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Between the lines...

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Key Highlights...

- ✓ *Rules on roll back of Advanced Pricing Agreements notified*
- ✓ *High Court ruling on marketing intangibles*
- ✓ *Securities Appellate Tribunal clarifies meaning of term 'control' in context of DIP Guidelines*
- ✓ *Section 66A of the IT Act repealed*
- ✓ *Relaxed norms for creation of security against corporate bonds*

I. Rules on Roll Back of Advanced Pricing Agreements notified

Section 92CC of the Income Tax Act, 1961 empowers the Central Board of Direct Taxes ("CBDT")to enter into an Advance Pricing Agreement ("APA") with any person. An APA is essentially a contract between a taxpayer and the tax authorities that sets out beforehand the method for determining the arm's length price ("ALP") or specifying the manner in which the ALP is to be determinedpertaining to transactions between a subsidiary and its foreign parent. The agreement entered into is valid for a period, not exceeding 5 (five) consecutive financial years, as may be mentioned in the agreement.

The Finance (No.2) Act, 2014 amended the Act to permit roll back of APAs for a maximum period of 4 (four) prior years with effect from 1 October 2014. Rollback provisions essentially mean that a negotiated position on pricing of an international transaction reached under the advance pricing arrangement can be applied to a similar transaction for up to 4 (four) years in the past.

The CBDT, on 14 March 2015, has notified the announced Income-tax (Third Amendment) Rules, 2015 ('APA Roll Back Rules') to prescribe the conditions, procedure and manner for such roll back mechanism.

As per the APA Roll Back Rules, an applicant who has filed or proposes to file an application may seek a roll back of the APA for the same international transaction for which an APA has been applied or is proposed to be applied.

The APA shall contain roll back provision subject to following conditions:

> *(i)* the international transaction is same as the international transaction to which the agreement (other than the rollback provision) applies;

(*ii*) the return of income for the relevant rollback year has been or is furnished by the applicant before the due date of fling return under Section 139(1)of the Income Tax Act, 1961;

(*iii*) the report in respect of the international transaction had been furnished in accordance with section 92Eof the Income Tax Act, 1961;

(*iv*) the applicability of rollback provision, in respect of an international transaction, has been requested by the applicant for all the rollback years in which the said international transaction has been undertaken by the applicant; and

(*v*) the applicant has made an application seeking rollback in Form No. 3CEDA in accordance with prescribed Rule. An additional filing fee of INR 5,00,000 is to be paid along with the rollback application.

An applicant can apply for rollback provision even in those cases wherein agreement has been entered into prior to January 1, 2015 or wherein an APA application has been filed prior to 1 January 2015. In such cases, the applicant was initially required to request for roll back provision on or before 31 March 2015. However, considering that the window for filing the rollback applications was very short i.e. just 16 days, the CBDT has issued a press release declaring the extension of the deadline for filing of rollback forms to 30th June, 2015. The formal notification in this regard is awaited.

The APA rules have also been amended to make the APA pre-filing consultation optional for a potential APA applicant.

However, the roll-back provisions shall not be applicable in case the international transaction has been subject matter of an appeal and the Income Tax Appellate Tribunal has passed an order disposing of such appeal before signing of the agreement. Roll back is also not applicable if the application of the roll back has the effect of reducing the total income or increasing the loss, as the case may be, of the applicant as declared in the return of income of the said.

Source: http://www.incometaxindia.gov.in/communications/notification/notification23_2015.pdf

VA View

The incorporation of the rollback provisions in the APA program in India is an attempt to align with the best global practices and a positive attempt to resolve pending litigation and extending certainty to the taxpayers for at least 9 years. What would be important at this stage for the success of the Rollback program is for the CBDT to facilitate the practical implementation of the Rules.

II. High Court ruling on marketing intangibles

VA represented the recent path breaking decision rendered by the Delhi High Court ("DHC"), in the case of Sony Ericsson Mobile Communication India Pvt. Ltd. v CIT and a batch of 17 connected appeals and cross-appeals, dealing with Transfer Pricing dispute related to marketing intangible.

