/2020/81 dt. May 14,2020]

SEBI circular No. CFD/CMD/CIR/P/2017/115 dated October 10, 2017 lays down the procedure to be followed by the recognized stock exchanges / depositories with respect to MPS non-compliance. However, considering prevailing business and market conditions, the stipulations of the aforesaid October 10, 2017 SEBI circular are relaxed for listed entities for whom the deadline to comply with MPS requirements falls between the period from March 1, 2020 to August 31, 2020. SEBI has also advised the Stock Exchanges to not take any penal action as envisaged in the said circular against such entities in case of non-compliance during the said period (any action initiated after March 1, 2020 may be withdrawn).

SEBI Regulatory updates

SEBI issues advisory on disclosure of material impact of COVID–19 pandemic on listed entities under SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 ("LODR Regulations") [SEBI/HO/CFD/CMD1/CIR/P/2020/84 dated May 20, 2020]

Emphasizing on the importance of timely availability of information about the impact of COVID-19 on listed companies and its operations to its investors and stakeholders, SEBI has issued an advisory for listed entities advising them to evaluate the impact of the COVID 19 pandemic on their business and disseminate the same to stock exchanges. Below is an illustrative list of information that listed entities may consider disclosing:

- Impact of the CoVID-19 pandemic on the business;
- Ability to maintain operations including the factories/units/office spaces functioning and closed down;
- Schedule, if any, for restarting the operations;
- Steps taken to ensure smooth functioning of operations;
- Estimation of the future impact of CoVID-19 on its operations;
- Details of impact of CoVID-19 on listed entities;
- Existing contracts where non-fulfilment of the obligations by any party will have Significant impact on the listed entity's business;
- Other relevant material updates about the listed entity's business.

SEBI has also advised listed entities to revisit, refresh, or update its previous disclosures relating to the impact of COVID-19 pandemic on a timely basis, if possible.

CORPORATE LAW UPDATES

MAY 2020

Corporate Law updates

Mumbai NCLT approves demerger of investment business from wholly owned subsidiary company into Parent[1]

The said Scheme of Arrangement ("Scheme") was for demerger of investment business from the wholly owned subsidiary i.e. the demerged company by the name of Ensemble Holdings and Finance Limited ("EHFL") to its parent entity or the resulting company being Godrej Industries Limited ("GIL").

The said demerger aimed at achieving the following:

(i) consolidation of investment of EHFL in GIL; and

(ii) flexibility to GIL to exit from the NBFC activities of EHFL and to transfer shares of EHFL having NBFC License to another promoter group entity at fair value.

Certain key facets of the Scheme that are noteworthy are that the composition of the undertaking being the NBFC license sitting in the subsidiary along with strategic investment being a very nominal stake (0.60% in this case) in the real estate arm being Godrej Properties Limited. The said scheme facilitates consolidation of investments of EHFL with GIL, while enabling transfer of shares of EHFL (and therefore, the NBFC license) to the promoter group entity.

Devadhaantu Comments:

For a demerger to be tax neutral, one of the basic conditions is that the demerger should be that of an "undertaking" (i.e. the assets and liabilities so demerged should constitute a valid business activity). However, in case of demerger of investments, whether such investments, albeit strategic in nature, could constitute an "undertaking" would require further evaluation, basis the facts of each case. Further, even if such demerger is considered as tax neutral, one would need to evaluate whether such investments so demerged could be deemed as "distribution of assets" and therefore, be deemed as dividend u/s 2(22)(a) of the Income-tax Act, 1961.

[1] Godrej Industries Limited [LSI-274-NCLT-2020(MUM)]