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TAX SCOUT

A quarterly update on recent developments in Taxation Law

JULY 2018 - DECEMBER 2018

FOREWORD

We take this opportunity to wish you a very happy, healthy and prosperous New Year 2019!

At the outset, we would like to express our regret for not being able to circulate our quarterly newsletter "Tax Scout" for the period from July 2018 to September 2018. We sincerely apologize for the delay.

We are pleased to present to you, two issues of the *Tax Scout*, our quarterly update on recent developments in the field of direct and indirect tax laws for the quarters ending September 2018 and December 2018.

Insolvency and Bankruptcy Code, 2016 was enacted as an overhauling legislation, with the objective of consolidating myriad positions and existing laws surrounding the insolvency resolutions and liquidation proceedings of various corporate entities. As a cover story, we have analyzed the impact of IBC on the provisions of IT Act, reflected through amendments in the IT Act inserted by Finance Act, 2018 and have delve into the interplay of the two legislations in light of the recent judgements of the Indian courts.

There have also been a spate of tax rulings in the year 2018 that have managed to create significant concerns in the minds of the taxpayers, especially for MNCs operating in India. We have discussed a couple of tax rulings and their impact on MNCs operating in India in our cover story for the Tax Scout for the quarter ending in December 2018.

Additionally, we have also analysed some of the important rulings by the Indian judiciary and certain key changes brought about by way of circulars and notifications in the direct and indirect tax regimes during the aforementioned quarters.

In these editions of the Tax Scout, we have also tried to restructure the manner in which they were prepared and presented over the last few editions. Accordingly, we have bifurcated the updates into broader themes relating to such updates, for ease of reference and simplicity. The direct tax case law updates have been bifurcated into three sections; namely international tax, transactional advisory, and miscellaneous, while indirect tax case laws have been bifurcated into; specific rulings by AAR and other judicial pronouncements. We hope you will enjoy reading them and we sincerely look forward to receiving your comments.

We hope you find the newsletter informative and insightful. Please do send us your comments and feedback at cam.publications@cyrilshroff.com.

Regards,
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INTERPLAY BETWEEN THE IT ACT AND INSOLVENCY AND BANKRUPTCY CODE 2016

Background

Insolvency and Bankruptcy Code, 2016 ("**IBC**") was enacted as an overhauling legislation, with the objective of consolidating myriad positions and existing laws surrounding the insolvency resolutions and liquidation proceedings of various corporate entities. The IBC also intended to be a one stop, coherent and consistent framework seeking to simplify the processes simultaneously making the route to recovery of maximum value from the business in the simplest and time bound manner. It also intended to establish the superiority of secured lenders and creditors over others, thereby removing many obstacles which used to prevent banks, financial institutions and other secured lenders from being able to recover their dues without losing precious time and avoiding unnecessary and unwarranted (and at times, protracted) litigations. Thus, IBC provided an air of relief to onshore as well as offshore creditors by providing a comprehensive and seamless framework aimed at reducing the inconsistency and ambiguity surrounding the insolvency of corporate debtors.

In the process of achieving the aforesaid objectives, IBC also had a trickle-down effect on several other legislations including the IT Act. It must be noted that there have been certain amendments to the IT Act in order to pave way for the relevant provisions of IBC and to achieve a seamless integration of the two legislations. However, there still exist certain conflicts between the two legislations. Some of such conflicts have been brought to light and had the Courts had the occasion of reviewing the legislative intent of the provisions of either legislations, on account of certain disputes pertaining to certain pending cases under the IBC. So far, the prevailing position of judicial bodies, including the SC, gives precedence to the provisions of IBC over the contradictory provisions of other legislations, thereby reiterating the primacy of IBC over the other legislations.

This story is a short comment on the juxtaposition of IBC *vis a vis* IT Act. The story looks into the impact of certain IBC provisions that could require the provisions of IT Act to be examined with a fresh perspective, especially after taking into account the amendments brought into the IT Act by Finance Act, 2018. Further, the story also delves into the conflicting zones of the two legislations in light of the recent judgements of the Indian Courts, specifically the SC decision in the case of *Monet Ispat*[1] and the Andhra Pradesh and Telangana HC decision in the case of *Leo Edibles and Fats ltd.*[2]

Recent amendments in IT Act relevant to IBC

The IBC has had a substantial parallel impact on IT Act and same can be reflected through the latest amendments in the IT Act inserted vide the Finance Act, 2018. We have summarized below key amendments to IT Act, in this context:

- Section 79 of the IT Act, dealing with carry forward and set off of losses, has been amended to insert a provision to accommodate IBC. The earlier provision mandated that when there is a change in the shareholding of an assessee company in a previous year, the losses incurred by the company in the years prior to the relevant previous cannot be carried forward to set off the income of the relevant previous year, unless 51% of the shareholding of the company during the year in which such loss were incurred, remains unchanged. This change has clarified that in case the change in shareholding occurs as a result of approval of a resolution plan under the provisions of IBC, after a reasonable opportunity of being heard has been accorded to the IRA, then the aforesaid restrictions regarding carry forward of losses shall not be applicable.
- Similarly, the erstwhile section 115JB of the IT Act provided that if the income tax payable by a company is less than a 18.5% of its book profit for any financial year, then such company shall be liable to pay MAT at the rate of 18.5% of its book profits. While calculating such book profit, the amount of losses brought forward or

[1] Principal CIT v. Monnet Ispat and Energy Ltd., 2018 SCC Online SC 984 (SC).
[2] Leo Edibles and Fats Limited v. Tax Recovery Officer (Central), Income Tax Department and Ors., W.P. No. 8560 of 20118; 2018(4)ALT700 (AP & Telangana HC).

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unabsorbed depreciation (whichever is less) as per the books of accounts is required to be reduced. This used to be a very big issue because most of the companies against whom Corporate Insolvency Resolution Process ("**CIRP**") application has been filed under IBC, used to have significantly higher amount of brought forward loss as well as unabsorbed depreciation and since this provision allowed them to reduce only one of such items, it could have created potentially higher tax liabilities under MAT while computing book profits for the purpose of MAT.

The Finance Act, 2018 has attempted to address this issue through an amendment which provides that in case of a company against whom CIRP application has been admitted under the IBC, the aggregate amount of unabsorbed depreciation and brought forward loss shall be allowed to be reduced from the book profit. Thus, instead of reducing the lower amount, the company shall now be allowed to adjust the entire aggregate amount of unabsorbed business loss and depreciation against its future profits.

This amendment came into effect subsequent to the several representations made by the stakeholder companies undergoing CIRP. The amendment was a result of the press release made by the CBDT dated 6 January, 2018, making the similar provision for companies undergoing CIRP, allowing total brought forward loss (including depreciation) to be deducted from the book profit of the companies, for the purposes of levy of MAT. Such an amendment is further implicit of the fact that while there maybe reliefs provided under the IBC for compliance with MAT provisions, there is still no complete escaping from the applicability from MAT provisions even for the companies undergoing insolvency proceedings.

Procedural conflicts between IT Act and IBC

In order to ensure a smooth and timely resolution of insolvency of corporate debtors, which has been defined under section 3(8) of the IBC as "*a corporate person who owes a debt to any person",* IBC has introduced moratorium provisions for smoothening the insolvency as well as liquidation processes. The imposition of such moratorium sometimes conflicts with the tax recovery proceedings against the companies undergoing insolvency or liquidation proceedings.

Before we deal with the interplay between IT Act and IBC, it is important that we revisit the concept of moratorium vis~a~vis the IBC. The dictionary meaning of the term 'moratorium', generally refers to 'a waiting period set by an authority; or a suspension of activity'. Under the IBC, the provision for moratorium is provided under Section 14 as well as Section 33 of the IBC.

Section 14 of the IBC imposes moratorium on *inter alia* the institution of any suit or continuation of pending suits or proceedings against the corporate debtor. The moratorium would commence at the behest of the order of the National Companies Law Tribunal ("**NCLT**") once the insolvency order is passed and will continue till the completion of the insolvency resolution process.

It is pertinent to note that section 33(5) of the IBC also deals with the moratorium with respect to liquidation proceedings, albeit differently. Section 33(5) prohibits the institution of any suit or other legal proceedings by or against the corporate debtor, subject to section 52 of IBC. Although it may be debated whether the restriction imposed under section 33(5) is on the nature of a moratorium or not because the ban is imposed for an unspecified duration but commences with the commencement of liquidation.

Given the above two provisions under IBC, once there are restrictions imposed on the legal proceedings by or against the corporate debtor, there is an automatic and likely impact on the tax assessments and tax recovery proceedings that are instituted against the corporate debtor, under the provisions of IT Act. This specific issue came to limelight in the two judgements discussed below.

In the case of *Monnet Ispat*, the issue was regarding the applicability of moratorium under section 14 of IBC on the appeal filed by the IRA against the order of the ITAT. The SC has held that the provisions (including

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provisions dealing with moratorium) of IBC would have an overriding effect on all other inconsistent legislations. The SC also heavily relied upon section 238 of IBC to reaffirm the overriding effect of IBC.

Similarly, in the case of *Leo Edibles*, the dispute was regarding the rights of various types of creditors over the assets of the company undergoing liquidation proceedings since there were pre-existing tax recovery proceedings against the company. The HC was required to comment on the fate of tax recovery proceedings, once section 33(5) of the IBC had commenced. Considering the order of attachment of assets of the corporate debtor under the second schedule of IT Act, the HC did not find merit in the priority claim by the IRA on the assets of the corporate debtor.

The HC based its decision on section 53 of the IBC, which enlists the hierarchy of the secured creditors for the purposes of distribution of proceeds from the sale of the assets of the corporate debtor. In such hierarchy, as provided by section 53 of IBC, the IRA would fall in the fifth place. Further, at the time of enactment of IBC, section 178 of the IT Act was amended to provide for the overriding effect of the liquidation proceedings of under the IBC. The HC interpreted this provision along with section 238 of the IBC, to de-merit the priority claim of IRA on the assets of the corporate debtor undergoing liquidation. However, as an *obiter dicta,* in this case, the HC did comment upon the applicability of section 281 of the IT Act, as an effective tool for the IRA.

While the aforesaid discussion on moratoriums is strictly from the perspective of insolvency/ liquidation proceedings of a company, there are similar moratoriums imposed on insolvency proceedings of other taxable entities. For instance, the later part of the code deals with the insolvency resolutions and bankruptcy for partnerships and individuals and similar moratorium provisions have been imposed as per the requirement of the code.

Other than the aforesaid moratorium proceedings, another procedural issue that the IRA may face could be with respect to institution or continuation of assessments post liquidation. It is an evident position that once the liquidation proceedings completed, the existence of the company ceases. In such a scenario, the question still remains as to whether further assessments can be instituted against the liquidated company, which are well within the limitation periods of prescribed under the IT Act. If the same can be done, there would still be further questions on who would be representing such liquidated companies and whether there can be an imputation of liability on the erstwhile directors of the company.

Is harmonious reading of the two legislations possible?

From an overall reading of the provisions of IBC and IT Act, it may be noted that a clear precedence has to be given to the provisions of IBC over the provisions of IT Act. However, it must also be noted that there are still a few ambiguities which will have to be dealt with while reading the two legislations together.

For instance, section 33(5) of IBC states that "*when a liquidation order has been passed, no suit or other legal proceedings shall be instituted by or against the corporate debtor.*" While the moratorium nature of this provision may be debatable due to unspecified period, there is also ambiguity on whether the ban is on mere initiation / institution of proceedings or it includes continuation of proceedings as well. Strict reading of the section would mean that fresh suits instituted against the debtor could fall under the ambit of the so called moratorium under section 33(5) of the IBC, but continuation of suits would not. However, it must also be noted that the HC in case of *Leo Edibles* had extended the section to cover on-going tax recovery proceedings against the corporate debtor. Akin to this interpretation, if one were to look at the intention behind this section, the same could be inferred from the following notes to this section:

"*The liquidation in specified form, order shall result in a moratorium on the initiation or continuation of any suit or legal proceeding by or against the corporate debtor.*"

From the perusal of the notes, it may be observed that the aforesaid provisions intended to grant moratorium from the time of initiation till the continuation of any suit or legal proceeding and, therefore, the absence of the word *continuation* from the section could, at best, be construed as a mere miss. The logic is, after all, to

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keep the assets of the corporate debtor in tact, in the form of a liquidation estate, and thereafter, proceed with liquidation.

In the specific context of tax proceedings, the possible interpretation that could be derived is that the assessment proceedings are a mere determination of rights and liabilities of the Assessee (or corporate debtor for the purposes of IBC), and, therefore, moratorium need not be applied on them. However, the subsequent appeal proceedings could be said to within the ambit of moratorium under section 33 of the IBC. The same has also been affirmed by the SC in the case of *Monnet Ispat*, as discussed above.

Another instance of ambiguity is the position of IRA in the claims over the assets of the assesse. In this regard, HC in the case of *Leo Edibles* made an observation by referring to the fact that the IRA can seek a claim remedy under section 281 of the IT Act. Here, it may be pertinent to note that Section 281 of the IT Act deals with the power to the IRA to treat any transfer of specified assets, in favour of another party, during the pendency of proceedings or after completion of proceedings but before the notice of tax recovery proceedings, as void, against any claim in respect of any tax or any other sum payable by the transferor assessee. However, in order to ensure that genuine business transactions are not impacted by this provision, it also contains certain exceptions, where this provision cannot be applicable. For example, if the transfer is made for an adequate consideration and without any notice of pendency of proceedings or the transfer is made with the prior approval of the IRA, then the IRA cannot subsequently invoke this provision to negate the transaction. If it were to be applied, it would effectively require the purchasers acquiring the designated assets of the company, they need to require such company to obtain a no – objection certificate from the IRA which will confirm that the IRA does not have any problem in the transfer of such an asset by the assessee. It may be noted such a presumption by the HC is infructuous and highly theoretical because in such situations, the IRA would generally avoid issuing no objection certificates unless they are able to ensure adequate protection from the taxpayers. This would not only make the process under IBC cumbersome or unworkable, but would also fall in contradiction to the decision of the HC itself in *Leo Edibles*, which refused the claim of IRA over the liquidator's right to sell the assets. It remains to be seen whether the Courts will agree to the position that the provisions of IBC would still take precedence even if section 281 is invoked.

Given that only a couple of years have elapsed since the enactment of IBC, a number of other intricate matters, including potentially contentious matters, have not yet reached the Courts. It will be interesting to see how the Courts respond to such live matters as and when they are confronted with an issue. From a prima facie analysis, it appears that IBC being the all-encompassing and embracing legislation, ought to be given the priority and in case of any disputes, its provisions should generally override the other legislations, it remains to be examined by the Courts.

Having said the above, it will also be pertinent to take note of the fact that even though only two years have passed since IBC was legislated, most legislations seem to have come a long way in their harmonious co-existence. While the objective of enactment of all legislations are different, their applicability may overlap and hence, may lead to a position of unintended confrontation between the legislations. Therefore, to answer the question of harmonious reading of such legislations in complete affirmation at this stage may be premature. One would need to wait and watch the course Indian Courts take over time in reading such legislations together and rule on their relative supremacy.

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RECENT TAX DEVELOPMENTS AND THEIR IMPACT ON MNCS OPERATING IN INDIA

1. Background

With the advent of globalisation, the presence of Multinational Companies ("**MNCs**") has become a norm rather than an exception. With operations in multiple countries at the same time, the MNCs strategically decide their global workforce and business activities in such a manner that they can carry out the same without too much of force or friction. They also form regional headquarters to enable greater focus on regional issues leading to better management of the group companies spread over the world. Further, all administrative and support processes are rendered to all the affiliates located across the world to successfully run a business. As a consequence of this, sometimes a company is divided into various other separate companies within the group to generate efficiency, economies of scale, improve core processes, and eventually increase growth and performance. Consequently, flow of consideration within the group companies located in different jurisdictions for rendering various intra-group services is a common sight in every group. However, with the advent of MNCs, a myriad of tax issues have emerged over the years with each country looking to earn their individual share of revenue from the overall global profits earned by the business entity in terms of taxes.

Further, armed with an army of tax experts and sophisticated tax planning methods, most MNCs try to utilise the beneficial provisions of the domestic tax regulations as well as those of the relevant DTAAs to ensure that their effective tax outgo is the most economical. In their pursuit to minimise their overall global tax outflow, they also try to take advantage of any loophole available in any domestic tax provision or under the DTAA.

One of the important issues relate to the division of income between various jurisdictions from services rendered by an MNC. As per the conventional international tax rules, where an enterprise is a resident in one state with income originating in another state (source country), international tax rules provide that the source country will have the taxing rights over such income only if it is established that the enterprise has a PE in the source country. It may be noted that even the most developed economies who were earlier focussed on residence based taxation, have realised the shortcoming of their approach because a number of developing economies have now become exporter of technology and capital, thereby reducing their share in the rapidly increasing global pie of taxation.

India has witnessed an exponential growth in its digital economy over the last two decades. Credit may be given to the information and communication technology, with affordable and smart technology, standardized and improved business processes leading to innovation across all industries. According to media reports, the number of mobile phone users in India is almost 800 million in the year 2018. Identifying its great power and potential and the benefits it can garner, digital India has been a prime focus area of the present Indian government which is evident from the push for the same through various programs like Start-up India programme, Skill India, etc. An illustration in this regard could be the Budget speech of 2018, wherein the Finance Minister commented that global economy is transforming into a digital economy thanks to development of cutting edge technologies in digital space – machine learning, artificial intelligence, internet of things, 3D printing.

However, with the advancement of technology particularly the digital economy, it has become increasingly possible to undertake business operations in a country with minimal physical

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presence in the form of a PE in that country e.g. cloud computing, app stores, etc. This has given rise to its own set of tax challenges wherein new and emerging business models have rendered the existing tax rules inadequate for use by tax authorities. In absence of effective tax rules for digital transactions, tax authorities have started to force-fit the existing tax rules, designed for a non-digital world, thus resulting in asymmetry, double tax burden and sometimes excessive profit allocation.

2. Recent changes in the international taxation arena

Global tax rules for digital transactions are in an evolution stage, with various ideas and thoughts being debated upon. One of the significant idea has been the BEPS. As a result, under the BEPS Action Plan, more than 100 countries have come together to address the international tax avoidance techniques of high-profile MNCs. Technically, it refers to tax avoidance strategies of MNCs that exploit gaps and mismatches in tax rules to artificially shift profits to low or no-tax locations and reduce tax base for other countries.

BEPS Action Plan 1 has tried to address this situation which had been grappling the tax experts of many countries. This Action Plan identifies the main difficulties that digital economy poses for application of existing international tax rules and develops options to address such difficulties. The Action Plan 1 included the proclamation that "the digital economy is the economy itself."

One should also note that the IRA in its response to the United Nations Questionnaire on BEPS stated the following aspects on Action Plan 1:

- Tax challenges posed by digital transactions are very crucial for India and deserve greater attention
- Existing international tax rules are not adequate to allocate profits to source jurisdiction in respect digital companies
- Withholding tax should be levied on digital transactions.

It is pertinent to note that India was one of the foremost countries to tax digital economy through a different form of tax by way of Equalization Levy from 2016 onwards.

Based on recommendation of BEPS Action Plan 7, India has recently tried to address the artificial avoidance of PE. The definition of PE in the DTAAs has been changed through MLI. Also, to bring the IT Act at par with the DTAA, agency PE clause has been revised and the concept of 'Significant Economic Presence' has been introduced in the Indian domestic tax regulations. As per the recent changes to the IT Act, the term "business connection", which is the equivalent of PE under the relevant DTAA, shall include any significant economic presence of a non-resident in India and accordingly, will require such non-resident to pay taxes in India.

In the context of the digital economy, an example is of an online seller of goods that maintains a large warehouse with significant number of personnel, which is essential for proximity to customers and quick delivery. Pursuant to modifications to the exception to definition of PE, the online seller would now create a PE in the country where the warehouse is located.

3. Some important case rulings

It is in this environment that there have been a spate of tax rulings in the year 2018 that have managed to create significant concerns in the minds of the taxpayers, especially for MNCs operating in India. They assume increased importance as they have tried to address taxability of transactions of the modern world technologies with the existing tax provisions leading to certain unanswered questions and some rising controversies about the taxation. A careful look at the cases may lead to a conclusion that the existing tax provisions may not be enough to analyse the taxability of the transactions. A couple of significant tax rulings and their impact have been described herein below:

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3.1 Bangalore ITAT ruling on *Google India*[1]

Google India was appointed as a non-exclusive authorised distributor of advertisement space (pertaining to its Adwords program) over the territory of India under a contract by Google Ireland, for further resale to advertisers in India – in the nature of marketing and distribution rights. Google India was also engaged in the business of providing information technology ("**IT**") and information technology enabled services ("**ITES**") to its group companies. While IT services included application development, maintenance and testing services, ITES related to administration of advertisements in accordance with guidelines provided by Google Ireland and provision of customer support services. Google India was remunerated on cost plus markup basis for all the above mentioned services i.e. distribution services, IT services and ITES. The funds collected by Google India from advertisers in India was paid by it to Google Ireland without withholding any tax in India on the ground that such payments were not liable to tax in India because they represented sale consideration of advertisement space and Google Ireland did not have a PE in India.

Google India was required to show cause as to why it should not be construed as an assessee in default for not withholding tax while making payment to Google Ireland. Google India gave the following arguments in relation to non-taxability of the amount paid to Google Ireland:

- Google India was appointed as a mere non-exclusive Distributor/Reseller of AdWords program to the advertisers in India.
- Distribution fee was not in relation to any 'transfer of any right' or any 'right to use' any patent/ invention, etc.
- The agreement between Google Ireland and Google India did not involve any use of patents, invention, model, design, secret formula or process or trade mark or similar property.
- All rights, title and interest in and to all information and data including the user data (i.e. data provided by the users) were owned by Google Ireland.
- Distribution fee payable under the agreement with Google Ireland was neither in relation to any knowledge concerning a patent or invention nor was it concerned with use or right to use of any scientific equipment.
- Google India also argued that it was a distributor with no access to infrastructure or process of Google Ireland. In this context, the roping in of such a payment within "patented technology", "secret formula" etc. could be construed as a stretch.

However, Bangalore ITAT did not agree with the contentions made by Google India and held that payments made by it to Google Ireland was in nature of royalty and hence, was taxable under the IT Act as well as under the India-Ireland DTAA. The same was held to be covered under the limb of 'similar property' in Explanation 2 of the definition of royalty.

- Referring to use of Google Analytics which is connected with Google AdWord Program, the ITAT held that since Google India was responsible for providing targeted advertising services using patented technology and confidential information, it cannot be construed as mere reseller of the advertisement space. It is an agreement for facilitating the display and publication of an advertisement to targeted customers.
- Analysing Google's technical functioning of Adword program, the ITAT also observed that Google India had access to all personal information and data pertaining to the users of website in the form of age, gender, eating habits, wearing preferences, etc. which parameters were used by Google Group for focussed targeted marketing. The ITAT

[1] Google India Pvt. Ltd. v. Joint DIT, (2018) 93 taxmann.com 183 (Bangalore ITAT).