DHC ruled that advertising, marketing and promotion expenses ("AMP") spend in India in relation to a foreign brand constituted an international transaction. DHC laid down important transfer pricing principles, namely,

(a) 'Bright Line Test' applied by the Revenue has no statutory mandate, and the contention of the Revenue that any excess expenditure beyond the bright line should be regarded as separate international transactions is unwarranted; (b) clubbing of closely linked transactions is permissible; (c) benchmarking of a bundle of transactions applying entity wide transactional net margin method ("TNMM") is permissible; (d) once the Revenue accepts the TNMM as the most appropriate method, then it would be inappropriate for the Revenue to treat a particular expenditure like AMP as a separate international transaction; and (e) compensation for AMP expenses could also be benchmarked under resale price method ("RPM") or cost plus method. The Court concluded that when TNMM and RPM methods adopted and applied show that the net / gross profit margins are adequate, no further Transfer Pricing adjustment on account of AMP expenses would be warranted.

VA View

It is a welcome and significant judgment in the arena of transfer pricing. The maiden ruling lays down the broad parameters to be applied in case of AMP spend adjustments which would serve as a guiding principle to the transfer pricing officers.

The appeal was argued by Mr. Ajay Vohra, Senior Advocate, who was assisted by Neeraj Jain, Partner of the Firm.

III. Securities Appellate Tribunal on the meaning of control

The issue as to what would be construed as 'Control' in relation to Securities and Exchange Board Of India (Disclosure and Investor Protection) Guidelines, 2000 ('**DIP Guidelines**'), where term 'Control' is not defined under the DIP Guidelines, propped up for consideration in the matter of **DLF Ltd.** *v*. **SEBI**.

In the absence of a specific definition of the term 'Control', the SEBI at the lower level while deciding on the issue as to whether DLF is in control of its subsidiaries which it has earlier divested, relied on the definitions of the term 'Control' under various legislations, primarily those under the Companies Act, 1956 (**Companies Act**), SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 (**SAST Regulations**), and the Accounting Standards as issued by the Institute of Chartered Accountants of India.

The SAT as regards the definition of 'Control' under the SAST Regulations, observed:

"*These SAST Regulations are commonly called the 'Takeover Code' and mainly deal with the takeover of one company by another and the merger as well as de-merger of companies. The present matter is, undoubtedly, not a case of take-over or merger and hence the reliance placed by the "2nd WTM (Whole Time Member)" on the definition of control, occurring in the Takeover Code, 1997, appears to us to be misplaced*.

The SAT on the definition of 'Control' under the Accounting Standards observed,

"*If there is any lacuna in the DIP Guidelines, the same cannot be replenished by introduction of the definition of "control" which currently sits in AS-18, AS-23 and AS-24 in a different context altogether.*

…

At the risk of stating the obvious, "significant influence" does not amount to "control". It is clear from the above discussion that AS-23 is applicable only when an Investor has "significant influence" and not "control"."

Placing reliance on the definition of control under Sections4(1) and (2) of the Companies Act and various precedents on the issue, the SAT observed,

"*The composition of the Directors of a Company shall be deemed to be controlled by another company only if that other company exercises power at its sole discretion to appoint or remove the Directors of the other company. Therefore, the Appellant-Company, i.e., DLF, could be said to control the three companies, namely – Shalika, Sudipti and Felicite, only if it can be proved that DLF had exclusive power or sole discretion to appoint or remove the Directors of these three companies and not otherwise.*"

and held that,

"*the Appellant*[DLF] *did not control either the composition of the Board of Directors of these three companies or in any manner attempt to appoint or remove the earlier Directors which was the task of the share-holders of the three erstwhile subsidiaries post the total divestment of shares. A holding company, after it has sold its 100% shares in a subsidiary, practically becomes functus-officio qua the management and control of the erstwhile subsidiary*."

In the present case, the directors of the subsidiaries continued to be on the board, despite the transfer of shareholding. But the Tribunal did not regard this as indicating "control" as it cannot create a presumption in law of a 'continued relationship' between DLF and its subsidiaries. Instead the SAT opined that it is up to the shareholders of the subsidiary companies to decide who would be appointed as the company's directors. Control can be established only if it is proved that DLF had exclusive power or sole discretion to appoint or remove the directors of these three companies and not otherwise.

