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CHARTERED ACCOUNTANTS

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Foreword

Dear Readers,

In this edition, we have come up with an article on recent judgement of the Hon'ble Apex Court, in the matter of **DBS Bank Ltd Singapore v. Ruchi Soya Industries Ltd and another**, wherein the 2 member bench, referred the matter to a larger bench, as to whether Section 30(2)(b)(ii) of the Insolvency and Bankruptcy Code, 2016, as amended in 2019, entitles the dissenting financial creditor to be paid the minimum value of its security interest?, as the view and ratio of the bench in the instant case, was different from the decision of a coordinate bench, in **India Resurgence ARC Private Limited** case.

The next article is on the tax sparing credit in the Double Taxation Avoidance Agreement. Various countries have entered into DTAA in order to eliminate potential double taxation. In certain circumstances, CoS may provide tax incentives to foreign companies in order to attract foreign investors. In order to pass on such tax incentives to foreign companies in true sense, tax sparing credit has been incorporated into the DTAA. In this Article, the concept of tax sparing credit has been discussed.

We have also collated certain important judgments under direct tax and provided our comments wherever necessary.

I hope that you will have good time reading this edition and please do share your feedback.
Thanking You,

Suresh Babu S
Founder & Chairman

Articles of the Month

Corporate Laws

Is a Dissenting Financial Creditor Eligible to minimum value of its security interest?

Evolving law with evolving scenarios, has been the case of IBC. The question as to whether Section 30(2)(b)(ii) of the Insolvency and Bankruptcy Code, 2016, as amended in 2019, entitles the dissenting financial creditor to be paid the minimum value of its security interest? was before the Apex Court, and the 2 Judge bench, has referred the matter to a larger bench of the Apex Court. In this Article an attempt is made to understand case under reference and the reasoning of the Hon'ble Apex Court, in referring the matter to a larger bench.

-Contributed by CS D.V.K. Phanindra
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In the matter of **DBS Bank Ltd Singapore v. Ruchi Soya Industries Ltd and another**[1], the Supreme Court, has referred to a larger bench the issue/question as to whether a dissenting financial creditor is to be paid the minimum value of its security interest as per Section 30(2)(b)(ii) of the Insolvency and Bankruptcy Code, 2016, as amended in 2019.

Facts of the case:

The Appellant herein being DBS Bank Limited Singapore had extended financial debt of around USD 50,000,000 (fifty million dollars only) or Rs.243,00,00,000/- (Rupees Two Hundred Forty Three Crores only) to M/s. Ruchi Soya Industries Limited, the Corporate Debtor, secured by a sole and exclusive first charge over immovable and fixed assets of the Corporate Debtor in Gujarat, Rajasthan, Madhya Pradesh and office space at Nariman Point, Mumbai.

The Corporate Debtor went into CIRP. The appellant had submitted its claim, which was admitted by the Resolution Professional at Rs.242,96,00,000/- (Rupees Two Hundred Forty Two Crore Ninety Six Lakhs only).

M/s. Patanjali Ayurvedic Limited submitted a resolution plan for Rs. 4134,00,00,000/- (Rupees Four Thousand One Hundred Thirty Four Crores only) against the aggregate claims of around Rs. 8398,00,00,000/- (Rupees Eight Thousand Three Hundred Ninety Eight Crores only) representing almost 49.22% of the total admitted claims of the financial creditors.

The appellant informed the Committee of Creditors [CoC], that the sole and exclusive nature

[1] [2024] 158 taxmann.com 111 (SC); Civil Appeal No.9133 of 2019 with Civil Appeal No.787 of 2020, in the matter of DBS Bank Ltd, Singapore v. Ruchi Soya Industries Ltd and another.

of security held by the appellant by way of mortgage/hypothecation over immovable and fixed assets of the Corporate Debtor was of greater value compared to collaterals held by other creditors. Emphasising the specific treatment of the exclusive and superior security, the appellant requested the CoC to consider the liquidation value of such security while considering the distribution of proceeds and to make such distribution in a "fair and equitable" manner. ***The CoC approved pari passu distribution of the resolution plan proceeds,*** instead of the request made by the Appellant herein, to consider the liquidation value of such security.

The resolution plan was approved by 96.95% of the CoC. The appellant had voted **against** the resolution plan, thereby becoming a ***dissenting financial creditor.***

The resolution plan was filed for approval before the Hon'ble Adjudicating Authority i.e., NCLT, Mumbai Bench. Also an application was filed by the present appellant challenging the distribution mechanism of the resolution plan proceeds.

The Adjudicating Authority granted provisional/conditional approval to the resolution plan, and through the same order dismissed the appellant's application challenging the distribution mechanism of the resolution plan proceeds.

The appellant challenged the dismissal and preferred an appeal with the Appellate Authority i., the Hon'ble National Company Law Appellate Tribunal, New Delhi bench.

As the matter stood thus, Section 6 of the Insolvency and Bankruptcy Code (Amendment) Act, 2019, was notified by way of a gazette notification dated 16.08.2019, and the same amended Section 30(2)(b) of the Code, accordingly, the amended Section 30(2)(b)(ii) of the Code provided that ***operational and dissenting financial creditors shall not be paid an amount lesser than the amount to be paid to creditors in the event of liquidation of the Corporate Debtor under Section 53(1) of the Code*****, and vide explanation 2, the amended provision was also made applicable to pending proceedings.**

Section 30(4) was also amended to state the CoC shall take into account "the order of priority" amongst creditors as laid down in Section 53(1) of the Code.

The Appellant requested the CoC to reconsider the distribution of the resolution proceeds, in line with the amended provisions, as per which the appellant would be entitled to receive Rs. 217,86,00,000/- (Rupees Two Hundred Seventeen Crores Eighty Six Lakh only) which is the liquidation value of the security interest held by the Appellant. The CoC, however, did not accept the prayer, observing *inter alia* that the appellant had already filed an appeal before the NCLAT, which was pending.