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also held that Intellectual Property ("**IP**") of Google vested in the search engine technology, associated software and hence, use of these tools by Google India would be characterised as royalty.

- The ITAT also noted that the Adwords agreement between Google India and Google Ireland and the service agreement would have to be read together as they are interconnected i.e. without resorting to the service agreement the terms and conditions under the Adwords agreement cannot be complied with. Therefore, it is relevant to note that due importance has been given in conjoined reading both the agreements.
- The ITAT further observed that both the associated enterprises (i.e. Google Ireland and Google India) were trying to misuse the provision of DTAA by structuring the transaction with the intention to avoid payment of taxes.
- The ITAT also held that the payment entails payment for use of copyrighted information, patented technology, secret process (of determining target audience based on various criteria) etc. owned by Google Ireland and used in the Adwords Programme, though the process of placing the ad on the search engine by the advertiser seems to be a highly automated process.
- The ITAT observed that four layers of holdings were involved in relation to licensing of Adwords program and it was not clear exactly how much right in the license were conferred to different holdings and how the revenue was distributed amongst the above holdings. It was noted that Google India could not bring the requisite evidence on record that major share of the revenue collected on account of AdWords program was received by it. Google India also failed to produce various agreements executed amongst various Google entities. Accordingly, this matter was remanded by the ITAT to the AO for fresh adjudication.

It may also be pertinent to note that the ITAT had done an extremely detailed factual verification in order to ensure that they arrive at the correct conclusion. They had gone beyond the arguments made before them and documents presented before them and had tried to do their own factual assessment. It is also evident from the detailed factual summary made by them, which is very rare to find in India. The ITAT also did not accept any of the arguments made either by the taxpayer or by the tax administrator and tried to analyse the provisions on the basis of their own understanding. The fact that Google India played a far important role and had access to a number of important facets of the business activities being carried out by Google in India, had been established by the ITAT.

Based on a fairly detailed factual assessment, the ITAT came to the conclusion that the amount being remitted by Google India to Google Ireland cannot be construed as a resale of advertisement space because the services being rendered by Google India cannot be said to merely consist of sales support activities towards Google Ireland.

Hence, on the basis of such assessment, it was ultimately decided that such payments are in the nature of royalty and accordingly, tax was required to be withheld by Google India while making payments to Google Ireland.

3.2 How this case could impact similar businesses/entities

Generally, income streams in technology driven businesses seem to be at a greater risk of being treated as royalties/FTS, even if the services performed are otherwise comparable to those provided in a non-digital context. Here, the fact that technology was used to improve the range, targeting and pricing of advertisements was a crucial factor in the ITAT's decision to view the amounts paid to Google Ireland as royalty and to

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distinguish them from payments for advertising in traditional media such as television, magazines and newspapers.

It may also be pertinent to note that before this decision, the issue of taxability of businesses like Google have been under dispute and one can find various positive and negative decisions in this regard. The issue gets even more complicated on account of the introduction of equalisation levy. One needs to examine the services provided by the foreign company with respect to online advertising, etc. vis-à-vis applicability of equalisation levy. After introduction of equalisation levy, it seems that such income would now not be taxed as royalty or business income, but it would be subject to equalisation levy.

Having said that, it is also pertinent to note that in order to be liable to pay equalisation levy, the concerned non-resident shall have to confirm that it had not established any PE in India. Hence, this decision has made the tax planning for digital businesses significantly more complex and it remains to be seen how the taxability of digital income develops over the next few years.

It is also important to take note of the fact that GAAR provisions have been introduced under the IT Act and the taxpayers should take appropriate caution before entering into any arrangement/structure especially if it leads to tax benefit under the IT Act or under the DTAA because such benefits may be denied by the tax authorities by invoking unless the business exigencies of such steps can be justified.

3.3 AAR ruling in the case of *Mastercard Singapore*[2]

Mastercard Singapore approached the AAR to ascertain whether the fees to be collected by Mastercard Singapore from India would be subject to tax in India.

Mastercard Singapore argued that activities undertaken in India are limited to transmission of encrypted data and significant authorization processes are undertaken outside India. Further, cost of equipment in India is a fraction of total cost of the network.

However, disagreeing with the arguments put forth by Mastercard, the AAR held that it would constitute a fixed place PE, a dependent agent PE as well as a service PE due to the various activities proposed to be performed by the Indian subsidiary for Mastercard Singapore as well as the automated equipment installed in India for Mastercard Singapore. It was also decided that the activities performed by the automated equipment were not preparatory or auxiliary in nature and hence, cannot be excluded from constitution of a PE.

The AAR concluded that the employees of Mastercard Singapore visiting India are providing services to Indian clients and hence, once they cross the threshold of 90 days in a year, a service PE shall be created. AAR assumed that if they would be visiting India to inform their Indian clientele about the new products being introduced, they would have undertaken feedback for the existing services being rendered to such clients also. Feedback services for the transaction processing services currently rendered was assumed by AAR as an integral part of service.

The AAR also observed that the office of Mastercard India would be at the disposal of employees of Mastercard Singapore and hence, activities of Mastercard Singapore would be carried out from such physical premises belonging to Mastercard India, thereby creating a fixed place PE.

The AAR also noted that till the year 2014, Mastercard group had a Liaison Office in India and thereafter, the work of Liaison Office was proposed to be transferred to Mastercard India. It was pointed out by the AAR observed that as per the proposal submitted by Mastercard, while the proposed activities undertaken in India would have remained the same over such restructuring, the profits of the Indian subsidiary

[2] MasterCard Asia Pacific Pte. Ltd., In re., (2018) 94 taxmann.com 195 (AAR).

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was expected to experience a serious fall. The reasoning that Liaison Office taxation was accepted to buy peace of mind cannot negate the fact that there was no PE and services were not rendered earlier.

In a noteworthy finding, AAR held automatic equipment can also create PE because to create a PE, it is not necessary that the equipment should be fixed to the ground. It was only required to be at disposal of Mastercard Singapore. The AAR held that the automated equipment satisfied the permanence, a fixed place and disposal test as provided for by SC in the case of *Formula One*[3].

Mastercard India was also held to be legally and economically dependent on Mastercard Singapore, being its wholly owned subsidiary. It was held that it gets its instructions and remuneration from the Mastercard Singapore. Although Mastercard India was envisaged to work with other companies, it accepted during the hearing was that it is not planning to work with any third parties.

The aforementioned facts led to a finding by the AAR that functions actually being carried out by Mastercard India were not forming a part of Functions, Assets and Risk ("**FAR**") analysis and hence, a proper FAR analysis shall have to be carried out and a proper attribution of profits to the proposed PE of Mastercard shall have to be made taking into consideration the arm's length price, as specified under the Transfer Pricing Regulations.

3.4 How this case could impact similar businesses / entities

It must be pertinent to note that the aforesaid AAR ruling is very important for companies where substantial part of business is carried through digital/e-commerce platforms from outside India without having any office or establishment in India and without any significant human intervention from India. It must be noted that most such organisations like Visa, American Express, etc. are presently undertaking significant amount of operations in India. It is likely that the tax authorities, armed with the current decision of the AAR, are expected to go at such entities in a very aggressive manner and it will have to be seen that whether such entities will proceed to change their business model or practices to keep themselves immune from any such exposure.

It may also be noted that Mastercard has already filed a writ petition before the Delhi HC alleging that the AAR had misconstrued the facts and misapplied the applicable provisions in the instant case. It will be interesting to note what the final decision of the Delhi HC shall be.

4. Impact of these decisions on other entities

Analysing the above decisions and the reasoning given by the ITAT and AAR on various issues examined by them, it may be said that other companies having similar arrangements like equipment placed in India used for data transmission or where the Indian entity facilitates distribution of advertisement rights, may study the decisions in greater detail.

As far as advertisement companies are concerned, although web based advertisement services are now specifically covered under Equalisation Levy, in order to be covered within its ambit, it will have to be ensured that the foreign company had not established any PE in India. Further, the transaction of IP, license etc. may not get covered in the Equalisation Levy. In order to avoid any questioning regarding beneficial ownership of royalty income, it is imperative that all agreements of the Group may be submitted before the authorities so as to enable them to adjudicate on the matter. They should substantiate that the company is a beneficial owner. Further, with regard to the PE taxation issue, it may be said that the activities of the foreign company may be limited in such a way that risk of PE taxation may be limited.

For entities similar to Mastercard, it may not be difficult to expect the tax authorities to rely

[3] Formula One World Championship Limited v. CIT, (2017) 394 ITR 80 (SC).

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heavily on these cases to hold in other cases of other taxpayers wherein significant equipment placed in India may constitute a PE. Thus, in order to overcome the risk posed by these decisions, it may have to be seen as to whether the ownership of the automated equipment are transferred to the Indian subsidiary. Alternatively, the MNCs may analyse, subject to business and commercial objectives being met, whether it would be possible to have the equipment placed outside India.

Therefore, one must structure their global operations in a manner which is in sync with what they provide in its FAR analysis or any other document submitted before relevant tax authorities.

It must be noted that notwithstanding the technical objections available by the taxpayers, these decisions are very significant and would generally force MNCs operating in the same or similar field to review, revise or reconsider their business models. It is pertinent to note that both the ITAT as well as the AAR have gone far beyond than the arguments and documents available with them while delivering their decision. They have undertaken their own independent research and have looked into the relevant papers and documents (including going through the websites of Google and Mastercard) to examine the substance of the transactions.

Hence, adequate care must be taken while formulating the business model and drafting of the agreements to keep as close to reality as possible. It may also be noted that digital business models are more vulnerable to the changing tax landscape.

5. Conclusion

In a recent development, the Indian Government has brought in the "data localisation norms" effective from 2018 itself, whereby it has mandated the foreign companies to store personal data related to Indian users in India. While the Reserve Bank of India says it wants "unfettered supervisory access" to the data, some foreign companies are still lobbying against it indicating the challenges involved. One corner of the domestic industry is also indicating that foreign companies are trying to avoid data localisation in order to continue to evade taxes in India. It would be interesting to follow the developments in this arena to analyse the stance of the law making authorities and the Government.

Bridging the gap between the efforts of the Government and its impact on taxability of such transactions in India, it may be said that where the data is mandated to be stored in servers in India only, it may lead to taxation in India. Thus, the structure of the company may need a relook and Indian subsidiaries may be set up having ownership of the server and overseeing the quality control and transmission of the same. Further, with regard to the advertisement industry, the introduction of Equalisation Levy seems to limit the taxation of such transactions to 6% and is in accordance with the global BEPS initiative on digital economy taxation. However, the taxation of other transactions like IP, license, etc. would continue as before.

To conclude, a holistic review of the complexities surrounding the modern day digital world and its tax implications is required. While BEPS Action Plan 1 deals exclusively with digital transactions, each country's domestic laws and interpretation have been varied and hence, India should develop a standard code or framework for digital transactions. The code may specify the taxability of such transactions in greater detail so that room for vagueness and multiple interpretations may be reduced. Else, we could be in a situation where there are conflicting rulings and vague interpretations leading to unrest and discomfort amongst corporates that could take a while before being settled by higher authorities.

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CASE LAW UPDATES - DIRECT TAX

CASE LAW UPDATES - INTERNATIONAL TAX

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IT ACT CANNOT LIMIT DEDUCTIONS ABSENT EXPRESS PROVISIONS IN THE DTAA

In the case of ***Unocol Bharat Limited***[1], the ITAT Delhi Bench had held that the restrictions on deductibility of expenses contained under the IT Act cannot be applied to cases where the applicable DTAA does not provide for any such restrictions on deductibility of expenses in computing the taxable business income of the PE.

FACTS

The Assessee, a Mauritian company and a subsidiary of Unocol Corporation USA, was engaged in pursuing opportunities in exploration, development and production of natural gas and crude oil, and fertilizer plant in India. During AY 1998-99, the Assessee had a PE in India and had pursued contracts for 21 projects in India and had claimed loss. During the assessment proceedings, the AO disallowed the following expenses in the hands of the Assessee:

- Employee cost due to Assessee's failure to furnish the details such as the names, address, duration of stay of employees in India;
- Travel and entrainment costs due to such expenses not being incurred wholly and exclusively for the purpose of Assessee's business in India;
- Operating contract expenses due to failure to withhold tax at source on such payments, triggering disallowance under section 40(a)(I) of the IT Act.

The Assessee had appealed against the order of the AO to the CIT(A) who decided it in favour of the Assessee, holding that the disallowance of the expenses at the time of computing taxable income of the PE of the Assessee would need to be governed by the provisions of Article 7(3) of the India-Mauritius DTAA. Article 7(3) provides for deduction of expenses incurred for the purpose of the business of the PE and does not contain any restrictions in this respect. Aggrieved by the order of the CIT(A), the IRA filed an appeal before the ITAT.

> **If no restriction is provided for allowing expenses under an article in the DTAA, then limitation provided under the IT Act cannot be imported into such article.**

ISSUE

Whether the CIT (A) had erred in holding that no disallowance could be made in the hands of the Assessee in the absence of any restrictive clause under Article 7(3) of the India-Mauritius DTAA?

ARGUMENTS

The IRA argued that the Assessee could not substantiate whether these expenses were incurred wholly and exclusively for the purpose of the business. It was also argued that the expenses could not have belonged to the Assessee as it did not conduct any business of its own. The IRA also claimed that the details regarding stay of the employees were not furnished to the AO. Consequently, the same should not have been considered by the CIT(A) without complying with the provisions of Rule 46A of the IT Rules.

On the other hand, the Assessee argued that all details which were filed before the CIT(A) had also been filed during the assessment proceedings before the AO. It was further argued that employees had only spent a portion of their time to carry out certain activities in India and only such portion was claimed as an expense and the details of stay of the employees were submitted to the AO. The Assessee further argued that disallowance in respect of the expenses incurred by the PE cannot be made in the absence of a

[1] DDIT v. Unocol Bharat Limited, ITA 1388/Del/2012 (Delhi ITAT).

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specific language restricting deductibility of expenses in Article 7(3) of the India-Mauritius DTAA. In this regard, the Assessee also relied on the judgement of the Mumbai Bench of the ITAT in the case of *State Bank of Mauritius Limited*[2] wherein it was held that Article 7(3) of the India- Mauritius DTAA did neither restrict allowability of expenses nor was the deduction of such expenses subject to limitations prescribed under the IT Act.

DECISION

After going through arguments placed by both sides, the ITAT decided the issue in favour of the Assessee. The ITAT held that since the Assessee had a PE in India, all income and expenditure of the PE of the Assessee must be computed in accordance with Article 7 of the India-Mauritius DTAA. The ITAT further observed that there is no restriction contained in Article 7(3) unlike the India-US DTAA which subjects deduction of expenses to the limitations imposed under the domestic tax laws of the state of source. The ITAT thus concluded that in the absence of such restrictions under the India-Mauritius DTAA, all expenses incurred for the purpose of the business of the PE must be allowed as deductible expenses. The ITAT held that limitations under the IT Act in respect of such deductions cannot be read into the provisions of the India-Mauritius DTAA. Based on this premise, the ITAT upheld the order of the CIT(A) allowing the deduction of expenses towards employee costs and contract expenses. As regards the travel and entrainment costs, the ITAT held that as the Assessee had furnished the project wise split of such expenses along with relevant ledgers and vouchers, it was established that such expenses were incurred for the purpose of the business of the PE and the AO could not disallow such expenses in the hands of the Assessee.

SIGNIFICANT TAKEAWAYS

The ITAT observed that where the terms of the DTAA provides for a restricted manner of deductibility of expenses of a PE, or where such expenses are subjected to domestic tax law of the state of source, such restricted manner would need to be followed. In this respect, Article 7 (3) of the India-US DTAA provides that expenses for the purpose of business of the PE, whether incurred in the state of source or otherwise, shall be allowed as deductible expense in accordance with and subject to the provisions of the domestic tax laws of the state of source. Thus, if the expenses were incurred by the PE of Unocol Corporation USA and not a PE of the Assessee, a resident of Mauritius, the deduction would have been subject to the limitation under IT Act as per the terms of India-USA DTAA. However, in the present case, the expenses towards employee costs could still not have been disallowed in the hands of Unocol Corporation USA, since the employees were not taxable in India as their stay in India did not exceed 183 days. Consequently, the restriction under section 40(a)(I) of the IT Act for disallowance of payments on which the payer failed to withhold tax would not have triggered.

The ITAT ruling is a very good development, as it reaffirms the established principle of international tax and public international law, that the provisions of the domestic tax law should not override the provisions of an agreement agreed between the contracting states i.e. DTAA. This is in line with obligations contained in the Article 26 of the Vienna Convention of Law of Treaties, 1969 which also requires the contracting countries to a bilateral agreement to abide by the obligations agreed between them in good faith. The ruling of the ITAT provides clarity on the issue of computation of profits attributable to a PE. Thus, where treaty partners have agreed for a favourable manner of computation of profits attributable to a PE under their DTAA such favourable manner should be followed. Non-resident investors investing in another treaty country will, therefore, have to ensure their eligibility to claim relief under the applicable DTAA.

At the time of making the investment decisions, foreign investors are required to analyse the provisions of the relevant DTAAs carefully so that an appropriate investment destination can be found out to invest into India. This decision also reiterates basic principles of international taxation and emphasises that all contracting states should fulfill their international obligations in good faith so that international taxation can evolve and it continues to hold value for all the contracting states.

[2] State Bank of Mauritius Limited v. DDIT, (2012) 19 ITR (T) 675 (Mumbai ITAT).

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ADVICE IN RELATION TO MANAGEMENT, FINANCIAL AND LEGAL SERVICE DOES NOT 'MAKE AVAILABLE' UNDER INDIA- US DTAA

The Kerala HC in the case of ***US Technology Resources Private Limited***[1] had held that services rendered by a US company to an Indian taxpayer, in the field of legal, management and financial services, does not qualify as Fee for Included Services ("**FIS**") within the meaning of Article 12 of the India-US DTAA, as it does not tantamount to transfer of any technical knowledge, skill or know how. Accordingly, it can be regarded that such services will not satisfy the 'make available' clause in the India-US DTAA, hence, remuneration received for such services would not be taxable in India in the absence of a PE in India.

FACTS

US Technology Resources Pvt Ltd ("**Assessee**"), a company incorporated in India, entered into an agreement with a US company ("**Service Provider**") wherein the Service Provider was required to provide assistance, advice and support in management, financial, legal, public relations, treasury and risk management services to the Assessee. The Assessee claimed deduction of payments made towards management service rendered by the Service Provider. However, the AO held that the fee received for such services ought to have been charged to tax as FTS under the IT Act and accordingly, disallowed the expenditure incurred by the Assessee on account of failure to deduct TDS. The AO also treated the Assessee as an 'assessee in-default' under section 201 of the IT Act for failing to withhold tax on the fees remitted by it to the Service Provider. The CIT (A) and the ITAT held that such fee received for such services would fall within the ambit of FIS under the India-US DTAA and accordingly, upheld the disallowance on expenditure. Thus, the Assessee, being aggrieved by the order of the ITAT moved the HC.

Make available clause is presumed to have been satisfied only if the said services have been rendered to the Indian taxpayer in such a manner that it can be utilised later without any support.

ISSUE

Whether, the consideration received for rendering management, legal and financial services would be taxable as FIS under the India-US DTAA and accordingly, whether tax was required to be deducted on the fee paid for such services?

ARGUMENTS

It was argued on behalf of the Assessee that notwithstanding the provisions of the IT Act, the Service Provider being a non-resident, was entitled to take advantage of the beneficial provisions of the India-US DTAA. Accordingly, it was argued that according to the India-US DTAA read with the Memorandum of Understanding ("**MOU**") signed between the two countries, the said services availed by the Assessee would not fall within the ambit of FIS.

On the other hand, it was argued by the IRA that section 90(3) of the IT Act mandates the IRA to follow the definition of 'technical and consultancy services' as has been defined in the IT Act as the same has not been defined under the DTAA or a notification issued by the Central Government. Accordingly, the IRA argued that the fee received for such impugned services would fall within the definition of 'technical and consultancy services' under the IT Act and would be taxable in the hands of the Service Provider. Interestingly, the IRA also

[1] US Technology Resources Private Limited v. CIT, (2018) 97 taxmann.com 642 (Kerala HC).

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argued that the best evidence available to claim exemption under the DTAA, is the evidence of the said fees/income being taxed in the US in the hands of the Service Provider.

DECISION

The HC observed the Service Provider being a non-resident was entitled to obtain the benefit of the beneficial provision of the India-US DTAA. The DTAA defined the term 'fees for included services' quite differently from the definition of 'technical and consultancy services' under the IT Act. The HC also observed that the term FIS has been defined under the DTAA to mean *inter alia* payments for rendering of any technical or consultancy services which make available technical knowledge, experience, skill, know-how or processes or consist of development and transfer of a technical plan or technical design.

The HC further observed that the term 'make available' has been elucidated in the MOU, which provides that a technology would generally considered to have been made available only when the person acquiring the service is enabled to apply the technology, skill, know-how independently without any active assistance from the service provider. Thus, the HC held that the mere fact that the provision of a service which requires technical input, would not amount to technical skill, knowledge or know - how being made available; instead, there ought to be an actual transfer of technical skill or knowledge. The HC also observed that in the present case, the Service Provider merely provided advice on specified matter and assisted the Assessee in the decision making process as and when required, in respect of the specific issues for which advice was sought from time to time. Thus, the Service Provider did not provide any plan or strategy pertaining to management, finance, legal, public relations or risk management which would be available with the Assessee to be applied without the hands-on advice being offered by the Service Provider.

Thus, the HC held that the remuneration received for the said services would not qualify as FIS under the India-US DTAA. The HC also set aside the orders of the lower authorities as the Service Provider would not be taxable in India in absence of a PE in India, Consequently, the HC decided the issue in favour of the Assessee as there was no occasion for the Assessee to withhold tax when the fees received by the Service Provider was not taxable in India.

SIGNIFICANT TAKEAWAYS

In the present case, the HC, while interpreting the 'make available' clause in the India-US DTAA has affirmed the legal position that the provisions of the DTAA need to be interpreted in light of the MOUs, agreements, technical explanations etc., signed by the countries which are parties to certain DTAA.

This decision also outlines the distinction in the meaning of FTS under the IT Act, which provides for a broad definition of the FTS, and under the DTAAs (which restricts the scope of the term FTS/FIS through the make available clause).