Source: http://www.sebi.gov.in/cms/sebi_data/attachdocs/1426241669079.pdf

VA View

This order of SAT settles the issue as to what shall be construed as 'Control' for the purpose of DIP Guidelines. DIP Guidelines have now been replaced by Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009, ('**ICDR Regulations**') which defined the term 'Control' under Regulation 2(1) (i). The term 'Control' under the ICDR Regulations has been defined as to "*have the same meaning as assigned to it under clause (c) of sub-regulation (1) of regulation 2 of the SAST Regulations*".

Though the ambiguity of definition of term 'Control' in DIP Guidelines was resolved under the ICDR Regulations, the observation of the SAT that the definition of 'Control' under SAST Regulations could not have been relied on and reasoning given for the same seems to be 'misplaced', as ICDR regulations which is replacement of DIP Guidelines itself has relied on definition of the term 'Control' under SAST regulations.

IV. Section 66A of the Information Technology Act repealed

In a landmark judgment upholding freedom of expression, the Supreme Court has struck down Section 66A of the amended Indian Information Technology Act, 2000 ("IT Act"), a provision in the cyber law which provides power to arrest a person for posting allegedly "offensive" content on websites. The apex court ruled that the

section falls outside Article 19(2) of the Constitution, which relates to freedom of speech, and thus has to be struck down in its entirety.

Section 66A of the IT Act defines the punishment for sending "offensive" messages through a computer or any other communication device like a mobile phone or a tablet. A conviction can fetch a maximum of three years in jail and a fine.

The advent of the controversy

The first petition came up in the court following the arrest of two girls in Maharashtra by Thane Police in November 2012 over a Facebook post. The girls had made comments on the shutdown of Mumbai for the funeral of Shiv Sena chief Bal Thackeray. The arrests triggered outrage from all quarters over the manner in which the cyber law was used. Most cases of arrest were reported in 2012. Jadavpur University professor Ambikesh Mahapatra was arrested for forwarding caricatures on Trinamool Congress chief Mamata Banerjee on Facebook. Activist Aseem Trivedi was arrested for drawing cartoons lampooning parliament and the constitution to depict their ineffectiveness.

The grounds for the challenge

While the objective behind the amendment was to prevent the misuse of information technology, particularly through social media, Section 66A came with extremely wide parameters, which allowed whimsical interpretationof the provision by law enforcement agencies. Most of the terms used in the section have not been specifically defined under the IT Act. The petitioners argued that it was a potential tool to curtail freedom of speech and expression guaranteed under the Constitution and going far beyond the ambit of "reasonable restrictions" on that freedom.

Validity struck down

Given the above debate, the Supreme Court has struck a body blow for the basic right of free expression by striking down this provision in its entirety. The Hon'ble Supreme Court observed,

"*Section 66A is cast so widely that virtually any opinion on any subject would be covered by it, as any serious opinion dissenting with the mores of the day would be caught within its net. Such is the reach of the Section and if it is to withstand the test of constitutionality, the chilling effect on free speech would be total*."

The Hon'ble Supreme striking down the validity of Section 66A of the IT Act held, "*We, therefore, hold that the Section is unconstitutional also on the ground that it takes within its sweep protected speech and speech that is innocent in nature and is liable therefore to be used in such a way as to have a chilling effect on free speech and would, therefore, have to be struck down on the ground of overbreadth*."

Source: http://supremecourtofindia.nic.in/FileServer/2015-03-24_1427183283.pdf

VA View

Section 66A of the IT Act as it stood was so vague that law enforcement authorities could, and did, interpret opinions liberally in a manner as being worthy of putting citizens behind bars. It would, on the whole, be fair to say that with this ruling, India, which is a democracy in progress, took a solid step towards the maturing of democratic principles.