The Adjudicating Authority vide order dated 04.09.2019 finally approved the already provisionally approved Resolution Plan.

The Appellant challenged the said order of the Adjudicating Authority, and preferred an appeal before the NCLAT. Thereby Two appeals were pending before the Appellate Authority. The Appellate Authority dismissed both the appeals, and the same in appeal before the Apex Court.

While hearing the appeals, the Apex court, by way of an interim order, directed that an amount of Rs. 99,74,00,000/- (Rupees Ninety Nine Crores Seventy Four Lakhs only), being the difference between the amount which the appellant would have received in terms of the amendments noticed above i.e., had been the liquidation value of its security interest was paid, and the amount received by the appellant on *pro rata* distribution of proceeds, be deposited in an escrow account.

It was the case of the Appellant that against the admitted claim of Rs.242,96,00,000/- (Rupees Two Hundred Forty Two Crore Ninety Six Lakhs only), the Appellant would receive approximately Rs.119,00,00,000/- (Rupees One Hundred Nineteen Crore Only) on pro-rata distribution, against the liquidation value of the security interest of Rs.217,86,00,000/- (Rupees Two Hundred Seventeen Crore Eighty Six Lakhs only), which is in total disregard to the sole, exclusive and higher value of their security interest, and notwithstanding the amendments to Section 30 of the Code, the appellant is being deprived of its due share given its superior security assets. Further putting the appellant at par with financial creditors having inferior security interest has resulted in unjust enrichment and windfall benefits to the dissimilarly placed creditors to the detriment of the appellant.

For the sake of understanding the amended of provision i.e., Section 30 (2), is extracted below:

> **"30. Submission of resolution plan:**
> xx xx xx
>
> (2) The resolution professional shall examine each resolution plan received by him to confirm that each resolution plan:
>
> (a) provides for the payment of insolvency resolution process costs in a manner specified by the Board in priority to the payment of other debts of the corporate debtor;
>
> ***(b) provides for the payment of debts of operational creditors in such manner as may be specified by the Board which shall not be less than:***
>
> *(i) the amount to be paid to such creditors in the event of a liquidation of the corporate debtor under Section 53; or*
>
> ***(ii) the amount that would have been paid to such creditors, if the amount to be distributed under the resolution plan had been distributed in accordance with the order of priority in sub-section (1) of Section 53, whichever is higher, and provides for the payment of debts of financial creditors, who do not vote in favour of the resolution plan, in such manner as may be specified by the Board, which shall not be less than the amount to be paid to such creditors in accordance with sub-section (1) of Section 53 in the event of a liquidation of the corporate debtor.***
>
> ***Explanation 1:*** *For the removal of doubts, it is hereby clarified that a distribution in*

accordance with the provisions of this clause shall be fair and equitable to such creditors.

Explanation 2: For the purposes of this clause, it is hereby declared that on and from the date of commencement of the Insolvency and Bankruptcy Code (Amendment) Act, 2019, the provisions of this clause shall also apply to the corporate insolvency resolution process of a corporate debtor:

(i) where a resolution plan has not been approved or rejected by the Adjudicating Authority;

(ii) where an appeal has been preferred under Section 61 or Section 62 or such an appeal is not time barred under any provision of law for the time being in force; or

(iii) where a legal proceeding has been initiated in any court against the decision of the Adjudicating Authority in respect of a resolution plan;

In line with the explanation to the amendment, the issue for consideration before the Apex Court was whether the amendments made to Section 30(2), will be applicable when the first appeal was heard by the NCLAT. The sequence of events as below:

Sl. No.	Event	Effective date/date
1.	Amendment to Section 30 (2)	16.08.2019
2.	First Appeal preferred before the Appellate Authority against the provisional order of the Adjudicating Authority	31.07.2019

The Apex court opined that Clauses (i), (ii) and (iii) of Explanation 2 (extracts Supra) reflect the wide expanse and width of the legislative intent that the application of the Amendment Act, whether proceedings are pending before the adjudicating authority, the appellate authority, or before any court in a proceeding against an order of the adjudicating authority in respect of a resolution plan, and in the instance of a approved resolution plan, which has attained finality, the amendments will not apply to re-write the already settled case/matter.

Reference to the decision of the Apex Court in ***Committee of Creditors of Essar Steel India Limited*** v. ***Satish Kumar Gupta & Ors***.[2], wherein it was held that Explanation 2 applies to the substituted Section 30(2)(b) to pending proceedings either at the level of the adjudicating authority, appellate authority or in a writ or civil court. No vested right inheres in any resolution applicant who has plans approved under the Code. An appellate proceeding is a continuation of the original proceeding. A change in law can always be applied to original or appellate proceedings. Thus, Explanation 2 is constitutionally valid and despite having retrospective operation, it does not impair vested rights.

The Apex Court noted the Appellant's submission that the Adjudicating authority had provisionally/conditionally approved the Resolution Plan vide order Dt: 24.07.2019,

[2] (2020) 8 SCC 531

whereas the final approval to the Resolution Plan was vide order Dt: 04.09.2019, which is well beyond the amendment notification i.e., on 16.08.2019. The effect of the Amendment Act could not have been considered and applied by the Adjudicating Authority, when it had provisionally approved the Resolution Plan. However this was not the case, when the Appellate Authority had disposed off the Two Appeals, preferred by the Appellant herein, which was post the enforcement of the Amendment Act.

Interpreting Section 30(2)(b)(ii) of the Code, the Apex Court noted that the dissenting financial creditor is entitled to payment, which should not be less than the amount payable under Section 53(1), in the event of the liquidation of the corporate debtor. *The provision recognises that all financial creditors need not be similarly situated.* Secured financial creditors may have distinct sets of securities.