It may be pertinent to note that India has entered into DTAAs with several countries like Australia, Canada, Singapore, UK, Malta etc. containing a 'make available' clause, which restricts the taxability of income in the nature in the nature of FTS / FIS. It is also pertinent to note that the taxpayer may also have the option of indirectly invoking the 'make available' clause, even though the DTAA does not have a “make available” clause, but has a 'Most favoured nation' (“**MFN**”) clause. Generally, the MFN clause contained in India's DTAAs provide that in case India offers a lower rate or a restrictive scope in its DTAA with a specific group of companies (i.e. any member of OECD), such lower rate of tax or restricted scope of tax on royalty, FTS etc. could be imported into such DTAA. Since, the make available clause provides for a restrictive scope of taxation of FTS/FIS, the MFN clause in a treaty may be invoked to import the 'make available clause from another DTAA entered into by India. This position has also been positively affirmed by Indian Courts in various decisions.[2]

[2] Steria India Ltd v. CIT, W.P.(C) 4793/2014 & CM Appl. 9551/2014 (Delhi HC); DDIT v. IATA BSP India, ITA No. 1149/Mum/2010 (Mumbai ITAT); Sandvik AB v. DDIT, (2014)52 taxmann.com 211 (Pune ITAT).

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SANCTITY OF THE PROTOCOL TO A DTAA UPHELD BY THE ITAT DELHI BENCH

In the case of ***Ericsson Telephone Corporation India***[1], the Delhi ITAT held that the addition of Protocol to the India – Sweden DTAA ("**Protocol**") amounts to 'change in law' and would therefore impact the applicability of the ruling of the AAR issued before the insertion of the Protocol, on the orders passed by the AO subsequent to such ruling.

FACTS

Ericsson Telephone Corporation India AB ("**Assessee**"), is a foreign company incorporated in Sweden and engaged in the business of telecommunication. The Assessee is a wholly owned subsidiary of M/s Telefonaktiedolaget LM Ericsson AB, Sweden ("**LM Ericsson**") and has a branch office in India. The Assessee had entered into contracts with Indian telecommunication companies for installing GSM mobile networks. These contracts were assigned to an Indian company in the name of Ericsson Communication Pvt. Ltd. (which later came to be known as Ericsson India Ltd.), which is also a wholly owned subsidiary of LM Ericsson.

> **Protocol to the DTAA should be considered as an integral part of the DTAA.**

The Assessee had filed a return for AY 2001-02 declaring business losses. However, in the same AY the Assessee had received income from three streams, namely, fees rendered from the Indian concerns of the Assessee amounting, fees from foreign sources and interest income. Given the above income, the Assessee, however, had prepared a profit & loss account in which revenue from all sources was incorporated and the common expenses were deducted, thereby arriving at a net loss.

The dispute in the present case was regarding the fees received by the Assessee from its AEs in India. The AEs of the Assessee in India were involved in the process of installation of GSM network and the Assessee was supplying technical support in relation to the same. In respect of such support, the Assessee received the aforesaid fees. The AO assessed this receipt as FTS. The AO referred to Article 12(4) of the India - Sweden DTAA which provides that if an Assessee carries out business through a PE in India, and receives FTS or royalty connected with such PE the provisions of Article 7 of the DTAA shall apply. Since in this case the Assessee had a PE in India, the FTS received by it, was to be assessed as 'business income' as per Article 7 of the India- Sweden DTAA. Article 7(3) of the India-Sweden DTAA provides that in determination of profits attributable to a PE, expenses incurred for the PE shall be allowed as deduction subject to the tax laws of the contracting State in which the PE is located. Under Indian tax laws, section 44D of the IT Act provides that in case an assessee being a foreign company which earns any income which is in the nature of royalty or FTS received from an Indian concern, no deduction in respect of any expense or allowance shall be allowed to the Assessee in computing the income received by a foreign company in the nature of royalty or FTS. The AO, thus invoked the provisions of section 44D of the IT Act and held that the deductions claimed by the Assessee on the income received from its Indian concerns cannot be allowed.

The Assessee claimed that since it was rendering only installation services to its AEs it would qualify for the exception to FTS, as Explanation 2 to section 9(1) (vii) of the IT Act *inter alia* carves out consideration for any construction, assembly, mining or like project undertaken by the recipient. Consequently, the income received by the Assessee would not be in the nature of FTS, hence the Assessee argued that the restriction on claiming deduction in respect of any

[1] Ericsson Telephone Corporation India AB (India Branch) v. DDIT, (2018) 96 Taxmann.com 258 (Delhi ITAT).

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expenditures provided under section 44D, would not be applicable to it.

The AO rejected this argument on the basis of the earlier ruling of the AAR in the case of Assessee itself, in which the AAR had held the nature of payments made to the Assessee by the AEs, as FTS, thereby upholding the applicability of section 44D on the Assessee and asking such Indian concerns to deduct taxes as per the rates under section 115A, while making payments to the Assessee. Relying on the same ruling, the AO had held that the Assessee was liable to pay taxes on the payments received from Indian concerns as per section 115A and disallowed the expenses by applying section 44D of the IT Act

The order was challenged by the Assessee before the CIT (A) on the ground that after the AAR issued its ruling in the case of Assessee, the India – Sweden DTAA was amended, and the Most Favoured Nation clause was inserted into the India-Sweden DTAA. By virtue of this MFN clause, if there exists any favourable tax rate or definition in the DTAA with any other OECD country, such favourable tax rate or definition shall be read into the India – Sweden DTAA, provided that such DTAA (from which the favourable definition or tax rate has been imported) had been entered into on a later date. The Assessee argued that this amendment triggered the exception to the binding nature of the ruling of the AAR provided under section 245S(2) of the IT Act.

The decision of the AO was appealed before the CIT (A). The CIT (A) dismissed the appeal upholding the order of AO. The aggrieved Assessee, then preferred an appeal before the ITAT against the order of the CIT(A).

ISSUES

In light of section 245S(2) of the IT Act, whether the binding nature of the ruling passed by the AAR changes after the inclusion of the MFN clause in the DTAA, through Protocol enacted after the ruling was issued.

ARGUMENTS

While section 245S(1) refers to the binding nature of the AAR on both the taxpayer as well as the tax administrator, section 245S(2) limits the binding effect to be subject to any subsequent 'change in law or facts', on which the ruling was based. The Assessee, argued that as there was a subsequent and significant change in the provisions of the DTAA which amounts to 'change in law', thus, section 245S(2) of the IT Act would be applicable and the ruling of the AAR in the case of the Assessee shall be no longer be binding on the AO. The Assessee relied on section 245S (2) of IT Act, which is effectively a limitation on section 245S(1) of the IT Act.

Further, the Assessee argued that, by virtue of inclusion of the MFN clause vide the Protocol in 1997, the scope of definition of FTS was restricted. This is so because now the Assessee could import the make available clause from a DTAA with any another OECD country (i.e. the Indian – Finland DTAA) which was notified after the Indian – Sweden DTAA, into the definition of FTS of under the India – Sweden DTAA and would restrict the scope, to include only those services where the technology is made available to the recipient of the services. If that was the case, the services rendered by the Assessee would not fall under definition of FTS and the limitation on claiming deduction as provided under section 44D would no longer apply to the Assessee.

The IRA on the other hand, raised a preliminary objection on the applicability of Protocol in the present facts by arguing that the Protocol has to be referred only if there was some dispute concerning the terms of the DTAA and not otherwise. Therefore, the IRA argued that the insertion of the Protocol would not amount to a significant 'change in law' and therefore carve outs under section 245S(2) of the IT Act were not applicable.

DECISION

It is pertinent to note in the first place, that the Assessee had not challenged the ruling of the AAR at

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any point of time during the case and had put a limited challenge regarding the applicability of the AAR ruling.

The ITAT also did not approve of the preliminary objection made by the IRA i.e. the Protocol should be considered only when there is a dispute in the terms of the DTAA. According to ITAT, the Protocol is an integral part of a DTAA and not independent of the DTAA. Thus, insertion of Protocol into the DTAA was held to be a 'change in law' and, therefore, section 245S(2) was applicable in the present facts . The ITAT remanded the matter back to the AO for fresh consideration in the light of the Protocol to India – Sweden DTAA and section 245S(2) of the IT Act.

SIGNIFICANT TAKEAWAYS

There have been a number of decisions that have interpreted Protocols to DTAAs as being integral part of the DTAA.[2] The confusion regarding the applicability of the Protocol had been settled by the Delhi HC in 2016 in the case of *Steria India*[3] which involved the interpretation of nature of the protocol to the India France DTAA. The Protocol has an automatic applicability and impact on the DTAA once it is notified into the DTAA.[4] In this case, this position has not only been reinstated by the Delhi ITAT, but the ITAT has also gone a step ahead by unambiguously clarifying that it has the force of law. It is clear that the fundamental requirement to trigger section 245S(2) is either (i) change in law or (ii) change in facts, in the light of which the AAR issued the ruling. In the present facts, insertion of the protocol to the DTAA was considered 'change in law', sufficient to reconsider the applicability of the ruling of AAR.

[2] Steria India v. CIT, (2016) 72taxmann.com1(Delhi ITAT); DDIT v. IATA BSP India, ITA No. 1149/Mum/2010; Sandvik AB v. DDIT, (2014) 52 taxmann.com 211 (Pune ITAT); DCIT v. ITC ltd, (2002) 82 ITD239 (Kolkata ITAT).

[3] Steria India v. CIT, (2016) 72taxmann.com1 (Delhi HC).

[4] DCIT v. ITC ltd, (2002) 82 ITD239 (Kolkata ITAT).

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NO TDS ON COMMISSION PAID TO NON-RESIDENT AGENTS FOR ACTIVITIES CARRIED OUTSIDE INDIA

In the case of ***Ferromatic Milacron India Pvt. Ltd.***[1] the Gujarat HC held that no tax is required to be deducted at source on commission payments made to non-resident agents where their activities as agents are carried out outside India.

FACTS

Ferromatic Milacron India Pvt. Ltd. ("**Assessee**") had appointed non-resident agents for procuring export orders outside India. For performing the aforesaid activity the non-resident agents received commission from the Assessee. In AY 2011-12, the Assessee had paid the agents, commission to the tune of INR 1.20 crores. The AO observed that on such payments made by the Assessee, no taxes had been withheld at source. On inquiry by the AO, the Assessee submitted that the services rendered by the non-resident agents were outside India, therefore, no part of the income accrued or arose in India. The submission of the Assessee was rejected by the AO and the he disallowed entire expense under section 40(a)(i) of the IT Act.

Merely because a portion of the sale to the overseas purchasers took place in India would not change situation vis a vis the commission agents.

The Assessee went on appeal before the CIT(A). The CIT(A) gave a substantial relief to Assessee by restricting the additions on account of non-withholding of tax to INR 18.80 lakhs from INR 1.20 crores. The addition of the INR 18.80 lakhs was made on the pretext that such amount relates to the activity of sale of machines that took place in India.

The Assessee further appealed to the ITAT. The ITAT allowed the appeal of the Assessee and deleted the addition of INR 18.80 lakhs made by the CIT(A) by holding that no part of the income of the non-resident was arising or accruing in India.

The Revenue, being aggrieved of the order of the ITAT, went on appeal before the HC.

ISSUES

Whether the ITAT was justified in deleting the addition made by the CIT(A) of INR 18.80 on account of the commission payments made to the non-resident agents?

ARGUMENTS

The IRA argued that the commission payments received by the non-resident agents was with respect to the sales which were carried out in India by the non-resident agents to an overseas purchaser. Since the activity of sale had taken place in India, there was a business connection that existed under section 9(1)(I) of the IT Act. As a result of such business connection, the commission received by the non-resident agent accrued/arose in India and was subject to tax in India. Therefore, tax on such commission payments should have been deducted under Section 195 of the IT Act. Since the Assessee failed to do so, the aforementioned amount of INR 18.80 was to be disallowed as an expense under section 40(a)(i) of the IT Act.

As against the arguments put forth by the IRA, the Assessee argued that the non-resident agents, to whom the commission payments were made, did not have a business connection in India. Further, the non-resident agent had been rendering the services, as agents, outside India. Therefore, the commission received by agents from the Assessee did not accrue or arise in India. Thus, the liability to withhold taxes at source did not fall on the Assessee. The Assessee

[1] PCIT v. Ferromatic Milacron India Pvt. Ltd., (2018) 99 taxmann.com 154 (Gujarat HC).

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also relied upon the judgment of the SC in the case of GE India Technology Center Pvt. Ltd.,[2] ("**GE India**") to state that unless the amount remitted to a non-resident contains taxable income, wholly or partly, no requirement to withhold tax would arise on the payer at the time of mere remittance of payments.

DECISION

The Gujarat HC, in this case, dismissed the appeal filed by the IRA. The Gujarat HC took into account the arguments of the Assessee and stated that purely on the basis of the fact that a portion of sales to the overseas purchasers took place in India, the commission received by the non-residents agent, having no business connection in India, could not be held as taxable income. Further, since such income was not taxable in nature, obligation to withhold taxes would not arise under section 195 of the IT Act.

SIGNIFICANT TAKEAWAYS

The dispute over establishment of business connection has been a recurring one. It may be noted that, in the instant case, the solicitation and procurement of products had been done outside India by the foreign commission agents. Merely because the products were exported from India, the commission paid to the agents cannot be said to be constituting any business connection in India. The activity of earning of income, in such a case, was not the sale of products in itself but solicitation of sales by the commission agents and since the said activity took place outside India, the income accrued on the said activity cannot be construed to be having any connection with India. It was not the case of IRA that the commission agents had undertaken any of their solicitation activities in India. Therefore, the income of the commission agents cannot be deemed to have accrued or arose in India.

The ITAT has reiterated the position settled by the SC in the case of *Toshuku Ltd.*[3] which held that commission earned by the non-resident for acting as the selling agent for the Indian exporter, wherein such non-resident was rendering services from outside India, does not accrue in India.

Insofar as the issue withholding of tax is concerned, the position has been settled by SC in the case of *GE India* wherein it was categorically held that obligation of withholding tax does not arise when the income payable to non-resident is not taxable in India.

Taxpayers can take defense from the reiteration of the principle that a non-residents rendering services to Indian residents carrying on business activities in India do not have to pay any tax in India unless they have established a business connection or a PE in India. Merely because some part of their activities is undertaken in India, will not lead to such non-resident being required to pay tax in India. However, it is equally important for the non-residents to ensure that they do have all the requisite information and documents at their disposal to contend that they have not established any form of taxable presence in India.

[2] GE India Technology Center Pvt. Ltd. v. CIT and anr., 327 ITR 456 (SC).
[3] CIT v. Toshuku Ltd., 125 ITR 525 (SC).

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GENERAL CLAUSES RELATING TO IPR PROTECTION CANNOT BE USED TO TREAT INCOME AS 'ROYALTY'

In the case of ***TVS Motors Co Ltd.,***[1] the Madras HC held that the standard terms and conditions of an agreement cannot be read with the specific services being rendered under an agreement, to determine the nature of income received by the taxpayer.

FACTS

TVS Motors ("**Assessee**") had entered into an agreement with M/s. AVL List GmBH, Austria ("**AVL**") for designing an energy efficient cylinder head for an engine developed by the Assessee. Under this agreement, the Assessee was to supply the material along with all the design documentation, engine and components required for the project to AVL and the entire work of designing the cylinder head was to be carried out in Austria. In AY 2002-03, the Assessee, while acting as the representative assessee for AVL, had filed a 'nil income' return, claiming a refund of INR 64,41,795. On the re-assessment of the return filed, the AO treated a sum of INR 2,14,72,290, as royalty and subjected the same to tax under the India - Austria DTAA.

General conditions in the agreement should not be referred to while interpreting the characterization of the payments.

The Assessee had filed an appeal before the CIT(A) against the order passed by the AO. The CIT (A) ruled in favour of the Assessee. The IRA filed an appeal before the ITAT against the order of the CIT(A). The ITAT, however, dismissed the same and dispute was brought to before the Madras HC by means of an appeal preferred by the IRA.

ISSUE

Whether the general terms and conditions of an agreement in relation to intellectual property can be used to determine the nature of payments as royalty income?

ARGUMENTS

The IRA had argued that the main purpose of the agreement between the Assessee and AVL was to "*exploit such expertise*" of AVL for designing the energy efficient cylinder heads. The Assessee did not have the right to disclose, transfer, modify or sell the project design to any third party. Given this arrangement, the IRA had argued that the income received by AVL from the Assessee was in the nature of royalty, and, therefore, was chargeable to tax in the hands of the Assessee as per Article 12 of the DTAA. Article 12 of the DTAA provides that the income received in the nature of royalty and FTS may also be taxed in the jurisdiction in which it arises at a rate not exceeding 10%. Thus, the consideration received by AVL from the Assessee was chargeable to tax in India as its royalty income.

Further, the IRA also placed reliance on clause 7 of the general terms and conditions of the agreement which dealt with industrial property rights and maintained the exclusive rights of AVL on the ideas, know-hows, patents, inventions, drawings and technical documents that belonged to AVL. Based on the clause, the IRA argued that clause 7 of the general terms and conditions was indicative of the fact that there were such know-hows, patents and ideas, which were exclusive property of AVL. The Assessee only had the right to the use of such intellectual property of the Austrian company, and therefore the payments made in that regard constituted royalty. The IRA relied on the judgement of Karnataka HC in the case of *CGI Information Systems*[2] and compared certain clauses

[1] DIT, Madras v. TVS Motors Co. Ltd., (2018) 99 taxmann.com 40 (Madras HC).
[2] CIT v. CGI Information Systems & Management Consultants Pvt. Ltd., (2014) 48 taxmann.com 264 (Karnataka HC).

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in the CGI Information Systems case to clauses in the agreement between the Assessee and AVL.

In response, the Assessee argued that the primary purpose of the agreement was to modify the existing engine developed by the Assessee to make it fuel efficient. Thus, the technology supplied by AVL was not a readymade patented technology but a specific service performed by AVL in relation to the engine already developed by the Assessee in Austria. Therefore, the payment made to the Assessee should be treated as FTS (which was not subject to tax due to the applicable benefits of DTAA). Further, with respect to the general terms and conditions, the Assessee argued that these general terms and conditions were only intended to safeguard the interests of AVL and did not change the nature of technical assistance rendered by AVL to the Assessee. The Assessee also argued that the payments made by the Assessee to AVL were not periodic payments but lump sum payments, which met the requirement of FTS as under Explanation 2 of section 9(1)(vii) of the IT Act.

DECISION

After going through the arguments presented by both the sides, the Madras HC ultimately rejected the arguments of the IRA and ruled in favor of the Assessee. The HC held that the general terms and conditions of the agreement between the Assessee and AVL were merely part of the agreement only to ensure protection of the rights and interests of the AVL in general. The reading of such general clauses in context of the specific technical services being rendered by AVL was an incorrect interpretation, especially in light of the fact that the entire product and design of the engine was being supplied by the Assessee to AVL. Further, there was no property of AVL the right to use of which was getting transferred to the Assessee. Thus, payments made by the Assessee to AVL were in the nature of FTS and not royalty, and therefore were held not subject to tax as per the benefits applicable under the India – Austria DTAA.

The Madras HC had also adequately distinguished from the decision of Karnataka HC in the *CGI Information*[3] case on facts.

SIGNIFICANT TAKEAWAYS

More often than not, companies look to protect their rights and interest in their intellectual property used for providing services to its customers. For this purpose, contracts for services contain certain standard terms and conditions to protect their intellectual property rights and such other rights that are intrinsic to the interests of the company holistically. The relevance of such generic terms and conditions to the subject matter of the agreement could be very minimal.

However, if there develops a trend of scrutinizing these terms and conditions by the tax authorities for determining tax liabilities of persons, it could become an unwanted burden on taxpayers and could also lead to unnecessary litigation. It is important to distinguish the applicability and relevance of such general terms and conditions from the subject matter of the agreement which would prevent interpretation of agreements which result in unnecessary tax liabilities.

This decision very clearly brings out such issues into the forefront. It has been upheld that the characterisation of a payment shall be dependent on the nature of services being rendered and not on the basis of certain protective clauses provided in the agreement with an intention to ensure that the intellectual property rights of the said knowledge and experience is not violated by the receiver of the same.

[3] *Ibid.*

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ITAT UPHOLDS RIGHT TO APPLY THE IT ACT FOR ONE SOURCE & DTAA FOR ANOTHER

In the case of ***Dimension Data Asia Pacific Pte. Ltd.,***[1] the Mumbai Bench of the ITAT held that application of the beneficial provisions of IT Act for one source of income and the DTAA for another source of income while computing the taxable business income of an AY.

FACTS

Dimension Data Asia Pacific Pte. Ltd. ("**Assessee**"), a private limited company incorporated in Singapore, was engaged in the business of providing management support business to its group entities to Asia Pacific region. During AY 2012-13 and AY 2013-14, the Assessee had rendered management support services to its wholly owned subsidiary in India, Dimension Data of India Ltd ("**Subsidiary**") pursuant to an agreement for the provision of management, general support and administrative services for which the Assessee charged management fee at cost plus 10% basis.

Separately, the Subsidiary was awarded a contract by an Indian customer, BSNL, in prior years to set up 6 internet data centres in India. The Assessee sent its employees from Singapore to India, from time to time and whenever required, to provide the Subsidiary with assistance and guidance in setting up the internet data centres. The Assessee charged a service fee for rendering the said technical services to its Subsidiary. Thus, the Assessee had two sources of income from its Subsidiary i.e. management fee and service fee.

During the assessment proceedings and proceedings before the DRP, it was held that the Assessee had a service PE in India and the number of days for which the employees of Assessee visited India for rendering management services and technical services was aggregated. The entire receipts were attributed to activities in India and after allowing an *ad hoc* deduction of 10% of expenditure, the balance was treated as business profits taxable in India. Aggrieved by the order, the Assessee appealed before ITAT.

"A taxpayer is entitled to follow the provisions of the IT Act and the DTAA intermittently."

ISSUE

Whether the AO and DRP had erred in holding that the Assessee had a service PE in India under Article 5(6) of India-Singapore DTAA for both sources of income by aggregating the visit of employees for earning the management fee and service fee?

ARGUMENTS

The Assessee argued that the service fee could be considered as FTS under the IT Act as well as DTAA and hence had been offered to tax at the rate of 10% under section 115A(1)(b) of the IT Act. Regarding management fee, the Assessee argued that management fee would be business income under Article 7 of India-Singapore DTAA and would be taxable only if the Assessee constituted a PE under Article 5 of India-Singapore DTAA.

The Assessee argued that in case of rendering multiple services in India, it was entitled to adopt the provisions of IT Act for one source of its income and beneficial provisions of DTAA for other source. Reliance was placed on the decision of Bangalore ITAT in the case of *IBM World Trade Corporation*[2].

DECISION

The ITAT ruled in favour of the Assessee. Relying on the decisions of Bangalore ITAT in the case of *IBM World Trade Corporation*[3] and *IBM World Trade Corpn.*,[4] the ITAT held that in cases where the

[1] Dimension Data Asia Pacific Pte. Ltd. (formerly known as Datacraft Asia Pte. Ltd.) v. DCIT, ITA 1635 and 1636/Mum/2017 (Mumbai ITAT).
[2] IBM World Trade Corporation v. ADIT, (2015) 58 taxmann.com 132 (Bangalore ITAT).
[3] *Ibid*.
[4] IBM World Trade Corpn. v. DDIT (IT), (2012) 20 taxmann.com 728 (Bangalore ITAT).