V. Relaxed norms for creation of security against corporate bonds

The Ministry of Corporate of Affairs has *vide* amendment dated 18 March 2015, amended the Companies (Share Capital and Debentures) Rules, 2014, to the following effect:

a. Now security for the debentures by way of a charge or mortgage can be created in favour of the debenture trustee even by way of pledge.

b. Non - Banking Finance Companies can create charge on or mortgage any movable property, as opposed to specified movable properties for other companies, made in favour of a debenture trustee.

c. In case of any issue of debentures by a Government company which is fully secured by the guarantee given by the Central Government or one or more State Government or by both, the requirement for creation of charge on specific movable or immovable property in favour of debenture trustees shall not be required.

d. The charge or mortgage can be created on a holding company's properties and assets where loan is taken by a subsidiary company from a bank or a financial institution.

e. The time period for execution of debenture trust deed by the company issuing debentures in favour of the debenture trustee has been increased from 'sixty days of allotment of debentures' to '3 months from the date of closure of the issue or offer'.

f. The Companies (Share Capital and Debentures) Rules, 2014 are not to apply to Foreign Currency Convertible Bonds issued in accordance with the Foreign Currency Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism) Scheme, 1993 or other directions issued by the Reserve Bank of India (RBI), unless provided in such Scheme or regulations or directions.

Source: http://www.mca.gov.in/Ministry/pdf/Chapter4_Rules_19032015.pdf

VI. Tidbits

1. The Reserve Bank of India ("RBI") through its Sixth Bi-monthly Policy Statement 2014-2015 dated 3 February 2015 has revised the limits on the Liberalized Remittance Scheme (LRS). Where the limit earlier was USD 125,000 as of June 2014, the new enhanced limit is now set at USD 250,000. The LRS does not carry end use restrictions, except for prohibited foreign exchange transactions such as margin trading, lotteries and the like. The revised limits are yet to be notified by the Reserve Bank.

   Source: http://www.rbi.org.in/scripts/BS_PressReleaseDisplay.aspx?prid=33144

2. The Ministry of Corporate Affairs in consultation with RBI has clarified that amounts received by private companies from their members, directors or their relatives, prior to 16th April, 2014 shall not be treated as 'deposits' under the Companies Act,2013 and Companies (Acceptance of

Deposits) Rules, 2014 subject to the condition that relevant private company shall disclose, in the notes to its financial statement for the financial year commencing on or after 1st April, 2014, the figure of such amounts and the accounting head in which such amounts have been shown in the financial statement. Any renewal or acceptance of fresh deposits on or after 1st April, 2014 shall, however, be in accordance with the provisions of Companies Act, 2013and rules made thereunder.

Source: http://www.mca.gov.in/Ministry/pdf/General_Circular_5-2015.pdf

3. The Ministry of Corporate Affairs through an amendment dated 18th March 2015 has amended provisions of Companies (Meeting of Board and its Powers) Rules, 2014. The salient amendment is that the restriction on following powers exercisable by the Board (only by means of resolutions passed at meetings of the Board) has been removed. The powers are:
   - ✓ Appointment and removal of one level below the key management personnel
   - ✓ Taking note of the disclosure of director's interest and shareholding
   - ✓ To buy and sell investment held by the company constituting five percent or more of the paid up share capital and free reserves of the investee company
   - ✓ To invite or accept or renew public deposits and related matters
   - ✓ To review or change the terms and conditions of public deposit
   - ✓ To approve quarterly, half-yearly and annual financial statement of financial results

   Source: http://www.mca.gov.in/Ministry/pdf/Chapter12_Rules_19032015.pdf

4. Preferential Issue of Shares

   Rule 13(1) of Companies (Share Capital & Debentures) Rules, 2014 relates to issue of shares on preferential basis. A company going for preferential issue of shares is also required to comply with provisions of section 42 namely, Private Placement. A relaxation has been provided in the amendment in case preferential issue is made to one or more existing members only. In such a case the company shall be exempt from issuing of Private Placement Offer Letter in PAS-4 and also filing of PAS 4 and PAS 5.

   Source: http://mca.gov.in/Ministry/pdf/Chapter4_Rules_19032015.pdf

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