The Apex court also referred to the decisions in ***Committee of Creditors of Essar Steel India Limited*** (supra), ***Swiss Ribbons Private Limited and Another*** v. ***Union of India and Others***[3], and ***Vallal RCK*** v. ***Siva Industries and Holdings Limited and Others***[4], ***which have held that the commercial wisdom of the CoC must be respected***. Therefore, the resolution plan accepted by the requisite creditors/members of the CoC upon voting, is enforceable and binding on all creditors, and the CoC can decide the manner of distribution of proceeds amongst creditors and others, but Section 30(2)(b) as amended protects the dissenting financial creditor and operational creditors by ensuring that they are paid a minimum amount that is not lesser than their entitlement upon the liquidation of the corporate debtor.

The Court further noted that the very intent of the provision is to protect the minority autonomy of creditors, because, on the resolution plan being approved, an unwilling secured creditor has no option but to forgo the security, and such an unwilling secured creditor is entitled to the value of the security as payable on the liquidation of the corporate debtor. The provision should not be read down to nullify the minimum entitlement. Section 30(2)(b)(ii) in its amended form, forfends the dissenting financial creditor from settling for a lower amount payable under the resolution plan.

The Apex Court referred to the decision of a coordinate bench in ***India Resurgence ARC Private Limited*** v. ***Amit Metaliks Limited & Another***[5]***,*** *(wherein it was held that a dissenting secured creditor cannot challenge an approved resolution plan contending that higher amount should have been paid to it based on the security interest held by it over the corporate debtor), which* referred to the judgment in ***Jaypee Kensington Boulevard Apartments Welfare Association & Others.*** v. ***NBCC (India) Limited & Others***[6]***.***

[3] (2019) 4 SCC 17
[4] (2022) 9 SCC 803
[5] 2021 SCC Online SC 409
[6] (2022) 1 SCC 401

The Apex Court referred to **UNCITRAL Legislative Guide** on the treatment of dissenting creditors, forming part of the decision in the matter of **Committee of Creditors of Essar Steel India Limited (supra),** was taken by the Apex Court. The reasoning and ratio remains the same even in **Jaypee Kensington (supra).**

The Apex Court further opined that the provisions of Section 30(2)(b)(ii) by law provides assurance to the dissenting creditors that they will receive as money the amount they would have received in the liquidation proceedings. This rule also applies to the operational creditors. This ensures that dissenting creditors receive the payment of the value of their security interest.

The Apex court opined that there is a contradiction in the reasoning given in the judgment of this Court in **India Resurgence ARC Private Limited (supra)** and is in discord with the ratio decidendi of the decisions in **Committee of Creditors of Essar Steel India Limited (supra)** and **Jaypee Kensington (supra),** as detailed below (mentioned in verbatim):

(a) Paragraph 17 is respectfully correct in its observations when it refers to the provisions of Section 30(4) and that the voting is essentially a matter which relates to commercial wisdom of the CoC. The observation that a dissenting secured creditor cannot suggest that a higher amount be paid to it is also correct. However, this does not affect the right of a dissenting secured creditor to get payment equal to the value of the security interest in terms of Section 30(2)(b)(ii) of the Code.

(b) Paragraph 21 again in our respectful view is partially correct. It is correct to the extent that the legislature has not stipulated that the dissenting financial creditor shall be entitled to enforce the security interest. However, it is incorrect to state that the dissenting financial creditor would not be entitled to receive the liquidation value, the amount payable to him in terms of Section 53(1) of the Code.

*(c) Paragraph 22 refers to the **Committee of Creditors of Essar Steel** (supra), which we have already quoted and is apposite to the view expressed by us. The reasoning given in the earlier portion of paragraph 22 in our respectful opinion is in conflict with the ratio in **Committee of Creditors of Essar Steel India Limited** (supra) as it does not take into account the legal effect of Section 30(2)(b)(ii) of the Code. **While it is important to maximise the value of the assets of the corporate debtor and prevent liquidation, the rights of operational creditors or dissenting financial creditors also have to be protected as stipulated in law.***

The Apex Court further opined that in ***Jaypee Kensington*** (supra), it was held that the dissenting financial creditor, if the occasion arises, is entitled to receive the extent of value in money equal to the security interest held by him, and it would not be proper to read ***Jaypee Kensington*** (supra), ***as***

laying down that the dissenting financial creditor would be entitled to the extent of amounts receivable by him in the resolution plan. This would undo the very object and purpose of the amendment. It would make the portion of Section 30(2)(b)(ii) specifying the amount to be paid to such creditor in accordance with Section 53(1), redundant and meaningless.

For the purpose of discharge of obligation mentioned in the second part of Section 30(2)(b) of the Code, the dissenting financial creditors are to be paid an amount quantified in terms of the proceeds of assets receivable under Section 53 of the Code. A similar view was taken by a coordinate bench of the Apex Court in ***Vistra ITCL (India) Limited & Ors.*** v. ***Dinkar Venkatasubramanian & Anr***[7]***.***,

The Apex Court further dismissed the submissions that reference was only given to Section 53 and not to Section 52, in the amended Section 30(2)(b)(ii). Reference to Section 53 of the Code in Section 30(2)(b)(ii) is made with a specific purpose and objective to give a cogent and effective meaning to the words to effectuate the intent. The Court viewed that Section 53 of the Code refers to Section 52 thereof, Isolation of Section 53, when we refer to Section 30(2)(b)(ii) will make it meaningless and undo the legislative intent behind the amended provision, which is clear and apparent. A dissenting financial creditor is entitled to not partake the proceeds in the resolution plan, unless a higher amount in congruence with its security interest is approved in the resolution plan. The "amount" to be paid to the dissenting financial creditor should be in accordance with Section 53(1) in the event of liquidation of the corporate debtor. ***The Court opined that the dissenting financial creditor is entitled to a minimum value in monetary terms equivalent to the value of the security interest.***

Further the Apex Court also rejected the submissions that the secured creditor's entitlement to distribution under Section 53(1)(b)(ii) is applicable where the secured creditor relinquishes its security interest under Section 52 of the Code, and, therefore, is not applicable to dissenting financial creditors like the appellant, as erroneous and unacceptable.