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taxpayer has multiple sources of income, a taxpayer is entitled to adopt the provisions of the IT Act for one source while applying the provisions of the DTAA for the other, depending on which provision is more beneficial to it. The ITAT ruled on the taxability of the Assessee basis the above principles. Accordingly, while the service fees were held to be taxable as FTS under the IT Act and the India-Singapore DTAA, management fee was held to be taxable in India only in the presence of a PE in India.

SIGNIFICANT TAKEAWAYS

This ruling reaffirms the right of foreign companies to use provisions of DTAA or IT Act, whichever is more beneficial, for offering income earned from different sources to tax in the same AY. This right is available notwithstanding the fact that the income may be earned from the same customer since the categorisation of source of income is not customer dependent but is dependent on the nature of services.

This is a useful ruling for foreign companies which earn Indian income from various sources as they can potentially reduce their Indian tax liability by opting for the beneficial provisions of the DTAA or IT Act, as applicable.

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UNDERTAKING CONSTRUCTION ACTIVITY IN THE OIL FIELD WOULD NOT CREATE OIL WELL PE

In the case of ***GIL Mauritius Holdings Ltd.,***[1] the ITAT Delhi bench held that GIL Mauritius, a tax resident of Mauritius did not create a PE in India as the duration of the construction work carried out in the oil field did not exceed the threshold time limit of nine months as per Article 5(2)(i) of the India-Mauritius DTAA.

FACTS

GIL Mauritius Holdings Ltd. ("**Assessee**") is a company incorporated under the laws of Mauritius and is a tax resident of Mauritius, filed its tax return for the AY 2005-06 declaring nil income. The Assessee had rendered services under the subcontract with Hyundai Heavy Industries Co. Ltd. ("**HHIL**") and VMGL-VGL consortium ("**VMGL**") in connection with prospecting for extraction or production of mineral oil in India, the duration of these contracts was disputable.

No installation PE was established since it did not exceed threshold limit of nine months.

The Assessee claimed that the duration of the first and the second contract was 190 days and 136 days respectively. Accordingly, it was argued by the Assessee that it had not crossed the basic threshold time prescribed under Article 5 of the Indo-Mauritius DTAA for creating an installation PE. It is also pertinent to note that the Assessee also did not draw any profit and loss account for its Indian operations for the relevant AY.

The AO, however, rejected the contentions of the Assessee and held that since it had a 'vessel' at its disposal, which constituted a fixed place of business in India in view of Article 5(1) of DTAA, it had established a PE in India. The AO estimated the profits of the Assessee at 25% of the total revenue earned.

On appeal, the CIT(A) held that the Assessee had not only created a fixed place PE under Article 5(1) of the DTAA, but had also created an oil well PE under Article 5(2)(g) of the DTAA since it had undertaken projects in oil well.

Being aggrieved by the order of the CIT(A), the Assessee preferred an appeal before the ITAT.

ISSUE

Whether the Assessee constituted a PE under Article 5 of the Indo-Mauritius DTAA in India with respect to its contracts with HHIL and VMGL?

ARGUMENTS

With respect to the first contract with HHIL, the Assessee contended that the vessel entered India on February 1, 2005 and the contract was completed on May 20, 2005. For the second contract, the vessel entered into India on December 1, 2004 and the contract was completed on April 15, 2005. Assessee submitted that duration of both the contracts for construction and assembly work of laying pipeline was for less than 9 months. Hence, there was no PE of Assessee in India. It also placed its reliance on the case of *Kreuz Subsea Pte Ltd.,*[2] wherein it was held that even if the date of signing of the contract was taken as the date of commencement of the work, even then it did not exceed the threshold period of 9 months and hence, no PE was established in India.

It was also contented that it is the IRA's responsibility to show that income was chargeable under the IT Act or the DTAA. Assessee further pointed out that AO charged taxability under Article 5(1), whereas the CIT(A) considered Article 5(1) and 5(2)(g) of the DTAA as the charging Article. Assessee stated that Article 5(2)(g) of the DTAA would apply only when the Assessee was the 'owner' of an oil well or gas

[1] GIL Mauritius Holdings Ltd. v. DDIT (International Taxation), ITA No. 2354/Del/2012 (Delhi ITAT).
[2] Kreuz Subsea Pte Ltd. v. DDIT (International Taxation), (2015) 58 taxmann.com 371 (Mumbai ITAT).

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resource or any other place of exploration and mining of natural resources. However, in the instant case, since the Assessee was merely providing services on such places, the provisions of Article 5(2)(g) of the DTAA was inapplicable. It was further argued that since the Assessee was only carrying out construction activity in oil well, it cannot constitute any PE under Article 5(2)(g) of the DTAA. Alternatively, the Assessee contended that the transaction shall be taxable under section 44BB of the IT Act which provided for computing profits and gains in connection with the business of exploration of mineral oils. Accordingly, only 10% of the aggregate amount shall be deemed to be profits and gains of the Assessee as opposed to the levy of 25% of the income by the AO.

The IRA on the other hand contended that the duration of the vessel in India was not a determinative factor for the commencement of contract. It was contended that the onus would fall on the AO, only when the Assessee submitted complete details/data to the AO. In the absence of the same, the onus will not shift back to the AO for establishing that there existed a PE or not. The IRA further submitted that when the Assessee had failed to prove/provide any information about the profitability of the contract work, the AO was right in most reasonably attributing 25% of the income to its PE.

DECISION

ITAT opined that Assessee was not able to show the 'effective date' mutually agreed between the parties for the commencement of the work with HHIL and VMGL. Therefore, it adopted the date of execution of agreement as the date of commencement of construction activity i.e. November 1, 2004 for the project with HHIL and September 15, 2004 for the project with VMGL. It had also adopted the completion date as per the completion certificate issued by the project owners i.e. May 20, 2005 for the project with HHIL and April 15, 2005 for the project with VMGL.

It accepted the Assessee's argument that the contracts awarded to the Assessee did not cross the threshold time limit of 9 months as per Article 5(2)(i) of the India- Mauritius DTAA and, therefore, no PE was created as per Article 5(2)(i) of the DTAA.

The ITAT had further held that in order to create oil well PE under Article 5(2)(g) of the DTAA, the oil field should be 'at the disposal' of the Assessee in the sense of having some right to use the premises for the purposes of its business and not solely for the purposes of the projects undertaken on behalf of the owner of the premises. From the facts of the case, it is apparent that the Assessee had the place only for the purposes of above project undertaken as a sub-contractor. Therefore, it cannot be stated that Assessee had any kind of PE in India.

SIGNIFICANT TAKEAWAYS

As per Article 5(2)(g) of the India-Mauritius DTAA, a PE shall include a mine, an oil or gas well, a quarry or any other place of extraction of natural resources. Whereas under Article 5(2)(i), a PE shall include a building site or construction or assembly project or supervisory activities in connection therewith, where such site, project or supervisory activity continues for a period of more than nine months. As it can be seen, Article 5(2)(g) of the DTAA did not prescribe any time-limit for creating a PE whereas, Article 5(2)(i) of the DTAA prescribes a time-limit of 9 months. In the instant case, since the Assessee carried out construction activity in the oil well, it was contended by the IRA that the activity of the Assessee constituted PE under Article 5(2)(g) of the DTAA, since there's no prescribed time-limit for constituting a PE under the said Article. However, the ITAT rightly held that carrying out construction activity in the oil well would not create a PE under Article 5(2)(g) of the DTAA.

It is worthwhile to highlight that the AAR ruling in *P. No. 11 of 1995*[3], had held that burial of submarine cable sea-bed in Bombay High Sea, which would be used for transportation of oil and gas, could only fall under installation PE of the India-Singapore DTAA and not under oil well PE of the said DTAA since the oil well in question was not operated by the Assessee.

[3] In re (1997) 94 taxman 152/228 ITR 55 (AAR).

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WHERE SPECIFIC PE CLAUSE AVAILABLE IN THE DTAA, GENERAL PE CLAUSE CANNOT BE INVOKED

In ***ULO Systems LLC***[1] the ITAT held that where a construction activity was not carried for a period of 9 months in order to constitute construction PE, then the same activity cannot be brought under the general fixed place PE clause to constitute PE in India.

FACTS

ULO Systems LLC ("**Assessee**"), an entity incorporated in United Arab Emirates ("**UAE**"), was engaged in providing grouting and precast solutions for subsea off-shore construction activity. The Assessee provided products and solutions to support and protect subsea pipelines, cables and structures including fabric formwork, precast concrete, grout bags and grouting solutions for offshore or onshore pipelines.

IRA was of the view that such grouting activities of the Assessee constituted its PE in India. The Assessee challenged the finding before the DRP, wherein the DRP held that activities of the Assessee did constitute a PE in India under Article 5(1) of the India-UAE DTAA, which provides that any fixed place of business through which the business of an enterprise is wholly or partly carried on, constitutes a PE of that enterprise in India.

Being aggrieved by this finding of the DRP, the Assessee preferred an appeal before the ITAT.

ISSUE

Whether grouting activities carried on by the Assessee constituted PE in India?

ARGUMENTS

The Assessee contended that its activities were in the nature of 'construction activity' as contemplated in Article 5(2)(h) of India-UAE DTAA and since the activities were not carried on for a period exceeding the prescribed threshold under the India-UAE DTAA, it did not establish any PE in India. Article 5(2)(h) of the India-UAE DTAA provides that the term PE includes any construction activity or supervisory activities in connection thereto, if such activity is continued for a period of more than 9 months. The Assessee further contended that there was no PE in India as services were rendered to various third party customers in India through unrelated contracts.

Where an activity falls under a specific PE clause, the said provision should apply in preference to any general PE clause.

The IRA relied on the case of *Furgo Engineers Bv*[2] to contend that if activities did not constitute PE under the specific PE clause, it may constitute PE under the general fixed place PE clause. Consequentially, IRA argued that the Assessee had a PE in India, not under Article 5(2)(h) but under Article 5(1) of the India-UAE DTAA. The IRA further contended that benefit of the limitation clause should by granted only when activities of the Assessee are occasional but when such activities are carried on regularly and periodically every year, it may be presumed that Assessee deliberately kept the number of days to less than nine months to avoid establishment of PE in India.

DECISION

The ITAT held that activities of the Assessee fell within the ambit of 'construction activity' as provided under Article 5(2)(h) of the India-UAE DTAA and since the activities were undertaken for a period less than that stipulated in the DTAA, no PE was constituted under the said Article. The ITAT further held that when no PE was constituted under Article 5(2)(h), of the DTAA, no PE could be constituted under Article 5(1) of the DTAA, as it is a settled principle of law that a special

[1] ULO Systems LLC. v. ADIT, ITA No. 5968/Del/2010 (Delhi ITAT).
[2] ITA No. 2691/Del/2017 (Delhi ITAT).

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provision overrides a general provision, thus where a special provision has been provided, general provision would not be applicable. The case of *Furgo Enineers*[3] was distinguished on the ground that in that case, the nature of the activity did not fall within the specific clause unlike the present case where Article 5(2)(h) squarely applied to the nature of activities carried on by the Assessee.

The ITAT also observed that DTAA should be interpreted *uberrimae fidei*, which means that with utmost good faith and thus, the presumption that Assessee was manipulating the number of days to not breach the threshold provided in the DTAA amounted to rewriting of DTAA, which was impermissible. The ITAT further held that the India–UAE DTAA, unlike other DTAAs like Australia, Thailand, Canada, and USA, did not provide for aggregation of all connected sites, projects or activities for computation of threshold duration test and hence, in the absence of the specific threshold number of days position being violated, no PE was established in India.

SIGNIFICANT TAKEAWAYS

The ruling is line with the Mumbai ITAT ruling in *Kreuz Subsea Pte. Ltd.*,[4] wherein it was held that when activities relating to construction or installation were specifically covered under Article 5(3) of India-Singapore DTAA, then the general Article 5(6) of the DTAA, which provided for Service PE, could not have been invoked. However, recently, in the case of *Nordic Maritime Pte Ltd*.[5] which involved similar facts, Uttarakhand HC upheld the issue of notice by the CIT in exercise on its revisionary powers. In the said case, the taxpayer, a Singaporean entity, was operating a seismic vessel in Indian waters to render services in relation to collecting seismic data as well as gravity and magnetic data for exploration of oil. The contention of the taxpayer that its employees were present in India for a period of less than the threshold period and hence, no PE had been established was accepted by the AO, while the CIT used the powers granted to him under 263 of the IT Act and issued notice to the Assessee that it would constitute a fixed place PE in India. The action of the CIT invoking his powers under 263 and issuing notice to the Assessee was upheld by Uttarakhand HC.

The IRA have been very aggressive in such cases. The limited judicial pronouncements on the issue suggest that where specific provisions have been provided in the DTAA for establishment of PE, the IRA cannot invoke other general provisions to contend that the Assessee had established a PE. However, till the higher forums decide on the issue, the issue remains uncertain and prone to litigation. Having said this, one needs to be mindful of the overall approach adopted by the IRA. More specifically, the judicial trend in upholding the action of the IRA to invoke the revisionary power under section 263 of the IT Act could open Pandora's box for the cross border service providers such as in case of engineering, construction and procurement contracts, where the risk of the construction/installation PE could be very eminent, hence a considered tax advice and risk evaluation should come handy in defending such approaches or actions by IRA.

It is, therefore, advisable for the non-resident service providers to be extremely careful at the time of structuring of their agreements with Indian parties and also be meticulous in the maintenance of their records so that they will be able to defend their position in case of any such assault to their tax position.

[3] *Ibid*.
[4] Kreuz Subsea Pte. Ltd. v. DDIT, (2015) 58 taxmann.com 371 (Mumbai ITAT).
[5] Nordic Maritime PTE Ltd. v. CIT, Writ Petition No. 3708 of 2018 (Uttarakhand HC).

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SECTION 56(2)(viib) NOT CONTROLLED BY GENUINENESS TEST CONTAINED IN SECTION 68 OF THE IT ACT

A division bench of the Kerala HC, in the case of ***Sunrise Academy***[1], has upheld the taxability of shares at a premium, issued by a private company, under section 56(2)(viib) of the IT Act despite the assessee having fulfilled the two conditions under the first proviso to section 68 of the IT Act. It was held that a satisfactory explanation under section 68 cannot save an assessee from taxability under section 56(2)(viib) of the IT Act.

FACTS

Sunrise Academy of Medical Specialities (India) Pvt. Ltd. ("**Assessee**"), a private limited company, issued shares at a premium, exceeding the face value. The amount so received, however, was not offered to tax under the IT Act. Upon being served with a notice under section 143(2), the Assessee disclosed the source of funds received. Thereafter, the AO attempted to tax the premium amounts so received in excess of the fair market value, by invoking the provisions of section 56(2)(viib) of the IT Act.

The Assessee filed a writ petition before the Kerala HC contending that the notice served under section 143(2) only required it to disclose the source of the funds. Having fulfilled the said requirement, proceedings under section 56(2)(viib) could not be initiated. Further, it was argued that section 56(2)(viib) of the IT Act would not be applicable unless the test under section 68 of the IT Act was satisfied.

However, the learned Single Judge ruled against the Assessee. Aggrieved from the order of the single judge, the Assessee filed a Writ Appeal before the Kerala HC.

> **"Satisfactory explanation under section 68 cannot save the Assessee from liability under section 56(2)(viib)."**

ISSUE

Whether the aggregate consideration for shares issued at a premium above fair market value can be charged to income-tax under section 56(2)(viib) of the IT Act, even if the Assessee has provided satisfactory explanation under the first proviso to section 68? In other words, whether section 56(2)(viib) of the IT Act is controlled by section 68 of the IT Act?

ARGUMENTS

The Assessee argued that the scope of the notice served under section 143(2) of the IT Act was limited to the genuineness of the source from which the funds were received. The said requirement having been fulfilled, further proceeding under section 56(2)(viib) could not be initiated. Further, the Assessee argued that the application of section 56(2)(viib) was dependent on the satisfaction of the test under section 68 of the IT Act.

On the other hand, the Respondent argued that if parameters contained in section 68 were taken to be governing the provisions of section 56(viib) of the IT Act, the provisions of the IT Act would have to be rewritten as the provisions of section 56(viib) would become redundant.

DECISION

Scope of Notice served to the Assessee

The notice served to the Assessee had two limbs: first, the source of the amount received; and second, whether the amounts were being correctly offered for tax. An attempt to tax the amount so received under section 56(2)(viib) fell under the second limb of the notice.

[1] Sunrise Academy of Medical Specialities (India) Pvt. Limited v. ITO, (2018) 96 taxmann.com 43 (Kerala HC).

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Interplay between section 68 and section 56(2)(viib)

Section 68, under Chapter VI – *Aggregation of Income and Set Off of Loss*, provides that where any sum credited in the books of an Assessee for which the Assessee either offers no explanation as to its nature and source, or the explanation offered is not, in the opinion of the AO, satisfactory, the sum so credited may be charged to income tax.

Finance Act, 2012 inserted a proviso to section 68 (with effect from April 1, 2013) to provide that where the Assessee is a company (not to a company in which the public are substantially interested), and the sum so credited consists of share application money, share capital, share premium or any such amount, any explanation offered by the Assessee shall be deemed to be not satisfactory unless the following two conditions are fulfilled:

(a) the person, being a resident in whose name such credit is recorded in the books of such company also offers an explanation about the nature and source of such sum so credited; and

(b) such explanation in the opinion of the AO aforesaid has been found to be satisfactory.

Therefore, by virtue of the said proviso, the explanation offered by such company would not be deemed to be satisfactory unless conditions (a) and (b) are fulfilled. Where the explanation offered fails to pass the test, the entire sum so credited can be charged to income tax.

On the other hand, section 56 falls under Chapter IV – *Computation of Income from Other Sources*. Clause (viib), inserted in section 56(2) through Finance Act, 2012, provides that any consideration received by a Company (not being a company in which the public are substantially interested) for the issue of shares, in excess of the face value of such shares, shall be chargeable to income tax under the head "Income from other sources".

Thus, the HC observed that section 56(2)(viib) of the IT Act is triggered at the time of computation of income i.e. where the consideration so received is above the face value. The aggregate consideration received for the shares, as exceeds the fair market value, is treated as 'income from other sources' for the purpose of taxation.

Therefore, where no explanation has been offered or where the explanation offered is not satisfactory, the entire credit is charged to income tax under section 68. Where, however, the explanation offered is satisfactory, that portion of the consideration received, which exceeds the fair market value of the shares, is charged to income tax under section 56(2)(viib).

SIGNIFICANT TAKEAWAYS

The said amendments to section 68 and to section 56(2) were inserted by Finance Act, 2012. The Memorandum to the Finance Bill, 2012 placed both these amendments under the same heading i.e. *'Measures to Prevent Generation and Circulation of Unaccounted Money'*. However, these provisions apply in completely different spheres. In *Subhlakshmi Vanijya (P.) Ltd.*[2], the Kolkata Bench of ITAT observed that it failed to find any parallel between the amendments made to sections 68 and 56(2)(viib) except for the fact that these were added by the Finance Act 2012. It was observed that sections 68 and 56(2)(viib) of the IT Act could never operate, simultaneously.

Under the first proviso to section 68, in the absence of satisfactory explanation, the entire credit is charged to income tax. However, where the explanation given is satisfactory and the genuineness of the amount and the source is proved, income tax is still chargeable under section 56(2)(viib). Here, the genuineness of the transaction is irrelevant for determining taxability. Unlike section 68, only the aggregate consideration received, as exceeds the fair market value of such shares, is treated as income under the head 'Income from other sources'.

Recently, in *M/s Vaani Estates Pvt. Ltd.*[3] ("**Vaani Estates**"), ITAT Chennai Bench noted that section 56(2)(viib) of the IT Act was introduced as a measure

[2] Subhlakshmi Vanijya (P.) Ltd. v. CIT-I, Kolkata, [2015] 172 TTJ 721 (Kolkata ITAT).
[3] M/s Vaani Estates Pvt. Ltd. v. ITO, ITA No. 1352/Chny/2018 (Chennai ITAT).

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to deter the generation and use of unaccounted money. The provision creates a deeming fiction and in order to give effect to such legal fiction, it is necessary to assume all facts and circumstances thereto. In case of family arrangements, the corporate veil is required to be lifted and the transaction has to be viewed in light of the relevant provisions of the IT Act. In this case, the assessee company had two shareholders, Mrs. Sasikala Raghupathy and her husband Mr. B.G. Raghupathy, each holding 5000 shares. On Mr. B.G. Raghupathy's death, his shares devolved on their daughter, Mrs. Vani Raghupathy. Mrs. Shasikala introduced cash into the company against which she was allotted shares at a premium. The benefit of this investment at an unrealistic premium passed on to her daughter as there were only two shareholders. Since there was no possibility for generation and use of accounted money from the transaction, the addition under section 56(2)(viib) was deleted.

Therefore, in light of judgments in *Sunrise Academy* read with *Vaani Estates*, it may be concluded that unlike the provisions of section 68, genuineness is not an essential criteria for taxability under section 56(2)(viib). Hence, it is vital that a holistic view as regards the taxability, is taken after considering all the facts and circumstances surrounding the transaction. The relationship between the parties involved, as in the case of *Vaani Estates*, may also be an important factor in determining taxability under section 56(2)(viib) of the IT Act.

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ITAT CAN DIRECT AO FOR FRESH ENQUIRY INTO ASPECTS OF SUBJECT MATTER OF APPEAL

In ***Fidelity Business Services India Pvt. Ltd***[1]***,*** the Karnataka HC has held that powers of the ITAT under section 254(1) of the IT Act to pass such orders thereon 'as it thinks fit' cannot be lesser than the powers conferred upon the AO and the CIT(A).

FACTS

M/s. Fidelity Business Service India Pvt. Ltd. ("**Assessee**") had bought back its own shares in the AY 2011-2012 from M/s. FIS Holding Mauritian Ltd. ("**FIS**"), incorporated in Mauritius and held 99.99% shares of the Assessee. The capital gains arising therefrom were not taxable in India as per Article 13(4) of the India-Mauritius DTAA which prior to its amendment in 2016, provided for a residence based taxation of the gains from transfer of shares of Indian company, thus a Mauritian resident was not subject to tax in India on the capital gains arising from transfer of shares of Indian company. The AO was of the view that since FIS had 99.99% shareholding, the amount under the reserves and surplus was not distributable to others. Thus, Assessee and FIS adopted the other route to transfer reserves and surplus out of India without letting any single penny being taxed. Thus AO, declared the transaction to be a colourable instrument. The AO treated the payment by the Assessee to FIS on account of buy back of shares as deemed dividend under section 2(22)(d) of the IT Act and levied DDT under section 115O of the IT Act in the hands of the Assessee.

Being aggrieved by the assessment order passed by the AO pursuant to direction issued by DRP, the Assessee preferred an appeal before the ITAT. The ITAT held that so far as the payment on account of buy back of shares made by the Assessee to FIS, was within the extent of the fair market value of the shares, the same would be treated as capital gains as per section 46A and would not be taxable in accordance with Article (4) of the India-Mauritius DTAA. However, the ITAT also held that payment in the name of buy back of shares made by the Assessee over and above the fair market price of the share, would not be treated as capital gains as the transaction was between two closely related parties. The transaction would thus be a colourable device and a tax evasion method, falling in the ambit of section 2(22)(e) of the IT Act. Since, the issue of actual fair market price of the shares of the Assessee as on the date of the payment was not decided by the AO, the ITAT remanded the matter back to the AO to adjudicate upon the examination of fair market price of the shares vis-à-vis the buy-back price of the Assessee as per the applicable provisions of the law. Being aggrieved by the order of the ITAT, the Assessee appealed before the HC.

"A tax appeal is a rehearing of the entire assessment and appellate authority is vested with all the plenary powers which the subordinate authority may have in the matter."

ISSUE

Whether the ITAT had power under section 254(1) of the IT Act, to give directions for fresh enquiry into the aspects of the subject matter of appeal filed before it either *suo moto* or on any grounds raised by either party to the appeal which have not been investigated or enquired into by the lower authorities earlier and which may result in enhancement of tax liability of the Assessee?

[1] Fidelity Business Services India Pvt. Ltd. v. ACIT and Ors., (2018) 304 CTR (Kar) 244 (Karnataka HC).

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ARGUMENTS

The Assessee contented that the ITAT had exceeded its jurisdiction and unnecessarily opened an enquiry upon remand of the case to the AO into the questions of fair market value of the shares which were proposed to be bought back by the Assessee. It was also contended that adjudication was done perfectly in accordance with law after passing appropriate resolutions and paying out of the accumulated reserves and surpluses of the Assessee in accordance with section 77A of the Companies Act, 1956[2] and the same could not have been subject to DDT in the hands of the Assessee.

It was further contended that the ITAT had itself agreed that the transaction could not be taxed as DDT under section 2(22)(d) of the IT Act read with section 115O and section115QA of the IT Act, inserted prospectively with effect from June 01, 2013. Since the buy-back of the shares in question had taken place in the previous year 2010-2011 relevant to AY 2011-2012 i.e. before the insertion of section 115QA of the IT Act, therefore, ITAT was bound to allow the appeal of the Assessee in-toto and ought not to have ventured into a ground which was neither raised by the Assessee nor by the IRA in the matter.

Section 254(1) of the IT Act reads, “The Appellate Tribunal may, after giving both the parties to the appeal an opportunity of being heard, pass such orders thereon as it thinks fit”. The Assessee contended that the powers of the ITAT are circumscribed and restricted by the words 'thereon', used in juxtaposition with the words 'as it thinks fit'.

The Assessee relied on the decision of the Division Bench of Calcutta HC in the case of *R.L. Rajghoria*[3] which held that the word 'thereon' appearing in section 33(4) of the Income Tax Act, 1922 akin to section 254(1) of the IT Act restricts the jurisdiction of the ITAT to the subject matter of the appeal and there is no doubt that the ITAT has powers of remanding a case to the CIT(A) or the AO as the case may be, requiring him to hold further inquiry and to dispose of the case on the basis of such inquiry, but the jurisdiction of the ITAT is confined only to the subject matter of the appeal, the Assessee also relied on the case of *Karnataka State Forest Industries Corn. Ltd.*[4], by the jurisdictional HC for this purpose.

The Assessee also argued that the buy-back of shares from FIS, was not only legally permissible for the Assessee to undertake, but the payments made from the reserves up to the extent permitted under section 77A of the Companies Act, 1956 could not be treated by any stretch of imagination as loan or advance to the shareholder and which could be brought within the ambit of deemed dividends under section 2(22)(e) of the IT Act. Thus, ITAT could not have made such directions in excess of its powers to pass such orders 'as it thinks fit' as the said words did not give extra-ordinary or arbitrary powers to the ITAT to go beyond the subject matter of the appeal itself.

DECISION

The HC did not decide the issue on the merits of the case, however answered the substantial question of law regarding the powers of the ITAT under section 254(1) of the IT Act. The HC clarified that its directions could not be said to be per se amounting to taxability of the pay outs by the Assessee as deemed dividend as the same would depend upon the nature of enquiry to be conducted by the AO and findings arrived at, pursuant to the said direction.

The HC held that the remand direction of the ITAT to hold an enquiry into the aspect of fair market price of the shares bought back by the Assessee from FIS fell within the ambit and scope of the subject matter of the appeal filed by the Assessee.. The power to remand including for conducting an enquiry in the aspect of the matter which was not earlier adjudicated upon by the lower Authorities, could not be questioned by the Assessee or the IRA. The HC held that the words 'as it thinks fit' employed in section 254(1) of the IT Act were only bound by the requirement of giving an opportunity of being heard to the parties to the appeal.

The HC further observed that since the shares were not listed on the Stock Exchange, therefore, fair market value of the shares on a particular date of transaction was not ascertainable and the said aspect

[2] Section 68, Companies Act, 2013.
[3] ITO v. R.L. Rajghoria, (1979) 119 ITR 872 (Calcutta HC).
[4] Karnataka State Forest Industries Corn. Ltd. v. CIT, (1993) 201 ITR 674 (Karnataka HC).

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of the matter was not admittedly looked into by the lower authorities before the appeal was decided by the ITAT. Therefore, even though the ITAT ruled in favour of the Assessee that the said pay out for buy back of the shares at an abnormally high price was not taxable under section 115O or section 115QA read with its Explanation and section 2(22)(d) of the IT Act as per the contentions raised by the Assessee, the ITAT was perfectly justified in directing an enquiry into the fair market price of the shares of the Assessee which could have an implication of taxability under section 2(22)(e) of the IT Act.

The HC observed that while analysing the powers of the ITAT, the emphasis should be on the words 'as it thinks fit' rather than on the word 'thereon'. The word 'thereon' only related to the 'subject matter' of the appeal referred to in first limb of the 254(1) and therefore, while dealing with the subject matter of the appeal, ITAT could pass any such relevant order as it thinks fit, which would be rational, germane, reasonable, appropriate, necessary and expedient in the opinion of the ITAT subject to the requirement that both the parties to the appeal, have been accorded an opportunity of being heard.

The HC agreed with the view expressed by the Madras HC in the case of *Indian Express (Madurai) Pvt. Ltd*[5], relied by the IRA, which stated that ITAT is constituted as the final authority on facts and penultimate authority on law touching the assessment and other proceedings under the Act, and has the plenary jurisdiction in the matters of the assessment. It was held that the task of an appellate authority under a taxing statute, especially a non-departmental authority like the ITAT, is to address its mind to the factual and legal basis of an assessment for the purpose of properly adjusting the taxpayer's liability to make it accord with the legal provisions governing his assessment and to ascertain the tax payer's liability correctly to the last pie, if it were possible. The various provisions relating to appeal, second appeal, reference and the like can hardly be equated to a lis or a dispute as arising between the two parties in a civil litigation. The very object of the appeal is not to decide a dispute, but any point which goes into the adjustment of the taxpayer's liability.

The HC further agreed with the case of *Malalakshmi Textile Mills Ltd.*[6] where the SC observed that the ITAT is not precluded from 'adjusting' the tax liabilities of the Assessee in the light of its finding merely because the findings are inconsistent with the case pleaded by the Assessee.

Further, in the case of *Arulmurugan & Co.*[7], the Madras HC held that a tax appeal is quite different and the appellate authority is very much committed to the assessment process. The appellate authorities perform the same functions as the AO. The full bench expressed the view that a tax appeal is a rehearing of the entire assessment and it cannot be equated to adversary proceedings in appeal in civil cases. The appellate authority can itself enter the arena of assessment, either by pursuing further investigation or causing further investigation to be done. It can do so on its own initiative, without being prodded by any of the parties.

The HC held that the powers under section 254(1) of the IT Act, with the ITAT to pass such orders 'as it thinks fit' cannot be lesser than the powers conferred upon the lower and first appellate authority. The HC categorically stated that the higher and final fact finding authority under the IT Act cannot be intended by the Parliament to have lesser power than the CIT(A) as it is well settled that the powers of the appellate authorities are always co-extensive with that of the AO. Therefore what the AO or the CIT(A) could do in the matter of assessment, the ITAT cannot be said to have any lesser power to do so.

Accordingly, the HC held that the powers of the ITAT are not limited or circumscribed by the grounds raised before it and any order on the subject matter of appeal can be passed if it is found to be necessary, expedient and relevant by the ITAT. Thus, the HC dismissed the appeal filed by the Assessee and the substantial question of law relating to the powers of the ITAT under section 254(1) of the IT Act was answered in the favour of the IRA. The HC further held that the ITAT has the

[5] CIT v. Indian Express (Madurai) Pvt. Ltd., (1983) 140 ITR 705 (Madras HC).
[6] CIT v. Mahalakshmi Textile Mills Ltd., (1976) 66 ITR 710 (SC).
[7] State of Tamil Nadu v. Arulmurugan & Co., (1982) 51 STC 381 (Madras HC).

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power to give directions for fresh enquiry into the aspects of the subject matter of the appeal filed before it either suo moto or on any grounds raised by either party to the appeal in case such grounds had not been investigated or enquired into by the lower authorities earlier. It is immaterial whether such an exercise will result in the enhancement of tax liability of the Assessee or not. Hence, the ITAT was right and within its jurisdiction in directing the examination of the fair market value of the shares bought back by the taxpayer during the previous year relevant to AY 2011-2012 in question.

SIGNIFICANT TAKEAWAYS

This is a very good case which discusses the powers of the ITAT in accordance with section 254(1) very exhaustively.

It may be pertinent to note that the SC in the case of *Hukumchand Mills Ltd.*[8], while discussing the power of ITAT in dealing with appeals, as expressed in section 33(4) of the Income Tax Act, 1922[9], had observed that the powers of the ITAT are expressed in the widest possible terms. In that case the word 'thereon' and the words 'pass such orders as the ITAT thinks fit', were explained by the SC that they include all the powers *(except possibly the power of enhancement)* which are conferred on the Appellate Assistant Commissioner and the Income tax officer. Further, the SC had, once again, in the case of *Assam Travel Shipping Service*[10] after taking note of *Hukumchand Mills* case, had observed that the expression 'as it thinks fit' is wide enough to include the powers of remand to the authority competent to make the requisite order in accordance with the law in such a case, even though the ITAT may not itself have the power to make an order enhancing the penalty/tax liability.

Therefore, it can be concluded that while the ITAT does not have the power to enhance the tax liability of the tax payer, it can remand the matter back to the file of AO, which could possibly result in enhancement of the tax liability. Therefore, while it may appear that ITAT is bound to decide the appeal only on the subject matter, it may be able to decide all such issues which relate to the case under investigation even if such issue had not been put forward by either of the parties viz. the Assessee or the IRA. It may also remand the case back to the AO for fresh enquiry or examination which may result in enhancement of liability.

[8] Hukumchand Mills Ltd. v. CIT, (1967) 63 ITR 232 (SC).
[9] Section 254(1), IT Act.
[10] CIT v. Assam Travel Shipping Service, (1993) 199 ITR 1 (SC).

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RELATED PARTIES CAN VALUE UNLISTED SHARES AT A MUTUALLY CONVENIENT PRICE

In case of ***Topcon Singapore Positioning Pte Ltd.,***[1] the Delhi ITAT had held that in case the company whose shares were being transferred, was neither in the process of being wound up nor was there any reasonable prospect of its going into liquidation, the adoption of Net Asset Value or book value for determining Arm's Length Price ("**ALP**") of such unquoted shares was not warranted. The ITAT further held that a transaction value agreed between the AEs could never be construed as a valid Comparable Uncontrolled Price ("**CUP**") since only the transaction value of a transaction between independent enterprises can be considered as a CUP.

FACTS

Topcon Singapore Positioning Pte Ltd. ("**Assessee**"), a company incorporated in Singapore, held 99.99% shares in an unlisted Indian company, Topcon Sokkia India Pvt. Ltd. ("**TSIPL**"). The Assessee, entered into a stock purchase agreement ("**SPA**") and agreed to sell all its shares in TSIPL to another non-resident group company, Topcon Corporation, Japan at Net Asset Value ("**NAV**"). Under the SPA, the Parties had agreed only on the formula for working out the sale consideration. The NAV as per the SPA was estimated to be INR 224.00 per share, whereas the actual sale took place at a price (INR 206.88 per share) which was more than the fair market value ("**FMV**") of INR 187.00 per share as per discounted cash flow ("**DCF**") method.

The Assessee filed its return of income disclosing the capital gains arising to it as per the price at which the shares were transferred (INR 206.88 per share). The AO referred the matter to the TPO for determination of ALP of transferred shares. The TPO assessed the value of sale consideration by taking value of shares on NAV basis as was estimated under the SPA and accordingly, recomputed the capital gains. The AO adopted the ALP determined by the TPO and made additions in respect of capital gains on sale of shares basis the estimated NAV. These additions were later confirmed by DRP and the Assessee preferred an appeal against the order of the DRP.

> **Related parties may be able to justify the transaction value of unlisted shares based on the mutually negotiated value.**

ISSUES

Whether the TPO could determine the ALP for the transfer of unquoted shares on the basis of price agreed between the parties to the transaction in their agreement or whether the NAV basis of determination should be followed for determining the ALP of unquoted equity shares for transfer pricing purposes?

ARGUMENTS

The Assessee argued that an adjustment was not warranted as the sale consideration exceeded the FMV as per DCF method of valuation of shares, which has been the judicially accepted method of valuation of shares in cases of unquoted shares.

The IRA, on the other hand, relied on the order of TPO and contended that since the shares were not listed on any stock exchange, the value of the shares for sale / transfer should be determined on the basis of NAV or the book value.

[1] Topcon Singapore Positioning Pte Ltd. v. DDIT, ITA nos. 2 and 5030/Del/2017 (Delhi ITAT).

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DECISION

The ITAT analysed the scheme of section 92CA, which grants the power to AO to refer any matter to the TPO for determining ALP, and relied on the available judicial precedents[2] to hold that the role of TPO is limited to determination of ALP of a transaction. The ITAT observed that the determination of taxable income falls within the exclusive domain of the AO and the TPO cannot intrude into it. The ITAT further held that a price agreed between the AEs, can never be a valid CUP for the simple reason that it is only the transaction value for transactions between independent enterprises that can be considered as a CUP. Thus, the price agreed under the SPA was held to be irrelevant for determining the ALP for the transfer of shares.

As regards valuation method for determining ALP of unquoted shares, the ITAT relied on the SC's judgment in case of *Kusumben D Mahadevia*[3] wherein it was held that in case of a company whose shares are not quoted on the stock exchange, the profits which the company has been making and should be capable of making or the profit-earning capacity of the company would ordinarily determine the value of the shares. Valuation on the basis of the NAV would be justified where the company is ripe for winding up or where the situation is such that the fluctuations of profits and uncertainty of conditions on the date of valuation would prevent any reasonable estimation of profit earning capacity of the company. Basis the above observations, the ITAT held that NAV basis of valuation of the shares for transfer pricing was not warranted as TSIPL was not in the winding up nor was there any reasonable prospect of its going into liquidation. The ITAT thus held the DCF based valuation as the correct method even though it remanded the matter to TPO to make fresh determination of ALP as the TPO had not evaluated this aspect originally and had merely proceeded on the basis of the NAV valuation.

SIGNIFICANT TAKEAWAYS

The ruling is consistent with the judicial precedents on applicability of NAV method for valuation of unlisted shares. In *Grindlays Bank Ltd*[4] and *Mrs. Shardaben B Mafatlal*[5], Calcutta and Bombay HCs respectively had taken similar views that in case of a company which was a going concern and shares of which were not quoted on any stock exchange, the shares were not required to be valued as per NAV method and DCF method could be the most appropriate method which can be applied for arriving at the valuation of shares in such a case.

ALP has to be determined according to the methods prescribed under section 92C of IT Act. The said provision enlists five methods and grants power to CBDT to prescribe any other method for such determination. The CBDT has accordingly prescribed that a method which takes into account the price which has been or would be charged or paid for the same or similar uncontrolled transaction, with independent enterprises under similar circumstances, could be regarded as the fair value. This means that, to determine ALP of shares, the price at which the shares would be sold in the market has to be taken into consideration. The CBDT has not prescribed any specific method to determine ALP of unlisted shares. However, it may be noted that in *Ascendas (India) (P) Ltd.*[6] and *VIHI LLC*[7] determination of ALP of unlisted shares on the basis of DCF method was accepted by the judicial authorities. Thus, one would need to bear in mind that where the shares are transferred to an AE, even though the transfer price may be meeting the FMV for the purpose of section 50CA and section 56(2)(x) basis the prescribed valuation method under rule 11UA(1) of the IT Rules, such price would still need to be in compliance with the transfer pricing regulations in India and the DCF valuation should be procured for this purpose where the unquoted equity shares are transferred to a non-resident AE.

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[2] Cushman & Wakefield India Ltd. v. CIT, (2014) 730 (Delhi HC); Dresser Rand India (P) Ltd. v. ACIT, [2011] 47 SOT 423 (Mumbai ITAT).
[3] CGT v. Kusumben D Mahadevia, (1980) 122 ITR 38 (SC).
[4] Grindlays Bank Ltd. v. CIT, (1986) 158 ITR 799 (Calcutta HC).
[5] Mrs. Shardaben B Mafatlal v. CIT, (1989) 177 ITR (Bombay HC).
[6] Ascendas (India) (P) Ltd. v. DCIT, (2013) 33 taxmann.com 295 (Chennai ITAT).
[7] VIHI LLC v. ADIT, (2014) 42 taxmann.com 304 (Chennai ITAT).

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LOANS ADVANCED BETWEEN SISTER COMPANIES WOULD BE CONSTRUED AS DEEMED DIVIDENDS IN THE HANDS OF COMMON SHAREHOLDER

In ***Shri. Sahir Sami Khatib***,[1] the HC held that the loans advanced between sister companies would be construed as deemed dividend as per section 2(22)(e) of the IT Act and would be taxable in the hands of shareholders who holds not less than 10% of the voting power in the lender company and a substantial interest (i.e. not less than 20% of the voting power) in the borrower company.

FACTS

Shri. Sahir Sami Khatib held 15% shareholding in Medley Laboratories Pvt. Ltd. ("**MLPL**") and a 45% shareholding in Oryx Fisheries Pvt. Ltd. ("**OFPL**"). Similarly, Shri. Sarosh Sami Khatib also held 15% shareholding in MLPL and 99% shareholding in Steranco Health Care Pvt. Ltd. ("**SHCPL**"). (Both the shareholders, are collectively referred to as "**Assessees**")

During the year under consideration, MLPL had advanced a loan of INR 9.19 Million to OFPL and an amount of INR 2.72 Million to SHCPL. The AO had treated the loan amount, along with the interest, as deemed dividend in the hands of borrower companies i.e. OFPL and SHCPL and accordingly, concluded the assessment. The AO had simultaneously made similar additions in the hands of the shareholders (i.e. Assessees) on a protective basis.

On an appeal, the CIT(A) deleted the protective additions made in the hands of Assessees by holding that the loan amounts were received by OFPL and SHCPL and accordingly, the same should be taxable in the hands of said companies and not in the hands of the Assessees.

The IRA preferred an appeal to the ITAT and by that time, the ITAT had already deleted the additions made in the hands of borrower companies by holding that the deemed dividend can only be taxed in the hands of shareholders. In view of the same, the ITAT allowed the appeal preferred by the IRA so as to tax the loan the amount in the hands of shareholders.

Being aggrieved by the same, the Assessees preferred the appeals before the HC.

ISSUES

- Whether the loans advanced between sister companies can be construed as deemed dividends in the hands of shareholders as per section 2(22)(e) of the IT Act?
- Without prejudice, additions under section 2(22)(e) of the IT Act should be restricted only to the extent of shareholder's proportionate shareholding in the borrower company?

ARGUMENTS

The Assessees contended that the ITAT had erred in converting the protective additions made by the AOs into substantive additions by ignoring the undisputed fact that the loans were not received by them and thereby confirming addition of deemed dividend in their hands. Alternatively, the Assessees submitted that the additions, if any, under section 2(22)(e) of the IT Act should be restricted only to the extent of its shareholding in the borrower company. The Assessees relied on the decisions of HC in the case of *Impact Containers Pvt. Ltd.,*[2] ("**Impact Containers**") Delhi ITAT in the case of *Puneet Bhagat*[3] ("**Puneet Bhagat**") and the SC in the case of *National Travel Services*[4] ("**National Travel**").

> **"Deemed dividends are taxable in the hands of shareholders."**

[1] Shri. Sahir Sami Khatib v. ITO, ITA No. 722 of 2015 (Bombay HC) and Shri. Sarosh Sami Khatib v. ITO (ITA No. 724 of 2015 (Bombay HC).
[2] CIT v. Impact Containers Pvt. Ltd., (2014) 367 ITR 346 (Bombay HC).
[3] Puneet Bhagat v. ITO, ITA Nos. 3025-3026/Del/2015 dated December 16, 2015. (Delhi ITAT).
[4] The National Travel Services v. CIT, Civil Appeal No. 2068-2071/2012 dated January 18, 2018. (SC).

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The IRA contended that the issue of whether deemed dividend is taxable in the hands of the shareholder or in the hands of the borrower company is squarely covered by the decision of jurisdictional HC in the case of *Universal Medicare Pvt. Ltd.*[5] ("**Universal Medicare**") wherein it was categorically held that the dividend can only be taxable in the hands of shareholders and not in the hands of the borrower company.

DECISION

The HC concurred with the contentions of the IRA that the issue is squarely covered by the decision of jurisdictional HC in *Universal Medical.* Following the same, it had held that since the Assessees were owning more than 10% in the lender company and more than 20% (i.e. substantial interest) in the borrower company, the loan amount advanced by the lender company should be construed as deemed dividend in the hands of the shareholders i.e. Assessees as per section 2(22)(e) of the IT Act.

It further distinguished the decisions relied on the by the Assessees. It held that the decision in the case of *Impact Containers* in fact, followed the decision of HC in the abovementioned case of *Universal Medicare* to hold that loan amount advanced between the sister companies would be taxable in the hands of shareholders and, therefore, it did not help the case of the Assessees. It had also held that decision of SC in the case of *National Travel* would have no application to the facts of the present case.

The HC distinguished the decision of Delhi ITAT in the case of *Puneet Bhagat* by holding that the facts were different and not applicable to the facts of the present case. In the said case, there were two shareholders who were common to the lender and the borrower company and therefore, the ITAT had held that deemed dividend shall be taxable based on their proportionate shareholding.

The HC had also held that the loan amount would be taxed in the hands of the Assessees in its entirety and not on a proportionate basis since there was only one common shareholder in the lender and the borrower company.

SIGNIFICANT TAKEAWAYS

The question of whether loans advanced between the sister companies can be taxable in the hands of shareholders as deemed dividends or not, under the provisions of the IT Act, has been subject matter of litigation for a long time now.