As held in ***Jaypee Kensington*** (supra) the dissenting Financial Creditor is only entitled to the monetary value of the assets. The dissenting financial creditor has to statutorily forgo and relinquish his security interest on the resolution plan being accepted, and his position is same and no different from that of a secured creditor who has voluntarily relinquished security and is to be paid under Section 53(1)(b)(ii) of the Code.

The Apex court further clarified that in view of the foregoing reasoning, the reference given is only **Section 53(1)** and not the entire Section 53 in the amended Section 30(2)(b)(ii), that the dissenting financial creditor is not denied the amount which

[7] (2023) 7 SCC 324

is payable to it being equal to the amount of value of the security interest.

The Apex court also rejected the submissions made on behalf of the respondents that Section 30(2)(b)(ii) is unworkable because it involves deeming fiction relating to liquidation, which is inapplicable during the CIRP period. This would be contrary to the intent of the legislature.

On behalf of the Committee of Creditors (CoC), it was submitted that the provisions of Section 30(2)(b)(ii) is not applicable the appellant, as the appellant has dissented only the manner of distribution of the proceeds under the resolution plan, but did not as such dispute/oppose the resolution plan.

The Apex court clarified that Section 30(2)(b)(ii) relates to the proportion of the proceeds mentioned in the resolution plan or the amount which the dissenting financial creditor would be entitled to in terms of the waterfall mechanism provided in Section 53(1), if the corporate debtor goes into liquidation. The dissenting financial creditor does not have any say when the resolution plan is approved by 2/3rd majority of the CoC. The resolution plan will be accepted when approved by the specified majority in the CoC. ***The dissenting financial creditor cannot object to the resolution plan, but can object to the distribution of the proceeds under the resolution plan, when the proceeds are less than what the dissenting financial creditor would be entitled to in terms of Section 53(1) if the corporate debtor had gone into liquidation.*** This is the statutory option or choice given by law to the dissenting financial creditor.

The Apex court did not find merit in the Respondent's contention that there is conflict between Section 30 (4) and the amended Section 30 (2) (b) of the Code.

Section 30(4) provides that the CoC may approve the resolution plan by a vote not less than 66% of the voting share of the financial creditor. It states that the CoC shall consider the feasibility and viability, the manner of distribution proposed, which may take into account the order of priority amongst creditors under Section 53(1), including the priority and value of the security interest of the secured creditors, and other requirements as may be specified by the Board. These are the aspects that the CoC has to consider, and it is not necessary for the CoC to provide each assenting party with liquidation value. However, a secured creditor not satisfied with the proposed payout can vote against the resolution plan or the distribution of proceeds, in which case it is entitled to full liquidation value of the security payable in terms of Section 53(1) on liquidation of the corporate debtor.

Accordingly, **Section 30 (4)** cannot be in conflict with **Section *30(2)(b)(ii)***, as Section *30(2)(b)(ii)* relates to the minimum payment which is to be made to an operational creditor or a dissenting financial creditor. A dissenting financial creditor does not vote in favour of the scheme. Operational creditors do not have the right to vote.

In view of the different view and ratio taken by the Apex Court with the decision in ***India Resurgence ARC Private Limited*** (supra) on interpretation of Section 30(2)(b)(ii) of the IBC, the court felt that it would be appropriate and proper if the following question is referred to a Larger Bench:

"Whether Section 30(2)(b)(ii) of the Insolvency and Bankruptcy Code, 20161, as amended in 2019, entitles the dissenting financial creditor to be paid the minimum value of its security interest?"

Accordingly, the matter is placed for consideration of the Larger bench of the Apex Court.

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Income Tax – International Taxation

Tax Sparing – Taxation of exempt income in CoS and CoR

- Analysis from Indian tax perspective

A country may enter into Double Taxation Avoidance Agreement ("DTAA") with other country in order to provide relief from double taxation by way of providing credit by the country of residence in respect of tax paid in the country of source. On the other hand, in order to encourage FDI into the county, a country may provide tax incentives. If a CoS provides tax incentives, as no tax would be payable in the CoS, the CoR may not provide any credit which leads to same tax outflow in the hands of the taxpayer thereby it may defeat the objective of providing tax incentives by the CoS. In order to overcome this situation, a country may enter into DTAA there by CoR may provide credit of tax spared by the CoS. In this Article, tax sparing concept and its disadvantages have been discussed.

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A country may provide various incentives to attract investors both domestic as well as foreign in order compete with other investment destinations. Incentives provided by Governments may include tax incentives, financial back-up, offering free land or developed infrastructure etc., and among such incentives, tax incentives play a vital role in decision making by a probable investor. Tax incentives means levying the tax at Nil or reduced rate than applicable to other persons and Government provides such incentives in order to develop a particular area or economy.

In order to attract foreign investors and increase the flow of Foreign Direct Investment into the economy, the Government extends such tax incentives to foreign investors as well. However, as we know that a foreign investor is taxed in both the countries i.e., country of residence and country of source, a relief provided by the CoS may not be beneficial to the foreign investors this is because, CoR levy tax on global income. If such income is subject to tax in CoS, CoR provides relief by way giving credit of taxes paid in CoS. If such income is exempt CoS or reduced tax rate is applicable in Cos, CoR does not extend such exemption or relief to the taxpayer which will ultimately hurt the object and purpose of providing tax incentives to foreign investors.

In order to achieve the above objective, countries may agree in DTAA wherein the CoR provides relief not only from tax paid in the CoS but also tax spared by the Cos. Under this method, taxpayer would get

credit of taxes which would have been payable in the CoS even though such tax is exempt such country.

If such benefit is not passed on to the investors, relief provided by CoS would go into the pockets of exchequer of CoR this is because, CoR provides relief only to the extent of taxes paid in CoS. If no taxes have been paid in CoS, CoR levies and recover full tax from the taxpayer without any relief from double taxation.