Various HCs have held that loans or advance made between sister concerns can be construed as dividend and shall be taxable in the hands of the shareholders only. The said rationale had been upheld by the SC in the case of *Madhur Housing and Development Company.*[6]

While the provisions are clear, due to the close relationship between the parties, it may become inevitable for the parties to have transactions with themselves, thereby attracting such onerous provisions. Before undertaking any such transactions, it is advisable for the taxpayers to consult their tax advisors so that application of such provisions can be avoided.

In addition to such extreme provisions, it may also be pertinent to note that the Finance Act, 2018 has amended section 115-O of the IT Act to include deemed dividend within the scope of dividend distribution tax and therefore, the loans advanced between the sister companies would be taxable at the rate of 30% (plus applicable surcharge and cess) in the hands of lender company itself at the time of payment of loans or advances. It is worthwhile to highlight that Memorandum explaining the provision of the Finance Bill, 2018 states that the objective behind amending section 115-O of the IT Act was to address the extensive litigation in the provision relating to deemed dividend.

It remains to be seen how such extreme measures would be seen by the taxpayer community and how much will it impact business environment.

[5] CIT v. Universal Medicare Pvt. Ltd., 324 ITR 263 (Bombay HC).
[6] CIT v. Madhur Housing and Development Company Civil, (2018) 401 ITR 152 (SC).

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COMPENSATION RECEIVED ON BREACH OF RIGHT OF FIRST REFUSAL ("ROFR") IS A CAPITAL RECEIPT

In the case of ***Parle Bottling Co. Ltd.,***[1] the SC dismissed the SLP filed by the IRA against the decision of the Bombay HC which held that the compensation received for breach of RoFR, was in nature of capital receipt and, therefore, non-taxable under the IT Act.

FACTS

Parle Bottling Co. Ltd. ("**Assessee**"), as a part of Parle Group of companies was engaged in the business of manufacturing, bottling and distribution of beverages and soft drinks under several popular brands. The Assessee entered into a Master Agreement ("**Agreement**") with The Coca Cola Company, USA ("**TCCC**") in September 1993. As per the Agreement, the Assessee transferred IP rights in the nature of trademark, know-how and franchisee rights of various brands of beverages / soft drinks owned by it, to TCCC, while retaining the bottling rights on the soft drinks / beverages in the territory of Pune. Along with the bottling rights, the Agreement also had RoFR on the bottling rights.

Later, a business plan submitted by the Assessee for Pune territory was rejected by TCCC without any specific reason. Thereafter, TCCC also went ahead and established its own bottling plant in Bangalore. This led to a breach of obligation by TCCC in respect of the RoFR granted to the Assessee, which led to a dispute between the Parle Group and TCCC. The dispute was ultimately settled by TCCC paying an amount of INR 16.05 crores to the Assessee as compensation. The Assessee treated the compensation as a capital receipt.

During the course of assessment proceedings, the AO treated the compensation received taxable as long term capital gain on protective basis. On an appeal filed by the Assessee, the CIT(A) held that the receipt should be taxed as casual and non-recurring taxable income under section 10(3) of the IT Act. On an appeal before the ITAT, filed by the IRA, the ITAT held that compensation received by Assessee is a capital receipt and since, there was no transfer or extinguishment of any rights, there is no question of capital gain and hence, the IRA's appeal was dismissed.

Therefore, the disputed compensation was not subject to tax. The ITAT, while determining the nature of receipt as revenue or capital receipt, relied on the tests laid down by the SC decision in the case of *Kettlewell Bullen & Co*,[2] ("**Kettlewell**").

The IRA went on appeal before the division bench of Bombay HC. The Bombay HC held in favour of the Assessee in lieu of the SC decision relied upon by the Assessee in the case of *Oberoi Hotel Pvt. Ltd.*[3] ("**Oberoi**") which had also followed the SC decision in case of *Kettlewell.*

The IRA had further filed an SLP before the SC, which was dismissed by the SC in its order dated October 22, 2018.

ISSUE

Whether the amount received by the Assessee was in the nature of capital receipt and thus, not subject to tax?

ARGUMENTS

The fundamental contention of the IRA was that the Assessee had obtained benefits out of the compensation received from TCCC. The compensation received by the Assessee out of the breach of contract was a revenue receipt. To further this argument, the IRA placed reliance on the SC judgement in the case of *Shantilal Pvt. Ltd.*[5]

[1] Special Leave Petition (Civil) Diary No. (S). 33334/2018 (SC).
[2] Kettlewell Bullen & Co. Ltd. v. CIT, Calcutta, (1964) LIII ITR 261 (SC).
[3] Oberoi Hotel Pvt. Ltd. v. CIT, (1999) 236 ITR 203 (SC).

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("**Shantilal**") which dealt with compensation which represented settlement of damages on breach of the contract.

Against the arguments put forth by the IRA, the Assessee had argued that the compensation received was in the nature of capital receipt by primarily placing reliance on the tests for capital and revenue receipts laid down by the SC in the case of *Kettlewell* as well as *Oberoi*. The Assessee also argued that rejection of business plan by TCCC without giving any reason, breached the RoFR given to the Assessee. TCCC had deprived the Assessee of all potential rights to set up a bottling plant for Pune territory. The Assessee contended that there was a breach of contract which gave rise to a claim for damages on account of failure to honour commitment and, therefore, such damages were in the nature of capital receipt. The source of income by setting up the bottling plant in Pune territory was lost forever. Therefore, the Assessee submitted that the tests laid down in in the aforesaid cases were satisfied.

"Compensation received for the breach of RoFR is a capital receipt."

DECISION

The Bombay HC as well as the SC, by means of dismissing the SLP, have upheld the ruling of the ITAT in favour of the Assessee. The HC admitted reliance placed by the Assessee on the tests laid down by the SC in the case of *Kettlewell* and *Oberoi*. Further, the HC also upheld that the compensation paid to Assessee by TCCC cleared the aforesaid tests and was capital receipt in nature. Further, the HC also dismissed the reliance placed by the IRA on SC judgement in the case of *Shantilal* by stating that the case cited by the IRA was completely out of context and was not applicable to the facts of the instant case. Thus, the compensation received by the Assessee against breach of RoFR was upheld to be in the nature of capital receipt and accordingly the same was held to be not taxable.

SIGNIFICANT TAKEAWAYS

The dismissal of IRA's SLP by SC finalizes the judgment of the HC in the present case. At several points in the judgement delivered by the HC it was reiterated that the dispute in the present case is mainly factual and academic and the application of tests laid down by the SC in the cases of *Kettlewell* and *Oberoi* were the chief determining factors. However, taking into account the recent amendments in the IT Act, the dispute of capital receipt and revenue receipt on compensation may have to be re-looked all over. It is, thus, heartening to note that the SC decided to continue with its own findings on the subject rather than having a relook at it due to the recent amendments to the IT Act.

Having said the above, it is pertinent to note that the Finance Act, 2018 has added Section 28(ii)(e) to the IT Act which effectively states that any compensation received by any person in connection with the termination or modification of the terms and conditions of any contract relating to their business, would be treated as income chargeable to tax under the head 'Profits and gains for business and profession'. The language of the section is widely worded and such compensation as is disputed in the case at hand would now get covered regardless of the tests laid down by the SC.

In addition to the above, the IRA also now have the option of invoking GAAR in appropriate circumstances. Thus, tax payers should be advised to plan their tax affairs very carefully and should avoid taking any unnecessary aggressive position.

[5] CIT v. Shantilal Pvt. Ltd., (1983) 144 ITR 67 (SC).

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ITAT REJECTS TAXABILITY OF ALLOTMENT OF SHARES UNDER A RIGHTS ISSUE, IN A FAMILY HELD COMPANY

In the case of ***Sri Kumar Pappu Singh***,[1] the Vishakhapatnam ITAT held that the shares allotted to the taxpayer, pursuant to a rights issue, at a value less than the FMV (determined under section 56 read with Rule 11UA of the IT Rules) of such shares, would not be subject to tax under section 56(2)(vii)(c) of the IT Act.

BACKGROUND

Sri Kumar Pappu Singh ("**Assessee**"), was a shareholder in a private limited company (the "**Company**"), along with seven other shareholders. Pursuant to the direction received form certain lending institutions, the Company in order to increase its capital base, offered shares to its shareholder under a rights issue. The Assessee was allotted all the shares offered under the issue, as the other shareholders did not subscribe to the offer.

> **Excess shares allotted to the Assessee were pursuant to the renunciation by close relatives, therefore, section 56(2)(vii)(c) of the IT Act does not apply.**

The Assessee's case was taken up for scrutiny in the relevant AY, and the AO completed the scrutiny under section 143(3) of the IT Act. Subsequently, the PCIT called for the records of the Assessee and invoked revisionary powers under section 263 of the IT Act and held that since the Assessee, had received shares of the Company for a value less than the FMV of such shares, the difference between the FMV of such shares and actual consideration paid should be subject to tax under the provisions of section 56(2)(vii)(c) of the IT Act. The Assessee being aggrieved by the order passed by the PCIT, appealed to the ITAT.

ISSUE

Whether the allotment of shares to the Assessee, pursuant to a rights issue, was subject to tax under section 56(2)(vii)(c) of the IT Act?

ARGUMENTS

The Assessee argued that all the shareholders in the company were his close relatives and accordingly, in accordance with provision of the section 56(2)(vii)© of the IT Act, the same would not be applicable where the property is received from close relatives. On the other hand, IRA contended that since the shares were received from the Company and the Company and the Assessee could not be said to be 'relatives' within the meaning of section 56 of the IT Act, there was no case for invoking the said exemption.

The Assessee also contended that in case of a rights issue shareholders do not get any extra benefit other than the pre-existing interest of the shareholder in the company. Accordingly, the Assessee argued that even if it is assumed that ,the provisions of section 56(2)(vii)© of the IT Act were to be invoked in the instant case, the same should be applicable only in respect of the shares received in excess of Assessee's entitlement under the rights issue. The IRA, on the other hand, argued that section 56(2)(vii)(c) of the IT Act requires the entire difference between the FMV of the shares and the actual consideration to be subject to tax in the hands of the recipient shareholder.

DECISION

At the outset, ITAT observed that though the shares were allotted to the Assessee, the entire shareholding of the Company was retained by the family. The ITAT also noted that the Assessee had received the excess shares by the virtue of renouncement of shares by other shareholder, who were his close relatives. Further, the ITAT pointed out that the Assesse had the liberty of transferring shares to his relatives, without attracting the taxation under section 56(2)(vii)(c) of the

[1] Sri Kumar Pappu Singh v. DCIT, I.T.A.No.270/Viz/2018 (Vishakhapatnam ITAT).

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IT Act owing to the exemption to receipt of a 'property' from a 'relative'.

The ITAT placed reliance on the decision in case of *Kay Arr Enterprises*[2] and *R. Nagaraja Rao,*[3] wherein it was held that in transaction involving family arrangement with respect of transfer of shares, the corporate veil must be lifted and ruled that the transaction between close relatives must not been seen as a method of evasion of tax.

Accordingly, the ITAT held that since the excess shares were received by the Assessee pursuant to the renouncement of the shares by the Assessee's relative, such transactions between close relatives were covered under the exemption from taxability under section 56(2)(vii)(c) of the IT Act and there was no case for application of section 56(2)(vii)(c) of the IT Act. Thus, the ITAT set aside the order of the PCIT and allowed the appeal of the Assessee.

SIGNIFICANT TAKEAWAYS

This case reflects the recent approach of the courts, to interpret the anti-avoidance provisions of section 56(2) of the IT Act in consonance with the intention of the legislature and to ensure that only the mischiefs sought to be remedied by the legislature are brought to tax under the under such anti–abuse provisions. In lines with the said approach, recently, the Mumbai ITAT in the decision of *Subodh Menon*[4] observed that section 56(2)(vii) of the IT Act was enacted as a mechanism to prevent money laundering of un-accounted income. Accordingly, while deciding on the inapplicability of section 56(2)(vii) of the IT Act to this rights issue, the ITAT drew comfort from the rationale for insertion of the said section and noted that such a provision cannot be applied to *bona fide* transactions.

Similarly, the Chennai ITAT in the case of *Vani Enterprises Pvt. Ltd.*[5] held that the objective behind introduction of section 56(2)(viib) into the IT Act was to curb the circulation of unaccounted money/black money and when the transaction is genuine, the *vires* of the same should not be attracted.

Though the decision in the case of the Vishakapatnam ITAT provides a certain degree of comfort to the taxpayers, but the ratio of the said decision would be limited to a companies which are entirely held by close family members. Thus, one would need to wait for a judgment from the from a HC or SC, in absence of which, the issue regarding taxability of allotment of shares under a rights issue continue to lurk in the grey areas of the law. Having said this, it would be critical to evaluate the applicability of section 56(2)(x) of the IT Act in case of proposed rights issues, basis the facts of each case, and seeking a legal opinion on the same could go long way in avoiding any penalty at later stages.

[2] CIT v. Kay Arr Enterprises, (2008) 299 ITR 348 (Madras HC).
[3] CIT v. R. Nagaraja Rao, (2103) 352 ITR 565 (Karnataka HC).
[4] ACIT v. Subodh Menon, ITA No.676/Mum/2015 (Mumbai ITAT).
[5] Vani Enterprises Pvt. Ltd. v. ITO, ITA No. 1352/Chny/2018 (Chennai ITAT).
[6] Supra note 1.

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CASE LAW UPDATES - MISCELLANEOUS

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NO TDS WHILE MAKING INTEREST PAYMENTS TO STATUTORY CORPORATIONS

In case of ***Canara Bank***,[1] the division bench of the SC held that Canara Bank was not required to deduct any tax at source while making interest payments on fixed deposits to New Okhla Industrial Development Authority ("**NOIDA**") as it was covered under the notification issued by Central Government specifying a list of institutions to whom, interest payments made, were not to be subject to tax deduction at source.

FACTS

Canara Bank ("**Assessee**") was the banker of NOIDA which was constituted by notification dated April 17, 1976 issued under section 3 of Uttar Pradesh Industrial Area Development Act, 1976 ("**UPIAD Act**"). Assessee made certain payments to NOIDA as interest on deposits for FY 2005-06 without deducting any tax at source. Show cause notices were issued to the Assessee for not deducting tax at source under section 194A of IT Act which mandates any person making payments to any resident on account of interest to deduct income tax at time of making such payment or at the time of credit whichever is earlier.

Corporation established by or under an Act of legislature means a body corporate which owes its existence and not merely its corporate status to the Act/ governed by the Act.

In response to the show cause notice the Assessee contended that no tax was liable to be deducted while making payments to NOIDA relying on notification dated October 22, 1970 ("**Notification**") issued under section 194A(3)(iii)(f) of the IT Act which provided that no tax should be deducted at source for making interest payments to an institution, association or body which the Central Government may notify in the Official Gazette, pursuant to which the Central Government had notified the list of institutions / organizations which were covered within the scope of "*any corporation established by a Central, State or Provincial Act*" vide the Notification.

The AO rejected the contentions raised by the Assessee and treated it as assessee-in default on account of its failure to deduct tax at source on interest payments made to NOIDA. The Assessee preferred an appeal before CIT(A) which was allowed. The IRA assailed this order of the CIT(A) before ITAT and thereafter, before HC. Both the ITAT and the HC decided the issue in favor of the Assessee and held that NOIDA was an authority constituted by the 'State Act' and thus covered under the Notification.

ISSUE

Whether NOIDA was covered under the Notification and consequently, whether the Assessee was not liable to deduct tax at source under section 194A of IT Act while making interest payments to NOIDA?

ARGUMENTS

The IRA contended that NOIDA was not entitled for the benefit of Notification. It was contended that there is a difference between a corporation established by an Act and corporation established under an Act. It was contended that since Notification covered only those corporations which were established by an Act, NOIDA would not be covered as it was a corporation established under the UPIAD Act and not by the UPIAD Act.

The Assessee, on the other hand, contended that section 3 of UPIAD Act provides that the State Government may by notification, constitute for the purpose of the Act, an authority for any industrial development area. Relying on section 3 of the UPIAD Act and on the provisions of State Bank of India Act, 1955 and Life Insurance Corporation of India Act, 1956 which provides for establishing of corporation by

[1] CIT Kanpur and another v. Canara Bank, Civil Appeal No. 6020 of 2018 (SC).

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virtue of a notification, the Assessee contended that NOIDA was established by a notification under UPIAD Act, hence, it has to be treated as established by the UPIAD Act. The Assessee alternatively referred to sub clauses of section 194A(3)(iii) (which refers to Life Insurance Corporation of India established under the Life Insurance Corporation Act, 1956 and Unit Trust of India established under the Unit Trust of India Act, 1963) to contend that the words 'by' and 'under' have been used interchangeably under the IT Act itself, thus, even if NOIDA is established under UPIAD Act, it should be eligible to claim relief under the Notification.

DECISION

The SC upheld the decision of HC and held that NOIDA was eligible to claim the benefit of Notification. The SC relied on the decision of *S.S. Dhanoa*[2] to hold that corporation established by or under an Act of legislature means a body corporate which owes its existence and not merely its corporate status to the Act. The SC also relied on a Constitution bench decision in *Sukhdev Singh and Others*,[3] to hold that statutory corporations owe their existence from "by or under" statute, and non-statutory bodies and corporations are not created by or under statute rather are governed by a statute. The court also relied on the judgment in *Dalco Engineering Private Limited*[4] to explain the difference between statutory and non-statutory corporations through an example; a company does not owe its existence to the Companies Act but is governed under the provisions of the Companies Act, whereas National Company Law Tribunal and National Company Law Appellate Tribunal are the statutory authorities which are established by Companies Act and owe their existence to the Companies Act.

The SC, thus held that when the words "by and under the act" are preceded by the words 'established', it is clear that reference is to a statutory corporation. The SC based on the above observations, held that NOIDA owes its existence to UPIAD Act and hence, was established by the UPIAD Act. The SC further observed that the fact that composition of NOIDA was statutorily provided in section 3 of UPIAD Act itself, further strengthens the fact that NOIDA was established by UPIAD Act. Accordingly, it was held that, NOIDA was covered under the Notification and Assessee was right in not deducting tax at source while making interest payments to NOIDA.

SIGNIFICANT TAKEAWAYS

The decision of the SC is consistent with the judicial pronouncements on the issue and it reaffirms the difference between a corporation established "by or under" an Act and a corporation governed under an Act. The judgment manifests the rule of purposive interpretation and observes that while the provisions of a tax statute are to be interpreted strictly, but where literal interpretation leads to any manifestly unjust result, the courts may interpret the language used by the legislature in a way so as to produce a rational construction. Thus, it is vital that a statute should be read as a whole, i.e. every section should be construed with reference to the context and other surrounding provisions in order to best gather the intention of the legislature.

This is a welcome ruling clearing the cloud of uncertainties that other similarly situated authorities as the Assessee may be facing. The SC has clarified in clear terms that no tax is to be deducted at source while making interest payments to statutory corporations. The relevant fact for ascertaining if a corporation is a statutory corporation, is not the nomenclature used in the statute but instead if the concerned corporation owes its existence to the statute or is merely governed by the statute. If a corporation owes its existence to a statute, it should be regarded as a statutory corporation and should, therefore, be eligible to relief under the Notification.

[2] S.S. Dhanoa v. Municipal Corporation, Delhi and Ors., (1981) 3 SCC 431 (SC).
[3] Sukhdev Singh and Others v. Bhagatram Sardar Singh and Anr., (1975) 1 SCC 421 (SC).
[4] Dalco Engineering Private Limited v. Satish Prabhakar Padhye and Ors., (2010) 4 SCC 378 (SC).

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INCOME OF STATE HOUSING BOARDS AND DEVELOPMENT AUTHORITIES NOT EXEMPTED FROM TAXATION UNDER THE IT ACT

In ***New Okhla Industrial Development Authority***[1] ("**NOIDA**"), the SC held that Greater NOIDA and NOIDA are not local authorities within the meaning of section 10(20) of the IT Act. Thus, as regards the payment of rent to Greater NOIDA and NOIDA, the company was required to deduct tax at source. Further, amounts payable towards interest on the payment of lump sum lease premium were not amenable to tax deduction at source.

FACTS

Rajesh Projects India Pvt. Ltd. ("**Assessee**") was a private limited company engaged in the business of real estate activities of constructing, selling residential units etc. The Assessee entered into a long-term lease for 90 years with the Greater NOIDA for development and marketing of group flats. As per the terms of the lease, the company partially paid the consideration amount for the acquisition of the plot to Greater NOIDA at the time of execution of lease deed and was making payments towards the balance lease premium, annually. Notice under section 201/201(A) was issued by the IRA for show cause regarding non deduction of tax at source under section 194-I of the IT Act from the annual lease rent paid to Greater NOIDA and proposing to treat it as assessee-in default. The Assessee did not deduct tax at source under section 194-I of the IT Act on being advised by Greater NOIDA and NOIDA that they are 'local authority' under section 10(20) of the IT Act, hence the provisions relating to tax deduction at source were not applicable. The AO held the Assessee as assessee-in-default for the AY 2010-2011 and 2011-2012 for non-deduction/non-deposit of TDS on account of payment of lease rent and interest made to Greater NOIDA. Aggrieved by the order of the AO, the Assessee filed an appeal before the CIT(A) for stay of the demand, which was refused and recovery proceedings were initiated.

Simultaneously, the Assessee filed a writ petition with the Delhi HC praying that it should not be treated as assessee-in-default for failure to deduct tax at source, in respect of payment of lease rent and in respect of other charges paid to Greater NOIDA. The HC ruled that Greater NOIDA and NOIDA are not 'local authorities' within the meaning of section 10(20) of the IT Act, thus the Assessee was liable to deduct tax at source. Further, the HC also held that amounts which are payable towards interest on the payment of lump sum lease premium, in terms of the lease which are covered by section 194A are covered by the exemption under section 194A(3)(f) and therefore, not subject to tax deduction at source.

> **Greater NOIDA and NOIDA are not local authorities under the IT Act, hence, tax required to be deducted at source on payment of annual lease rent to these bodies.**

Aggrieved by the decision of the HC, Greater NOIDA, NOIDA and IRA preferred the appeal in the SC, which were clubbed before the SC.

ISSUE

Whether Greater NOIDA and NOIDA constitute 'local authorities' within the meaning of section 10(20) of the IT Act, consequently their income was exempt for taxation under IT Act? Whether the payment of annual lease rent by the Assessee was subject to TDS under section 194-I of the IT Act?

ARGUMENTS

It was contended by the Assessee that Greater NOIDA and NOIDA had been constituted under section 3 of the Uttar Pradesh Industrial Area Development Act,

[1] New Okhla Industrial Development Authority v. CIT(A) and Ors., (2018) 406 ITR 209 (SC).

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1976 ("**UPIAD Act**") and thus were 'local authorities' under section 10(20) of the IT Act. It was contended that by virtue of notification issued by Governor of Uttar Pradesh under Article 243Q(1) of the Constitution of India, both Greater NOIDA and NOIDA are municipalities and thus covered under the expression 'local authority' as explained under Explanation to section 10(20) of the IT Act.

Reliance was also placed on Circular No. 35/2016 wherein it was clarified that provision of section 194-I of the IT Act on lump-sum lease premium or one time upfront lease charges, which are not adjustable against periodic rent, paid or payable for acquisition of long-term leasehold rights over land or any other property were not payments in the nature of rent within the meaning of section 194-I and thus, such payments were not liable to tax deduction at source under section 194-I of the IT Act.

Section 194A provided that any individual responsible for paying income by way of interest, 'other than interest on securities' was liable to deduct tax at source. Section 194A(3)(iii)(f) of the IT Act, provided that the Central Government would notify the institutions, the income of which shall not be subject to tax deduction at source under section 194A of the IT Act. Thus, Greater NOIDA and NOIDA were exempted from tax, on the payment of interest by virtue of Notification dated 22.10.1970 issued under section 194A(3)(iii)(f).

The IRA on the other hand contended that Greater NOIDA and NOIDA were not local authorities within the meaning of section 10(20) by virtue of amendment to section 10(20) of the IT Act vide Finance Act, 2002 w.e.f. April 1, 2003. The IRA further relied on the judgment on the Allahabad HC in the case of *New Okhla Industrial Development Authority*,[2] wherein it was held that NOIDA was not a local authority within the meaning of section 10(20) of the IT Act as amended by the Finance Act, 2002. It is worth mentioning that appeal was filed by NOIDA against the said judgment before the SC in Civil Appeal No. 792-793 of 2014[3].

DECISION

The SC had held that NOIDA is not a local authority within the meaning of section 10(20) of the IT Act by virtue of judgment by SC in Civil Appeal No. 792-793 of 2014[3], wherein it was observed that Constitution of India did not recognize industrial township as referred to in proviso to Article 243Q, as being equivalent to a municipality. Further, the notification under the proviso to Article 243Q dated 24.12.2001 itself indicated that no municipality has been constituted in the area in which NOIDA operated. The Authority clearly was not a 'local authority'. The Finance Act, 2002 made substantial changes in the definition of 'local authority' by defining 'local authority' exclusively and by omitting section 10(20A), the benefits earlier enjoyed by various authorities which were treated as 'local authorities' were taken away. The provisions of section 10(20) were clear and taking plain and literal meaning of the provision, NOIDA was not entitled for exemption under section 10(20) of the IT Act.

With respect to the payment made by the Assessee as annual rent, tax shall be deducted at source on the payment of the lease rent to Greater NOIDA as per section 194-I. The SC stated that section 10(20) was amended by Finance Act, 2002, by adding an explanation and further section 10(20A) had been omitted w.e.f. 01.04.2003. Thus, the contention of the authorities that there was no requirement of TDS did not stand its ground. The SC held that TDS on payment of rent was clearly the statutory liability of the Assessee.

Insofar as payments made towards interest is concerned, the SC held that Greater NOIDA and NOIDA were covered under the exemption provided under section 194A(3)(iii)(f) of the IT Act by virtue of earlier judgment by the SC in the case of *Canara Bank*.[4] Thus, amounts which were payable towards interest on the payment of lump sum lease premium, in terms of the lease which are covered by section 194A of the IT Act were covered by the exemption under section 194A(3)(iii)(f) of the IT Act and, therefore, not subjected to TDS. Therefore, the SC upheld the decision of the Delhi HC.

[2] New Okhla Industrial Development Authority v. CIT and Ors., Writ Petition Tax No. 1338 of 2005 dated 28.02.2011 (Allahabad HC).
[3] New Okhla Industrial Development Authority v. CIT and Ors., (2018) 406 ITR 178 (SC).
[4] *Ibid.*
[5] CIT (TDS) Kanpur and Anr. v. Canara Bank, (2018) 406 ITR 161 (SC).

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SIGNIFICANT TAKEAWAYS

Section 10 of the IT Act provides for income which are not included in total income for the purpose of taxation. Section 10(20) provided that the income of a local authority which is chargeable under the head 'income from house property', 'capital gains' or 'income from other sources' or from a trade or business carried on by it which accrues or arises from the supply of commodity or service within its own jurisdictional area or from the supply of water or electricity within or outside its own jurisdictional area shall be exempt from taxation under the IT Act.

The Finance Act, 2002 amended section 10(20) of IT Act by inserting an Explanation to the said provision with effect from April 1, 2003. The amendment made by Finance Act, 2002 added an exhaustive definition of 'local authority' in the Explanation to the said provision. The amendment provided that the exemption has been restricted to the Panchayats and Municipalities as referred to in Articles 243(d) and 243(p)(e) of the Constitution of India respectively. Municipal Committees and District Boards, legally entitled to or entrusted by the Government with the control or management of a Municipal or a local fund and Cantonment Boards as defined under section 3 of the Cantonments Act, 1924 were also included under the expression of 'local authority' within section 10(20) of the IT Act.

Under the existing provisions contained in section 10(20A) of the IT Act, income of the housing boards or other statutory authorities set up for the purpose of dealing with or satisfying the need for housing accommodations or for the purpose of planning, development or improvement of cities, towns and villages was exempt from payment of income tax. Through Finance Act, 2002, section 10(20A) of the IT Act was deleted so as to withdraw exemption available to the abovementioned bodies. The income of housing boards and development authorities of the States would, therefore, become taxable in their respective hands.

Thus, Greater NOIDA and NOIDA were held to be outside the purview of 'local authorities' within the meaning of section 10(20) of the IT Act. Hence, if any person enters into a contract with these authorities, and makes payment on which tax is required to be deducted at source under the IT Act, such persons would be required to deduct tax at source while making the payments.

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IBC WILL OVERRIDE ANYTHING INCONSISTENT CONTAINED IN ANY OTHER ENACTMENT

The SC has, in the case of ***Monnet Ispat and Energy Limited***,[1] has held that the IBC will override anything inconsistent contained in any other enactment, including the IT Act and has accordingly, upheld the Delhi HC judgment[2] wherein it was held that the moratorium period under section 14 of IBC would also apply to the order of the ITAT in respect of the tax liability of the assessee.

FACTS

NCLT had admitted a petition filed by SBI, under section 7 of IBC, against Monnet Ispat and Energy Limited ("**Assessee**") and prohibited 'the institution of suits or continuation of pending suits or proceedings'. The Delhi HC held that the moratorium under section 14 of IBC would also apply to the appeal(s) filed by IRA against the order of the ITAT in respect of the tax liability of the assessee. Thereafter, the PCIT filed an SLP before the SC.

Moratorium under section 14 of IBC is also applicable on ITAT orders.

ARGUMENTS

The IRA had argued before the Delhi HC that unlike some of the previous insolvency laws, IBC does not envisage permission being sought from NCLT for the continuation of proceedings pending against the Assessee. The Assessee, on the other hand, had argued that the moratorium period under section 14(1) of IBC continues till the completion of the insolvency resolution process or until this Bench approves the resolution plan under sub-section (1) of section 31 or passes an order for liquidation of corporate debtor under section 33, as the case may be.

DECISION

Section 14(1) of IBC provides that on the insolvency commencement date, NCLT shall by order, declare moratorium, prohibiting 'the institution of suits or continuation of pending suits or proceedings against the corporate debtor including execution of any judgment, decree or order in any court of law, tribunal, arbitration panel or other authority'. This moratorium period shall have effect from the date of such order till the completion of the corporate insolvency resolution process. The Delhi HC, relying on the *Innoventive Industries case*,[3] had held that the moratorium period would extend to appeals proposed to be filed by the IRA against ITAT orders also.

The SC analyzed the judgment in the case of *Bhikhbhai Prabhudas Parekh & Co*,[4] where the issue was whether the recovery of sales tax dues amounting to crown debt, would have precedence over the right of the bank to proceed against the property of the borrowers mortgaged in favour of the bank. The SC in *Bhikhbhai Prabhudas Parekh & Co* had decided that the common law doctrine of priority of crown debts would not extend to providing preference to crown debts over secured private debts.

In *Monnet Ispat,* the SC reiterated the same principle and also held that given section 238 of the IBC, it is obvious that IBC will override anything inconsistent contained in any other enactment, including the IT Act. Referring to *Bhikhbhai Prabhudas Parekh & Co,* it observed that income tax dues, being in the nature of crown debts, do not take precedence even over secured creditors, who are private persons. The SC also categorically upheld the position taken by the Delhi HC in its 2017 decision.

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1 Principal CIT v. Monnet Ispat & Energy Ltd., 2018 SCC OnLine SC 984 (SC).
2 Principal CIT v. Monnet Ispat & Energy Ltd., IT Appeal Nos. 533 to 552 and 554 of 2017 (Delhi HC).
3 Innoventive Industries Ltd. v. ICICI Bank, Civil Appeal Nos. 8337-& 8338 of 2017 (Delhi HC).
4 Dena Bank v. Bhikhbhai Prabhudas Parekh & Co. and Ors., (2000) 5 SCC 694 (SC).

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SIGNIFICANT TAKEAWAYS

The decision of the SC is in line with section 14 of IBC, which is aimed at keeping the corporate debtor's assets together during the insolvency resolution process and to facilitate the orderly completion of the processes envisaged during the insolvency resolution process.[5] A fair assessment of the corporate debtor's financial position will ensure that the result of the insolvency proceedings is in the best interests of the corporate debtor as well as all the creditors.

It may also be pointed out that in terms of section 14(3) of IBC, the Central Government may, in consultation with any financial regulator, notify certain transactions to which section 14(1) shall not apply.

While no suit can be filed against the corporate debtor during the moratorium period, the parties are entitled to file a suit against the corporate debtor, post the completion of such moratorium period, in cases where the resolution process is not fructified. For this purpose, the moratorium period shall be excluded in the computation of the limitation period specified for any suit or application by or against a corporate debtor for which such moratorium order has been made, under section 60(6) of IBC.

[5] Ministry of Corporate Affairs, Report of the Insolvency Law Committee, March 2018, paragraph 5.2, available at http://www.mca.gov.in/Ministry/pdf/ILRReport2603_03042018.pdf.

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SC UPHOLDS AUTHORITY OF IRA TO GRANT STAY OF DEMAND ON PAYMENT OF LESS THAN 20% OF THE DISPUTED TAX DEMAND

In the case of ***LG Electronics India***,*[1]* the SC had held that the Office Memorandum of the CBDT dated 31 July, 2017 in F. No. 404/72/93-ITCC "**CBDT Circular**" permits the AO to grant stay on collection of disputed tax demand, upon receipt of an amount which is lesser than 20% of such demand as prescribed by the CBDT Circular.

FACTS

In the matter of LG electronics India ("**Assessee**"), the AO had passed an assessment order for AY 2007-2008, dated 30 June 2017, levying a tax demand of INR 32,00,07,958 and also penalty under Section 271(1)(c) of the IT Act. The demand was to be paid by 31 July 2017.

Against the aforesaid order, the Assessee filed an appeal before the CIT(A) and simultaneously filed an application for stay of demand with the AO. The AO, vide order 20 July 2017, asked the Assessee to pay 15% of the total tax demand as per the guidelines under Office Memorandum of the CBDT dated 29 February, 2016.

> **"In specific situations, tax authorities may grant a stay on the payment of a lower percentage of the outstanding tax demand."**

The Assessee filed an application before the PCIT, requesting for reconsideration of the order of AO staying the tax demand. The PCIT, vide order dated 2 August, 2017, asked the Assessee to pay 20% of the tax demand as per the CBDT Circular. The demand was stayed up to 15 December, 2017 subject to the said payment.

The aforesaid order of the PCIT was challenged by the Assessee before the Delhi HC by way of a writ petition (6778 of 2017). The Delhi HC, in an order dated 08 August, 2017, set aside the order passed by the PCIT on account of the order having no reference to the central issue in the pending appeal, being short of reasons and, therefore, unsustainable in law. Thus, the HC directed the PCIT to hear the appeal on merits and not merely rely on the CBDT Circular. Further, the HC also directed the CIT(A) to consider Assessee's request for an expeditious disposal of the pending appeal.

Against the order of the Delhi HC, the IRA filed a SLP before the SC.

ARGUMENTS

In the arguments advanced before the SC, the IRA had conceded to the discretion available with the PCIT in granting stay on the disputed demand.

DECISION

The SC decided the matter in favour of the Assessee. In its order, the SC, held that in all cases where there is a disputed tax demand, the IRA can exercise discretion and order for a payment of a lesser percentage of the outstanding tax demand.

The reasoning behind the order of the SC was primarily the argument advanced by the Petitioners themselves, wherein, the appellants had stated that the circulars issued by the CBDT are administrative circulars while the concerned tax authorities who are examining the stay applications submitted by the taxpayers are quasi-judicial authorities. Therefore, the

[1] PCIT and Ors. v. LG Electronics India (P) (Ltd), Civil appeal no. 6850 of 2018 (SC).

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Circular cannot have a restraining impact on the powers of the IRA to grant stay on payment of lower percentage of the outstanding tax demand amount.

SIGNIFICANT TAKEAWAYS

The aforesaid order of the SC has a significant positive impact on interpretation of the stay guidelines issued by the CBDT Circular. While the guidelines have provided for a standard payment of 20% of the disputed tax demand, depending on the case made by the Assessee while applying for stay of demand, it had permitted the IRA to grant a stay of demand on payment of a lower sum.

The order also comes as a relief for assessees undergoing high-pitched assessments. For instance, in the present case, the tax demand raised was of INR 32 crores of which 20% was payable, which amounted to INR 6.4 crores, which is a significant amount in itself. In a scenario where the assessee presents a convincing case about its inability to pay such high amounts, demand can be stayed on a payment of any amount less than 20% of the tax demand.

A similar discretion has also been upheld by the Madras HC in its judgement in the case of *Samms Juke Box*.[2] In this case, the assessee argued that the demand was unduly high-pitched and the income of the assessee was 1/4th of the tax demand raised. On applying for stay, the assessee was asked to furnish 20% of the tax demand, as against an absolute stay requested by the assessee. The IRA did not consider the facts presented by the assessee. The assessee had drawn the attention of the IRA on their financial position and prejudice being caused to them on account of it being a high pitched assessment. The Madras HC observed that the CBDT Circular, fixing the standard as 20% of demand, does not completely oust the jurisdiction of the AO to examine the case of the assessee while considering their application for stay of demand. The HC observed that though the CBDT Circular appears to fix a percentage of tax to be paid for being entitled to an order of stay (i.e. 20%), an exception has been clearly carved out in the very same CBDT Circular. As per this exception, the IRA is required to consider whether the petitioner has made out a *prima facie* case for grant of interim relief.

In the light of these orders by the SC and the Madras HC, aspects regarding obtaining stay of disputed tax demands basis the CBDT Circular have been clarified. Assessees undergoing high pitched assessments or facing difficulty in their ability to pay the disputed tax demand should be able to rely on these decisions and claim benefit on account of the beneficial interpretation of the CBDT Circular, adopted by the Courts.

[2] Samms Juke Box v. ACIT, Non Corporate Circle – 14(1), Chennai (2018) 95 taxmann.com 247 (Madras HC).

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HC DISMISSES WRIT CHALLENGING THE REASSESSMENT IN THE NATIONAL HERALD CASE

In the case of ***Sonia Gandhi***,[1] the Delhi HC dismissed the writ petition challenging the reassessment of the taxpayers and held that in the facts and circumstances of the case, non-disclosure of allotment of shares in a company could be a sufficient reason to initiate reassessment proceedings and such reassessment cannot be regarded as mere 'change of opinion'.

FACTS

The Indian National Congress ("**INC**") had advanced INR 90 crores to Associated Journals Ltd ("**AJL**"). In the meanwhile, a charitable non-profit company "Young Indian" ("**YI**") was incorporated under section 25 of the Companies Act, 2013. Subsequently, Mr. Rahul Gandhi ("**Assessee 1**") and Mr. Oscar Fernandes ("**Assessee 2**") were nominated as directors and ordinary members of YI respectively.

"Exemption from 56(2)(vii) should not extend to all benefits on acquiring shares in relation to a non for profit company, which may or may not undertake commercial activities."

Following the incorporation of YI, INC assigned the loan amounting to INR 90 crores receivable from AJL to YI for a consideration of INR 1 crore.

Subsequently, shares of existing shareholders of YI were transferred to Mrs. Sonia Gandhi ("**Assessee 3**") and Assessee 2. Further, YI allotted shares to Assessee 1 Assessee 2 and Assessee 3 ("collectively referred to as **Assesses**"), for a nominal price. Following this, AJL allotted 9.02 crore equity shares to YI. Furthermore, YI was granted exemption under section 12AA of the IT Act being an organisation engaged in charitable activities.

For AY 2011-12, while the return of income filed by Assessee 2 and 3 were accepted, the return of income filed by Assessee 1 was accepted after a scrutiny order made by the AO under section 143(3) of the IT Act. On March 31, 2018, Assessee 1 received an e-mail from the AO, intimating that notice for reassessment under section 148 of the IT Act was issued, which was eventually received through speed post on April 2, 2018. The AO furnished 'reasons to believe' for such assessments, alleging that the difference between the 'Fair Market Value' ("**FMV**") of the shares of the YI and the cost of acquisition of those shares by Assessee 1 was taxable as other income under section 56 of the IT Act. The AO placed reliance upon a letter written by the Department of Investigation and a Tax Evasion Petition ("**TEP**") addressed to the Finance Minister by Subramanian Swamy. Similarly, the reassessment proceedings were initiated against Assessee 2 and Assessee 3, as well. The Assessees moved the Delhi HC for exercise of its writ jurisdiction, to quash the reassessment notice, on the grounds that no income had escaped assessment.

ISSUE

Whether in the fact and circumstances of the case, the reassessment notice issued to the Assessees under section 148 of the IT Act, were liable to be quashed?

ARGUMENTS

The IRA placed its reliance on various judgements and argued that the HC's scope of judicial review over reassessment notices, was limited to ensuring that reasons for reassessment are recorded and the same are based on tangible evidence. The IRA also contended that the reassessment in the present case was based on the investigation report received post the regular assessment of the Assessee, along with other documents and information accumulated by the

[1] Sonia Gandhi v. ACIT, W.P. (C) 8482/2018 (Delhi HC).

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AO pursuant to the enquiry conducted by him. Further, such reasons were appropriately approved by the competent authority as required under the IT Act. Thus, it was argued by the IRA that reassessment notices should not be quashed as they were issued in accordance with the provisions of the IT Act.

The IRA also argued that incorrect information was furnished during the scrutiny assessment of Assessee 1, to the extent he represented that he was not a director in any other company (including YI). Further, the IRA contested that applying the provision of section 56(2)(vii)(c) of the IT Act, read with Rule 11UA of the IT Rules, it was apparent that income had accrued to the Assessees and the same had escaped taxation and accordingly, the reassessment notices issued to the Assessees were justified and valid in law.

The Assessees on the other hand argued that they were shareholders of YI, a non-profit company, therefore, in accordance with the Companies Act, 2013, they were under no obligation to disclose the value of their respective shareholding. It was further argued that akin to a beneficiary of a trust, who has no interest in the trust, apart from receiving income, the director of a not for profit company does not have any beneficial interest in the company. Thus, the Assessees argued that Assessee 1 had no interest which was required to be disclosed, as required by the IRA. It was also asserted that all relevant questions were raised and satisfactorily addressed the scrutiny assessment of Assessee 1 and in absence of any tangible evidence, the impugned reassessment should be quashed.

Further, it was argued that section 56(2)(vii) of the IT Act was not applicable in the present case i.e. where shares are received from YI (being an institution registered under section 12AA of the IT Act) as section 56(2)(vii) of the IT Act specifically exempts receipt of any property by an individual from any Trust or institution, including an institution registered under section 12(AA) of the IT Act, from its ambit.

It was also contended by the Assesses that the re-opening was based on material (investigation reports and TEP) which was lying with IRA over 2 years before re-opening the case and, therefore, it was inexplicable why the AO waited until the last day of limitation i.e. March 31, 2018 to record her 'reason to believe' and obtain the approval of the concerned authority. Therefore, it was contested that the reassessment of the Assessees constituted mala fide exercise of power and non-application of mind by the AO, making the said proceedings liable to be quashed.

DECISION

Firstly, the HC held that the reassessment notice was valid and could not be said to constitute a mala fide exercise of power as the AO had issued the reassessment notice based on the investigation report and TEP, along with other documents and information accumulated by the AO. Thus, the HC rejected the argument of the Assessees that reassessment of the Assessees constituted mala fide exercise of power and non- application of mind, only because IRA waited over the investigation reports and TEP for over 2 years before re-opening the case, on the last day of limitation. The HC placed reliance on various judgments[2] and observed that while exercising judicial review, what is relevant is that whether the AO relied and placed on record the relevant material for the purpose of reopening an assessment. The Court observed that in absence if any specific allegation of personal mala fides against any official, the mere circumstance that reassessment notice was issued on the last date of limitation would not vitiate the notice or the proceedings.

Similarly, the Court also held that since the PCIT had recorded its approval for issuing such notice, it was adequate for issuance of reassessment notice and in accordance with the provisions of section 151 of the IT Act.

The HC also rejected the argument of the Assessee 1 that, he was under no obligation to disclose his acquisition in YI, being a director of a company incorporated under section 25 of the Companies Act, 2013. The HC perused the relevant provisions of section 25 of the Companies Act, 2013 and related notifications and held that the exemption from disclosure, as provided for in section 25(6) of the Companies Act, did not relieve the shareholders or directors of such company, of their obligations in their individual capacity, to make disclosure to other

[2] ITO v. Purushottam Das Bangur, (1997) 224 ITR 362 (SC); Phool Chand Bajrang Lal v. ITO, (1993) 203 ITR 456 (SC); ITO v. Selected Dalurband Coal Company Pvt. Ltd., 1997 (10) SCC 68 (SC).

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statutory authorities, including the IRA. The HC also clarified that the nature of such exemptions are with respect to the duties of directors to disclose one or the other issue pertaining to their duties and in regard to affairs of the company.

The HC also added that unless that income or information related to it is exempted from the provisions of taxation laws which enact individual taxation events, it cannot prima facie be held that an individual is exempted from disclosing his or her interest in the acquisition of shares in the not-for-profit company.

Further, the HC perused the section 56(2)(vii) of the IT Act, which provides that where an individual or HUF receives any property for a value less than the FMV of such property, then the difference between the said values would be taxable in the hands of such recipient. The HC further noted that section 56(2)(vii) of the IT Act, *inter alia*, carves out an exception for cases where the property was received form an institution/trust registered under section 12AA of the IT Act. The HC held that having regard to all the recipient who have been exempted from the rigors of section 56(2) (vii) of the IT Act (which include property received from a *relative, on the occasion of the marriage of the individual, under a will or by way of inheritance, in contemplation of death of the payer or donor etc.)*, it can be observed that these are generally beneficiaries for whom the charitable trust (or not-for-profit) is created. Accordingly, the deemed income otherwise arising under section 56(2)(vii) would be inapplicable to the benefits or amounts received by such beneficiaries. In light of the above observations, the HC rejected the argument of the Assesses that the exemption from the provision to section 56(2)(vii) would apply to all benefits on acquiring shares in relation to not-for-profit companies (which may or may not undertake commercial operations) registered under section 12AA of the IT Act and accordingly the Assessee's argument regarding the non-disclosure of the acquisition on account of taxability at that stage was found unpersuasive.