Let us understand the tax sparing concept by way of example. Taxpayer has earned an income of Rs.1,000 in CoS where rate of tax is 30 percent and when such income is offered to tax in CoR wherein the rate of tax is 40 percent, taxpayer avails credit of tax paid in CoS to the extent of Rs.300 and pays balance tax of Rs.100 in CoR after availing credit of taxes paid in CoS. However, if CoS in order to encourage investments, provides exemption from taxation in respect of income earned in such country, no tax is payable in CoS however, when such income is offered to tax in CoR, taxpayer has to pay Rs.400 as tax as no tax has been paid in CoS, no credit could be available to the taxpayer. Ultimately, taxpayer ends up with paying same tax in respect of same economic activity despite of the fact that CoS provides full exemption from payment of tax in respect of income earned by the taxpayer and CoR gets excess tax collection as no credit has been given in such country.

Which means that giving exemptions by CoS benefits the CoR instead of taxpayer. Hence, countries may agree for tax sparing credit thereby credit of fictious amount would be available to the taxpayer in the CoR subject to satisfaction of conditions agreed upon. When CoR agrees for tax sparing credit, taxpayer in the above example is required to pay tax of Rs.100 after availing the credit of tax foregone by the CoS. Accordingly, by means of tax sparing mechanism, the true tax incentive provided by the CoS would reach the investor.

OECD commentary on Tax Sparing:

The purpose of tax sparing concept is to allow foreign investors/non-residents to obtain foreign tax credit that have been 'spared' under the incentive program of CoS. Tax sparing provisions may take different forms:

- CoR may allow as a deduction the amount of tax which the CoS could have charged in accordance with its domestic law.
- CoR, may as a counterpart for the reduction of tax by CoS, allows a deduction against its own tax of an amount fixed at higher rate.
- The CoR may exempt the income which have been benefited from tax incentives in the CoS.

While the tax sparing concept has been brought in to provide relief to the intended investors, in certain circumstances, the tax sparing concept may be misutilized in order to avoid the tax liability. The OECD report on Tax Sparing – A Reconsideration[8]

[8] Tax Sparing: A Reconsideration | READ online (oecd-ilibrary.org)

identified concerns about including tax sparing concepts in DTAAs. The above-mentioned report plays following concerns in its report:

The potential for abuse of tax sparing credit: Tax sparing provisions may provide wide opportunities for tax planning and tax avoidance. Tax sparing provisions was used to shift profits from other tax jurisdictions to CoS in order to avoid taxes by using transfer pricing abuse. However, this practice has been mitigated after the introduction of transfer pricing regulations by many countries.

Further, such country may be used as a conduit by third country investors by way of treaty shopping. The introduction of anti-avoidance rules and MLI may mitigate the risk of abuse of tax sparing provisions to some extent. Let us understand how tax sparing provisions are used to avoid potential tax liability:

Case Study: M/s CoS resident of X wishes to acquire a loan of $1,000 million from group company namely M/s Foreign Lender at the rate of 7.5% rate of interest. In order to avoid possible tax liability, group has structed the arrangement as follows:

Instead of giving a loan of $1000m directly to M/s CoS, M/s Foreign Lender has given a loan of $300m to M/s CoR1 (resident of country Y) which will invest such an amount in M/s COR 2 (resident of country Y) and has given a loan of $700m to M/sCoR2. Subsequently, M/s CoR 2 has given a loan of $1000m to CoS and group companies have agreed for interest at the rate of 7.5% in all transactions. There is a tax sparing agreement between Country X and County Y in respect of interest earned by CoR in CoS.

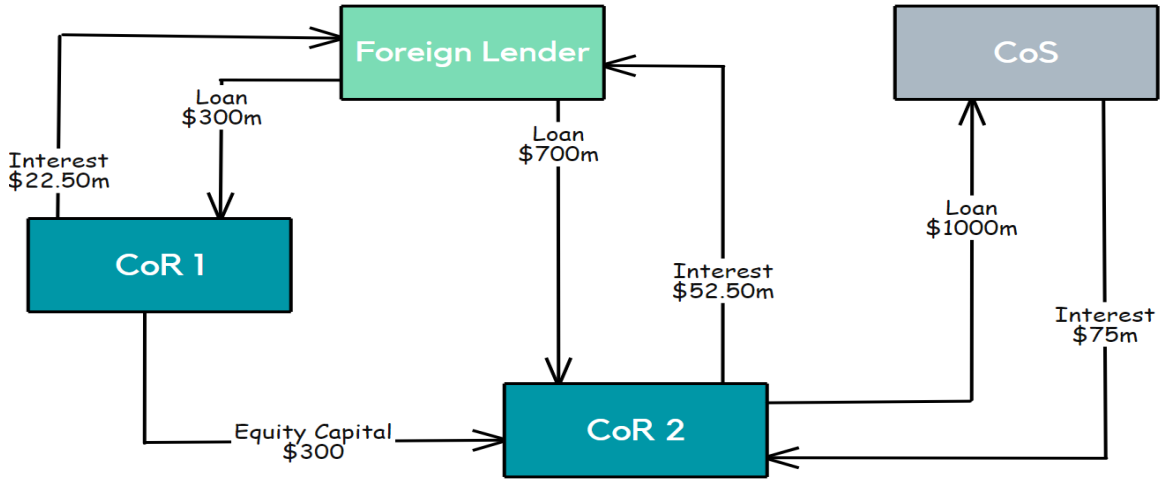

Chart 1: Chart depicting the transactions in case study.

Tax Liability in Country X: Country X has exempted interest income earned by non-residents in Country X in order to incentivize foreign loan borrowings.

Tax Liability in Country Y in the hands of CoR 2:

Particulars	Amount in million $
Interest Income (on loan given to M/s CoS)	75.00
Interest Expense (on loan obtained from M/s Foreign Lender)	52.50
Net Profit	22.50
Tax on Net Income @ 33.33%	7.50
Tax Sparing Credit ($7.5m*10% - Tax spared by Country X)	7.50
Balance Tax Payable	NIL

Further, CoR 1 has incurred an interest expense to the extent of $22.50 which can be set off against other income. As a result of the above loan structuring, the group has avoided tax of $7.5m ($22.50*33.33%) by way of CoR1 which is exactly equal to tax spared by Country X.

Effectiveness of Tax Sparing as an aid to promote economic development:

In most cases, tax sparing mechanism provides relief when profits are repatriated to CoR from CoS. In such a situation, tax sparing mechanism encourages short term investments in CoS which may not be objective of incorporating tax sparing credits in DTAA. Tax sparing mechanism has been incorporated with an objective to encourage foreign investments into CoS with long term invest plans. However, tax sparing provisions may have counterproductive effect as they provide excess repatriation of profits instead of reinvesting such profits in CoS.

Other Concerns in tax sparing:

Tax incentives are generally provided for a limited time frame and foreign investors may not have an express idea how long these incentives will be maintained. Another problem with the incentives is the complexity in qualifying for such tax incentives as they provide extensive conditions in order to qualify for tax incentives. Further, an increase in competition amongst the countries to provide incentives results in receiving lower tax revenues to both the countries.

Tax Sparing vis-à-vis Indian DTAAs:

India being a developing country has entered into DTAA with majority of the countries in the world and has negotiated for tax sparing provisions with more than 50 DTAAs entered into by it. DTAAs entered into by India contains both unilateral and bilateral tax sparing provisions. While unilateral tax sparing provisions provide tax sparing credit to foreign investors, bilateral tax sparing provisions provide tax sparing credit to foreign investors as wells as to Indian investors in respect of investment made in foreign countries.

With OECD member states: The Table below provides analysis of tax sparing provisions under DTAA between India and major OECD members states:

Treaty between	Country to provide TSC	Scope of TSC	Conditions to invoke TSC	Effective period of TSC
India – Australia	Australia	• Tax spared by India under section 10 (4), 10(15) (iv), 10A, 10B, 80HHC, 80HHD or 80I of ITA. • Tax spared under subsequent insertion of new section under Indian Income Tax Act which have been agreed between two countries. In respect of exempt interest income, TSC is available to the extent of 10 percent of such interest income.	• Tax sparing provisions are applicable only when such exemption provisions are in force and such provisions are not modified or such modifications does not affect the general character of those provisions. • When new exemption section is inserted, TSC is available only when Treasurer of Australia and MoF of India agree by exchange of letters in respect of TSC.	• Provisions of TSC are effective in relation to income derived in any of the first 10 years of income in relation to which DTAA has effect or any later year of income that may be agreed by countries.
India – Belgium	Belgium	• Tax spared by India under section 10 (4), 10(4B) 10(15) (iv) and 80L of ITA. • Tax spared under subsequent insertion of new section under Indian Income Tax Act which have been agreed between two countries.	• Tax sparing provisions are applicable only when such exemption provisions are in force and such provisions are not modified or such modifications does not affect the general character of those provisions. • When any new provision providing exemption is inserted, TSC is available only when CAs of two countries have agreed for.	No restrictions

India – Canada	Canada	• Tax spared by India under section 10(15)(iv), 10A, 32A (except ships/aircraft), 80HH, 80HHD and 80-IA (but not the part dealing with ships). • Tax spared under subsequent insertion of new section under Indian Income Tax Act which have been agreed between two countries.	• Tax sparing provisions are applicable only when such exemption provisions are in force and such provisions are not modified or such modifications does not affect the general character of those provisions. • When any new provision providing exemption is inserted, TSC is available only when CAs of two countries have agreed for.	• Provisions of TSC are effective in relation to period of 10 years starting from the year in which the exemption is first granted.
India – Czech Republic	India and Czech Republic	• Tax spared by India by way of incentives granted under the laws of the Contracting State and which are designed to promote economic development.	No conditions	No conditions
India – Denmark	Denmark	• Tax spared by India under section 10(4),10(4A), 10(4B), 10(6) (viia), 10(15)(iv), 10A, 32A, 80HH, 80-I, 80J and 80L of ITA. • Tax spared under subsequent insertion of new section under Indian Income Tax Act which have been agreed between two countries.	• Tax sparing provisions are applicable only when such exemption provisions are in force and such provisions are not modified or such modifications does not affect the general character of those provisions. • When any new provision providing exemption is inserted, TSC is available only when CAs of two countries have agreed for.	

India – Finland	Finland	• Dividend paid by a company being a resident in India to Finnish company which holds 10 percent voting power in Indian company is exempt from tax in Finland.	No restrictions	No restrictions
India – France	France	• Tax spared by India under section 10(4), 10(4B), 10 (15) (iv), 10(6) (viia), 80L ITA. • Tax spared under subsequent insertion of new section under Indian Income Tax Act which have been agreed between two countries. • If tax levied on interest arising in India is lets then the tax rate specified in Article 12(2), such low rate of tax is to be considered as TSC. If general tax rate on interest is reduced below the aforementioned rates, such reduced rates have to be considered. • Dividend paid by Indian company to French company is exempt from tax in France to the extent if both companies are resident in France.	• Tax sparing provisions are applicable only when such exemption provisions are in force and such provisions are not modified or such modifications does not affect the general character of those provisions. • When any new provision providing exemption is inserted, TSC is available only when CAs of two countries have agreed for.	

India – Italy	India and Italy	• Tax spared by India on income in the nature of business profits, dividends, interests, royalties or fees for technical services.	• No restrictions	• No restrictions
India – Netherlands	Netherlands	• Where, by reason of special relief for the purpose of investment in India, tax on interest arising in India is reduced to lower than the rate of tax specified in Article 11(2), such tax spared by India shall be allowed as credit in Netherlands.	However, if general rate of tax on interest in India is reduced, such reduced rate of tax shall be considered for TSC.	• TSC provisions shall apply only for a period of 10 years after the date on which the treaty became effective. This period may be extended by mutual agreement between the CAs.
India – New Zealand	New Zealand	• Tax spared by India under section 10(4), 10 (4A), 10(15) (iv) of ITA or under any other provisions agreed between the CAs.	TSC shall be allowed smaller of i. New Zealand taxa payable and ii. Limitation of tax agreed in the relevant Article in the treaty.	No restrictions
India – Spain	Spain	• Tax spared by India under section 10(4), 10(15)(iv), 10A, 10B, 32A, 32AB, 80HH, 80HHC, 80-I. • Tax spared under subsequent insertion of new section under Indian Income Tax Act which have been agreed between two countries.	• Tax sparing provisions are applicable only when such exemption provisions are in force and such provisions are not modified or such modifications does not affect the general character those provisions. • When any new provision providing exemption is inserted, TSC is available only when CAs of two countries have agreed for.	TSC provisions shall apply only for a period of 10 years after the date on which the treaty became effective. This period may be extended by mutual agreement between the CAs.

India – Sweden	Sweden	• Tax spared by India under incentive program to promote economic development to the extent such exemption/reduction is granted for Industrial and manufacturing activities, for agricultural, fishing or tourism if such activities are carried out within India. • Tax rate of 15 percent shall be considered for the purpose of TSC.		• TSC provisions shall apply only for a period of 10 years after the date on which the treaty became effective. This period may be extended by mutual agreement between the CAs.
India – U.K.	UK	• Tax spared by India under section 10(4), 10(4B), 10(6) (viia), 10(15)(iv), 10A and 10B, 33AB, 80HHD, 80I and 80IA ITA. • Any other provision to grant exemption or reduction of tax, similar to above provisions, which is agreed between CAs.	• When any new provision providing exemption is inserted, TSC is available only when CAs of two countries have agreed for and such provisions are not modified subsequently, or modification does not change its general character.	Provisions of TSC are effective in relation to period of 10 years starting from the year in which the exemption is first granted.

Treaties in which India is liable to provide TSC: The Table below provides analysis of tax sparing provisions under treaties with India in which India to provide TSC to residents of India:

Treaty between	Country to provide TSC	Scope of TSC	Conditions to invoke TSC	Effective period of TSC
India – Bangladesh	India and Bangladesh	**TSC by India:** • Tax spared by Bangladesh under section 29 (1)(x), 45, 46 and para 7 of third schedule to Income Tax Ordinance, 1984 (Bangladesh domestic tax law). • Tax spared by Bangladesh under para (a)-(h) of Notification S.R.O. 417A-L/76, dated 29 November 1976 as far as such Notification related to loans made with a view to promoting economic development in Bangladesh. • Tax spared under subsequent incentive program which have been agreed between two countries. • In case of dividend, interest and royalty, TSC is available at the rate of 10 percent (15 percent	• Tax sparing provisions are applicable only when such exemption provisions are in force and such provisions are not modified or such modifications does not affect the general character those provisions. • When new exemption section is inserted, TSC is available only when Treasurer of Australia and MoF of India agree by exchange of letters in respect of TSC.	No restrictions

		in case of dividend covered under Article 11(2)(b) of the treaty). **TSC by Bangladesh:** • Tax spared by India under section 10 (4), 10(4A), 10(6) (viia), 10(15) (iv), 10A, 32A, 33A, 35C, 35CC, 54E, 80CC, 80HH, 80HHA, 80-I, 80J, 80K, 80L of ITA. • Tax spared under subsequent insertion of new section under Indian Income Tax Act which have been agreed between two countries. • In case of dividend, interest and royalty, TSC is available at the rate of 10 percent (15 percent in case of dividend covered under Article 11(2)(b) of the treaty).		
India – Bhutan	India	• Tax spared by Bhutan under Fiscal Incentives, 2010 (Bhutan) in respect of education and health sectors which are designed for economic development in Bhutan (subject to other conditions).	• TSC is not available in respect of dividend, interest or capital gains or from activities not directly connected with educational health service. • TSC is not available in respect of transaction covered under Article 27 (LOB clause).	• TSC provisions shall apply only for a period of 10 years after the date on which the treaty became effective. This period may be extended by mutual agreement between the CAs.

India – China	India and China	• Tax spared by India/China by way of incentives granted under the laws of the Contracting State and which are designed to promote economic development.	• No conditions	• No conditions
India – Italy	India and Italy	• Tax spared by India/Italy on business profits, dividends, interest or FTS.	• No conditions	• No conditions
India – Kazakhstan	India and Kazakhstan	• Tax spared by India/Kazakhstan by way of incentives granted under the laws of CS in respect of profit from industrial or manufacturing activities or from agriculture, fishing or tourism (including restaurant and hotels).	• In order to avail TSC, activities in respect of which exemption/reduction is provided has to be carried out within the CS.	
India – Mauritius	India and Mauritius	**TSC by India:** • Tax spared by Mauritius under section 33,34, 34A and 34B of the Mauritius Income Tax Act. • Tax spared under subsequent insertion of new incentive for the purpose of economic development which have been agreed between two countries. **TSC by Mauritius:**	• When any new provision providing exemption is inserted, TSC is available only when CAs of two countries have agreed for.	

		• Tax spared by India under section 10(4), 10(4A), 10(6) (viia), 10 (15) (iv), 10(28), 10A, 32A, 33A, 33B, 35B, 54E, 80HH, 80HHA, 80-I or 80L of ITA. • Tax spared under subsequent insertion of new incentive for the purpose of economic development which have been agreed between two countries.		
India – Oman	India and Oman	Tax spared by India/China by way of incentives granted under the laws of the Contracting State and which are designed to promote economic development.	• No restrictions	• No restrictions

Summary of Income Tax Decisions

Honorable Supreme Court in the case of Bharti Cellular Limited[9] - Discount given to the telecom franchisees on the price of recharge tickets is not commission under section 194H. Hence, no liability to deduct TDS.

1. In a recent ruling, Honorable Supreme Court has delivered a common judgement to a bunch of appeals filed by the Revenue and the assessees, pertaining to TDS liability under section 194H of the IT Act. The High Courts of Delhi and Calcutta have held against to the assessees whereas, High Courts of Karnataka, Bombay and Rajasthan have held in favorable to the assessees.

2. The facts of the case were, the assessee, a cellular mobile telephone service provider entered into a franchise/distribution agreement with third parties for marketing the cellular services. The assessee sells the recharge tickets and top-up cards to franchisees by offering a discount on the printed price of the ticket. The franchisee sells these tickets to the retailers at a price determined on own by the franchisee. The margin between these two prices is the income to the franchisee.

3. The Apex court has dealt with two questions:
   i. Whether the income earned by franchisee on the sale margin can be treated as consideration paid indirectly by the assessee?
   ii. Whether there exists a principal agent relationship between the assessee and franchisee?

Question-(i):

4. The revenue has relied on the Delhi High Court's ruling in Singapore Airlines Limited[10] in which the airline operators enter into agreements with travel agents for selling tickets to the passengers. The travel agents in addition to a 7% commission, are entitled to additional commission on the sales made by them. Such additional commission is computed by travel agents and will be shared to airline operators via IATA[11]. Accordingly, the operators were held to be required to deduct TDS on payment of such additional commission.

5. In the above case, the commission details were shared and regulated by IATA and there is an actual commission payment happened. However, in the current case, the commission earned by franchisees is independent business information and the assessee is not privy to such information. Moreover, asking such information from the franchisees periodically would impose an unfair obligation and inconvenience to both the parties.

6. Further, there is a practical impossibility in deducting TDS in the given case, as the TDS liability accrues on earlier of the date of payment or date of entry made in books of the assessee. There is no actual payment made by the assessee

[9] [2024] 160 taxmann.com 12 (SC)

[10] (2023) 1 SCC 497, 23-29.

[11] International Airport Transport Association

and the payment is to be received by franchisee from a third party which cannot be kept tracking by the assessee.

7. Resultingly, the revenue's reliance on Singapore Airlines Ltd (Supra) has been rejected on distinguishable facts and held that there is no payment made either directly or indirectly by the assessee to franchisee.

Question-(ii):

8. Further, there are a series of judgements explaining the nature of principal-agent relationship. The Apex court, in the given case, has listed key factors for determining agency relationship which are as follows:

   a. Legal power to agent to alter his principal's legal relationship with a third party by making of contracts.
   b. Existence of control on the agent by the principal.
   c. Existence of a fiduciary relationship between principal and agent.
   d. Accountability of the work to principal.

9. In the given case, the court has identified the below pointers in determining the existence of agency relationship.
   a. Though the franchisee alters the legal position of the assessee, such act is being done incidentally but not primarily.
   b. Though there exists control on the method of operations, the franchisee is ultimately an independent contractor working on his own mode.
   c. The franchisee is neither a trustee nor a pure agent in order to establish a fiduciary relationship with the assessee.
   d. The franchisee is not required to report his business information or income details to the assessee.

10. Accordingly, the court has held that though the franchisee operates on behalf of the assessee and is partially regulated by the assessee, he cannot be said to be agent of the assessee and the income earned by the franchisee cannot be treated as commission paid by the assessee. Hence, the rulings of Delhi and Calcutta are set aside.

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Mumbai Tribunal in the case of M/s Dimexon Diamonds Limited[12] - Held that cash payment of Rs. 100 cr pursuant to merger as deemed loan by holding that it is a mere restatement of accounts without any actual transfer of asset and liability of amalgamating company.

1. The facts of the case were that the assessee was a wholly owned subsidiary of its holding company (DIHPL), which in turn was wholly owned by its ultimate holding foreign company (DIHBV). Pursuant to a scheme of amalgamation, DIHPL has merged into the assessee, resultingly DIHBV has become the direct holding company of the assessee. The assessee has paid purchase consideration in the form of its equity shares, Compulsorily Convertible Debentures and a cash

[12] [TS-24-ITAT-2024(Mum)-TP]

of Rs. 100 cr to DIHBV.

2. The TPO has found the transaction not in accordance with arm's length principle and disallowed the interest on CCD and treated the cash payment as deemed loan and made adjustment accordingly. Aggrieved by the order, the assessee has appealed before the Hon'ble Tribunal.

3. The Tribunal having held that the current business restructuring transaction can squarely be treated as international transaction basing on the OECD guidelines, has primarily dealt with the issue whether the CCD's and the cash payment could be attributable to the value of the assessee transferred to DIHBV.

4. On an analysis of the books and valuation of the assessee and DIHPL, it can be understood that the net worth of the assessee is Rs. 336 crores and networth of DIHPL is Rs. 369 crores inclusive of the value of the assessee held by DIHPL. Therefore, the value of DIHPL exclusive of the assessee is Rs. 33 crores. Hence, pursuant of merger of the DIHPL into the assessee, the value of the assessee post-merger becomes Rs. 369 crores (336 + 33). Hence, it is merely a restatement of the accounts of the assessee without any actual transfer of the assets and liability. Hence, the equity shares issued to DIHBV represent the fair value of the assessee and the CCD's and cash payment represent an excessive payment which is not at arm's length.

5. Further, the Tribunal had also considered the assessee's contention that the merger was legally approved by NCLT, and the purchase consideration was certified by a valuer concluding it at arm's length. The Tribunal has explained that mere approval from NCLT does not waive the rights to the income tax authorities to examine the tax aspects. Furthermore, as a matter of record, the valuation report does not provide any scientific computation of the fair value rather it had merely upheld the purchase consideration according to the management decision.

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