Thus, in light of the above the HC held that reassessment notice and the proceedings are valid and accordingly dismissed the writ petition. Having said the above, the HC clarified that the aforementioned observation are not conclusive and the Assessees would have the right to come up with these and other arguments during the tax proceedings.

SIGNIFICANT TAKEAWAYS

In the present case, the HC while dealing with the validity of reassessment notice issued under section 148 of the IT Act held that the AO had sufficient reason to believe that income had escaped assessment on account of deemed income arising under section 56(2)(vii) of the IT Act at the time of issue of shares. This may raise the question that whether issue of share for a value less than the FMV of the said shares would be subject to tax on the difference of the said values, under section 56(2)(vii) of the IT Act (which is similar to section 56(2)(x) under the existing provisions).

Because of the Assessees involved, this litigation is being examined by a number of people and is likely to put pressure on the IRA to be extra cautious. It may also be relevant to note that the fair market value of the shares of a private and unlisted company as well as a not for profit company would be an important issue on which the final decision shall be waited with bated breath!

It must be noted that in the recent past the IRA have aggressively tried to tax such deemed income arising on issue of shares. The IRA has recently appealed against the Mumbai ITAT decision in the case of *Sudhir Menon HUF*,[3] where the ITAT held that provision of section 56(2)(vii) of the IT Act would not be applicable in a case of a rights issue, where the shares are allotted on a proportionate basis.

It is also pertinent to note that section 56(2)(vii) of the IT Act (or section 56(2)(x) as per the extant provisions), were introduced as an anti-avoidance provisions, hence applying such provisions to genuine business transactions is unwarranted, therefore the validity of a reassessment notice in a case like this could also be challenged on its merits. A SLP against the decision of the HC has been filed before the SC. It will be interesting to see how this litigation unfolds before the SC.

[3] Sudhir Menon HUF v. CIT, SA No.192/MUM/2013 (Mumbai ITAT).

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WRIT PETITION FILED BEFORE MADRAS HC CHALLENGING THE CONSTITUTIONAL VALIDITY OF SECTION 94B OF THE IT ACT

Siemens Gamesa Renewable Power Pvt. Ltd., ("**Siemens Gamesa"** or **"the Petitioner**") has filed a writ petition before the Madras HC challenging the constitutional validity of the proviso to section 94B(1) of the IT Act, which was recently inserted in the IT Act, through Finance Act, 2017.

FACTS

Siemens Gamesa is a subsidiary of Siemens Gamesa Renewable Energy, which is a company incorporated in Spain. Siemens Gamesa has filed a writ petition before the Madras HC challenging the constitutional validity of proviso to section 94B(1) of the IT Act. The petition has been accepted by the HC and notice has been served to IRA.

Section 94B of the IT Act was inserted by Finance Act, 2017. This Section was added to the IT Act in pursuance of the BEPS Action Plan 4 of the OECD. BEPS Action Plan 4 acknowledges interest as one of the simplest and common mechanism of shifting profits from one jurisdiction to another. Thus, multinational companies use intra group debts to claim excessive deductions and thereby reducing their local profits within a particular jurisdiction.

Section 94B is triggered in circumstances where an Indian Company or PE of a foreign company in India, incurs an expenditure in the nature of interest in respect of any debt issued by a non-resident, which is also the AE of such Indian company or the PE. The monetary threshold of interest for triggering this section has been set at INR 1 crore.

> **Thin capitalization sees the first judicial challenge.**

Section 94B(2) of the IT Act provides that the quantum of interest that is allowable as deduction in such scenarios is 30% of earnings before interest, tax, depreciation and amortization. Further, the proviso to section 94B(1) of the IT Act, which forms the subject of the constitutional validity challenge in the writ petition, provides that where the debt has been issued by a non-resident lender, which is not an associate enterprise, but for which an implicit or explicit guarantee is provided by an associate enterprise of the Indian Company or the PE, such debt shall also be deemed to have been given by the AE only.

ISSUE

Whether the proviso to section 94B(1) is arbitrary and violates Article 14 and Article 19 of the Constitution of India and whether such classification created by means of the proviso to section 94B(1) lacks intelligible differentia.

ARGUMENTS

Siemens Gamesa has challenged the constitutionally validity of the proviso to section 94B(1) of the IT Act, on the following grounds:

Firstly, by way of Circular no. 2/2018, the CBDT has clarified that in case of resident borrower who obtains a loan from a non-resident, wherein the guarantee is provided by the AE, the interest on the loan will not be allowed as deduction. In such a case there is no possibility of BEPS. Thus, the entire jurisprudence behind enacting the section is failed in this proviso. Siemens Gamesa has argued that such a clarification is ambiguous and would lead to unnecessary increase in the tax burden of the tax payers.

Secondly, the Petitioner had argued that by enacting the proviso to section 94B(1), the legislature has created a distinct and separate class of taxpayers. Such distinction lacks 'intelligible differentia'. The

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enactment of the proviso has thus resulted in creation of distinction between similarly placed companies, merely because associate enterprises are involved, as a similarly placed company having more loans but without its AE furnishing guarantee would enjoy greater deductions and lesser tax burden, in contrast to a company with lesser loans, with its AE furnishing guarantee. Such a distinction has been argued as '*ex facie arbitrary*' by the Petitioner. Therefore, on the basis of such classification, if deduction of interest is disallowed, it would be unreasonable and in contravention of Article 14 and 19 of the Constitution of India.

Lastly, the Petitioner has also argued that Banks prefer guarantees from AEs of the resident companies due to ease of enforceability of the debts in case of default. The IRA should have considered the impact on the economic and monetary impact of the provision prior to enactment. This provision shall also put subsidiaries of multi-national entities compared to Indian multi-national enterprises.

DECISION

The writ petition is currently pending before the Madras HC. At present, notice has been served to the IRA with respect to writ filed.

SIGNIFICANT TAKEAWAYS

The proviso to section 94B has been the subject of critique on account of the unclear language. The challenge on the constitutional validity of this section has opened a new avenue of litigation and this uncertainty shall prevail until the position is settled by the courts. While it may not be completely denied that there is an underlying benefit derived by passive association, when the guarantee is furnished by the associated enterprise, thus the following questions assumes significance:

- Whether the classification is mandated by the underlying jurisprudence of the section and
- Whether this provision discriminates amongst different classes of taxpayers?

The question before Madras HC were essentially same as above. In the same sequence, it would also crucial for the courts to look into the ambiguous wording of the section.

For instance, the term '*implicit guarantee*' has not been defined in the aforesaid section and the ambiguity surrounding the term has been pointed out separately.[1] The interpretation to implicit guarantee can be derived from the OECD's draft on financial transactions guidelines[2], which states as follows:

"*142. By providing an explicit guarantee the guarantor is exposed to additional risk as it is legally committed to pay if the borrower defaults. Anything less than a legally binding commitment, such as a "letter of comfort" or other lesser form of credit support, involves no explicit assumption of risk. Each case will be dependent on its own facts and circumstances but generally, in the absence of an explicit guarantee, any expectation by any of the parties that other members of the MNE group will provide support to a related party in respect of its borrowings will be derived from the borrower's status as a member of the group. The benefit of any such support attributable to the borrower's group member status would arise from passive association and not from the provision of a service for which a fee would be payable.*"

Thus, it would be imperative for the Court to also comment on what constitutes implicit guarantee and whether an implicit guarantee of an AE can be a mechanism of BEPS for the multi-nationals.

Similarly, the proviso does not clarify whether the 'associated enterprise' mentioned in the proviso pertains to a non-resident AE only, or encompasses, within its ambit, resident AEs as well. The wide language of the proviso can result in a resident borrower who has obtained a loan from a resident buyer on a guarantee by a resident associated enterprise, also being covered under the ambit of section 94B of the IT Act, thereby watering down the purpose of the Section.

Alternatively, argument can also be made that the applicability of the proviso should be triggered only when the guarantee is actually invoked as against

[1] Shweta Gupta, Analysis of section 94B limiting interest deduction; available at: http://orange.taxsutra.com/articles/a67a2d81a7d8bf98c3b61244d00b5f/expert_article.
[2] Available at: https://www.oecd.org/tax/transfer-pricing/BEPS-actions-8-10-transfer-pricing-financial-transactions-discussion-draft-2018.pdf.

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merely giving of guarantee by the associated enterprise. This is so because where the guarantee has not been invoked, the provisions of section 94B merely becomes an additional burden on the borrower.

It is, therefore, expected that the HC will provide clarity in respect of such ambiguous provisions and depending on the outcome of this litigation, one would hope that the CBDT will clarify on all of these contentious points.

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COMMERCIAL EXPEDIENCY OF GROUP CONCERNS FOR SWAPPING OF TRANSACTIONS BY JOURNAL ENTRIES CONSTITUTES 'REASONABLE CAUSE' UNDER SECTION 273B OF THE IT ACT

In ***Lodha Properties Development Pvt. Ltd.***,[1] the SC had held that accepting/repaying loans through journal entries aimed at extinguishment of mutual liabilities cannot be considered as a transaction undertaken in contravention of section 269SS and 269T of the IT Act, which restricts accepting and repaying a loan or advance otherwise than by an accounts payee cheque/ draft/electronic mode of transfer through a bank account. It held that undertaking transactions through journal entries constitutes a 'reasonable cause' under section 273B of the IT Act.

FACTS

Lodha Properties Pvt. Ltd. ("**Assessee**") was engaged in the business of land development and construction of real estate properties. It filed return of income for the AY 2009-10 declaring the total income as nil. During the course of assessment proceedings, the AO noted that the Assessee had accepted/repaid loans from various sister concerns entirely through journal entries. The Assessee was asked to show cause as to why it should not be held liable for violating the provisions of section 269SS and 269T of the IT Act, which prohibits any person from accepting and repaying the loans in a mode otherwise than by account payee cheque/ draft. The Assessee responded that the loans/ transactions were made with the sister concerns only and stated that section 269SS/269T of the IT Act would get attracted only in cases where the loan was obtained through cash or its alternatives and not in the instant case. The AO rejected the contention and held that Assessee violated the provisions of section 269SS and 269T of the IT Act and levied penalty under section 271D and 271E of the IT Act.

Mere journal entries to adjust accounts payables and accounts receivables does not violate the provisions of section 269SS / 269T of the IT Act.

The CIT(A) confirmed the decision of the AO and the Assessee preferred an appeal before ITAT Mumbai, which looked into the commercial nature and occurrence of the transactions. ITAT held that the transaction by way of journal entries were in the normal course of the business operation of the group concerns. The ITAT observed that the AO had not made out in the assessment that any of the impugned transactions were aimed at non-commercial reasons and were outside the normal business operations and hence, deleted the penalty.

The IRA preferred an appeal before the Bombay HC[2] which concurred with the ITAT and held that no penalty could be imposed upon the Assessee as there was a reasonable cause in terms of section 273B of the IT Act for having received loans/deposits through journal entries and it was at the least a possible view in the facts of the case.

Subsequently, being aggrieved by the order of HC, the IRA filed the instant SLP.

ISSUE

Whether the acceptance and repayment of loans or advances through journal entries constituted

[1] SLP No. 42791/2018 dated December 10, 2018 (SC).
[2] CIT v. Ajitnath Hi-Tech Builders Pvt. Ltd., (2018) 92 taxmann.com 228 (Bombay HC).

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contravention of section 269SS and 269T of IT Act. If so, whether there existed 'reasonable cause' under section 273B in Assessee's case?

ARGUMENTS

The Assessee argued that the provisions of 269SS and 269T of the IT Act are essentially anti-abuse provisions and were introduced to prevent the tax payers from undertaking cash transactions. In the instant case, it had received the loans by way of journal entries and there was no acceptance of cash. The core transactions were undertaken by way of cheque only and the Assessee resorted to the journal entries for transfer/assignment of loan among the group companies solely for business consideration. Assessee further argued that in case of journal entries, the liabilities were transferred/assigned by the group companies to the Assessee to take effect of actionable claims/ payments/received by group companies on behalf of the Assessee. The journal entries were also passed in the books of accounts for reimbursement of expenses and for sharing of the expenses within the group. Thus, the provisions of section 269SS and 269T of the Act had no application. It relied on the Madras HC ruling in the case of *Idhayam Publications Ltd*.,[3] wherein it was held that the deposit and the withdrawal of the money from the current account could not be considered as a loan or advance.

The Assessee further relied on the contents of CBDT Circular No. 387 of 1984,[4] which stated that the purpose of introduction of section 269SS of the IT Act was to curb cash transactions only and submitted that the same was not aimed at transfer of money by transfer / assignment of loans of other group companies. The Assessee further submitted tha as per section 273B of the IT Act, no penalty could be levied *inter alia* under section 269SS and 269T of the IT Act, if there was a reasonable cause. It substantiated its reasonable cause by submitting that all journal entries were bona fide and genuine, made with the group companies in order to avoid delay in procedural hassles of preparing cheque and obtaining signature of authorized person. Assessee further relied on the case of jurisdictional HC in *Triumph International Finance Ltd.,*[5] ("**Triumph**") and submitted that commercial expediency of group concerns was held to be an acceptable reason for squiring up/swapping of the transactions by passing the journal entries and therefore, it constituted a reasonable cause in Assessee's case as well.

On the other hand, the IRA argued that the genuineness of the transactions in the matters of impugned penalty proceedings was irrelevant and submitted that even otherwise the Assessee failed to establish the genuineness of the transactions. Reliance was placed on the case of *Triumph* which stated that where the loan/deposit were repaid by debiting the amount through journal entries, it must be held that the Assessee had contravened the provisions of section 269SS and 269T of the IT Act. Since journal entries constituted contravention of section 269SS and 269T of the IT Act, therefore, such contraventions attracted the penalty provisions of section 271D and 271E of the IT Act.

DECISION

The SC summarily dismissed SLP filed by the IRA, which re-established the findings of the HC and ITAT. It is worthwhile to note that ITAT placed reliance on the case of *Triumph* wherein it was held that receiving loans/deposits through journal entries would be in violation of section 269SS of the IT Act, however, the transactions in question were undertaken not with a view to receive loans/deposits in contravention of section 269SS of the IT Act but with a view to extinguish the mutual liability of paying / receiving the amounts by the Assessee and its sister concern to the customers. Further, neither the genuineness of the receipt of loan/deposit nor the transaction of repayment of loan by way of adjustment through book entries carried out in the ordinary course of business had been doubted in the regular assessment. Thus, ITAT held that as the transactions by way of journal entries were aimed at the extinguishment of the mutual liabilities between the Assessee and the sister concerns of the group, therefore, such reasons constituted a reasonable cause under section 273B of

[3] CIT v. Idhayam Publications Ltd., (2007) 163 taxmann.com 265 (Madras HC).
[4] CBDT Circular No. 387, dated July 6, 1984.
[5] CIT v. Triumph International Finance Ltd., (2012) 22 taxmann.com 138 (Bombay HC).

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the IT Act. Thus, ITAT deleted the penalty imposed under section 271D and 271E of the IT Act which was later sustained by the HC.

SIGNIFICANT TAKEAWAYS

Chapter XX-B of the IT Act titled 'Requirement as to mode of acceptance, payment or repayment in certain cases to counteract evasion of tax' was introduced through Income-Tax (Second Amendment) Act, 1981 with a view to curb tax evasion and black money. The chapter contains section 269SS/269T which debars acceptance/repayment of loan, otherwise than by account payee cheques/drafts. Section 271D of the IT Act levies the penalty for such violations and section 273B of the IT Act provides immunity against penalty on AO being satisfied about the existence of 'reasonable cause'. The IT Act does not define the term 'reasonable cause' and the application of the provision depends on the facts of each case.

The Bombay HC in the case of *Triumph* stated that the expression 'reasonable cause' used in section 273B of the IT Act had not been defined under the IT Act. Unlike the expression 'sufficient cause' used in section 249(3), 253(5) and 260A(2A) of the IT Act, the legislature has used the expression 'reasonable cause' in section 273B of the IT Act. A cause which is reasonable may not be a sufficient cause. Thus, the expression 'reasonable cause' would have wider connotation than the expression 'sufficient cause'. Therefore, the expression 'reasonable cause' in section 273B of the IT Act for the non-imposition of penalty under section 271D of the IT Act would have to be construed liberally depending upon the facts and circumstances of each case.

Madras HC in the case of *Balaji Traders*[6] stated that the deletion of penalty was justified in a case where: (i) creditors were genuine and transactions not doubted (ii) there was no revenue loss to the exchequer, and (iii) there was business exigency forcing the Assessee to take cash loan. In the case of *Omec Engineers,*[7] it was held that where there was no finding that transactions were not genuine and there was no malafide intention, then the penalty under section 271D/271E of the IT Act could not be sustained in law.

Thus, in the instant case as well ITAT was correct while observing that there was no point in issuing hundreds of account payee cheques/account payee bank drafts between the sister concerns of the group, when transactions could be accounted in books using journal entries, which was also an accepted mode of accounting. This is a welcome decision for the tax payers since they can undertake genuine business transactions, which did not involve unaccounted money, through journal entries and shall save unnecessary hassle of mandatorily routing the transactions through banking channels.

It must be noted that in spite of the number of cases wherein the Courts have reiterated the principle of business exigency being paramount to revoke any attempt by the tax authorities to levy penalty under sections 269SS / 269T of the IT Act, the IRA still seems to be hell bent on trying to invoke these provisions even in the case of genuine business transactions. This attitude of the IRA does not seem to be in line with the Government's enunciation of a tax friendly jurisdiction and presenting the tax authorities as friendly to the taxpayer.

[6] CIT v. Balaji Traders, (2008) 303 ITR 312 (Madras HC).
[7] Omec Engineers v. CIT, (2007) 294 ITR 599 (Jharkhand HC).

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TDS NOT APPLICABLE ON REIMBURSEMENT OF EXPENSES

The SC has, in the case of ***M/s Organizing Committee Hero Honda FIH World Cup***,[1] upheld the decision of the impugned Delhi HC wherein it was held that TDS under section 195 of the IT Act is not applicable on reimbursements.

FACTS

The Organizing Committee of the Hero Honda FIH World Cup (**"Assessee"**) entered into a contract with the Federation of International Hockey (**"FIH"**) for organizing the Men's Hockey World Cup in FY 2009-10. In terms of the contract, FIH was to act as the facilitator, receiving amounts and arranging for provisional services in connection with the event, i.e. services primarily concerned with travel, hospitality, food, etc. In view of the same, the Assessee had paid a sum of INR 41.76 Million to FIH for undertaking expenses on its behalf, without deducting any taxes.

The AO had held that FIH had used the said amount for making various payments on behalf of the Assessee, including the payment of commission to various non-residents, which were undisputedly taxable in India but no taxes were withheld under section 195 of the IT Act. Therefore, he proceeded to disallow such expenses in the hands of the Assessee by disallowing them under section 40(a)(I) of the IT Act.

The Assessee is not required to withhold taxes under section 195 of the IT Act on reimbursement of expenses incurred by a facilitator.

Thereafter, on an appeal filed by the Assessee, the CIT(A), ruled in favour of the Assessee by holding that the reimbursements claimed were of such nature that the Assessee could not have held an independent inquiry into each transaction to determine its taxability. The said decision was later affirmed by the ITAT.

Thereafter, the IRA filed an appeal before the Delhi HC. The said appeal was dismissed by the Delhi HC as there was no substantial question of law involved. It was also held that there was no privity of contract between the Assessee and the service provider and, therefore, the provisions of section 195 of the IT Act was not applicable on the said reimbursements.

Aggrieved by the decision of the HC, the IRA filed an SLP before the SC.

ISSUE

Whether the Assessee was required to withhold taxes under section 195 of the IT Act on the reimbursement of expenses to the payee?

ARGUMENTS

The IRA argued that the Assessee was required to deduct tax at source, under section 195 of the IT Act, on the reimbursements claimed by FIH for payments made on its behalf. It was argued that the pay-outs made by FIH also included commission, which were undisputedly taxable. Therefore, the Assessee had erred in not withholding tax at source on such commission payments. The IRA further submitted that it was the responsibility of the Assessee to conduct an independent inquiry into each of the transaction undertaken by the facilitator to determine if tax had to be deducted on source on any of the payments in order to undertake the necessary compliances.

The Assessee, on the other hand, argued that the payments made by it to FIH were in the nature of reimbursement of expenses and were duly supported

[1] Principal CIT Delhi L v. M/s Organizing Committee Hero Honda FIH World Cup, TS 660 SC 2018 (SC).

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by documentary evidence. Further, the reimbursements were such that the Assessee could not have held an independent inquiry into each transaction. The Assessee submitted that the responsibility of organizing the event rested solely with FIH and that it was not privy to the contracts that FIH had entered into with third parties for the purpose of organizing the event and was not authorized to hold enquiry into it as well since it did not have any privity of contract with the service provider.

DECISION

The Court had appreciated the critical fact that the Assessee did not have privity of contract with the facilitator/service provider to determine whether payments made by the facilitator were taxable or not and therefore held that the Assessee would not be required to withhold taxes under section 195 of the IT Act.

The Court had also upheld the finding of lower authorities that since FIH was merely undertaking the transactions on behalf of the Assessee and therefore, the amount reimbursed by the Assessee cannot be considered as income in the hands of FIH. Consequently, no disallowance can be made in the hands of the Assessee under section 40(a)(I) of the IT Act as it was not an income in the hands of FIH.

SIGNIFICANT TAKEAWAYS

This is a welcome decision as it appreciated the peculiar facts of the case i.e. the Assessee had organized the event through a facilitator and it did not have privity to the contracts entered into between the facilitator and third party service providers. Therefore, expecting the Assessee to undertake independent inquiry on the payments made by FIH, on which it had no control, for the purposes of undertaking withholding compliances, is unjustifiable.

It must be noted that the Court would have most likely held that the Assessee ought to have withheld the requisite taxes on the commission payments made to the non-residents, if the Assessee had undertaken the transaction on its own (i.e. without the facilitator), since the payments *per se* were taxable in India.

The Court had also appreciated the fact it cannot be considered as income in the hands of FIH since it had merely undertaken transaction on behalf of Assessee, as a facilitator.

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BENEFICIARY NOT LIABLE TO TAX ON INCOME OF A DISCRETIONARY TRUST UNLESS IT RECEIVES SOME DISTRIBUTION FROM SAID TRUST

In case of ***Deepak B Shah***,[1] the ITAT Mumbai held that income of a discretionary trust could be taxed in the hands of the beneficiaries only when such trust had made some distribution of income in favour of the discretionary beneficiaries. The ITAT further held that additions under section 69A of IT Act could not be made unless it was established that taxpayer was the owner of money, bullion, jewellery or other valuable articles.

FACTS

Deepak B Shah and Kunal N Shah (“**Assessees**”) filed their income tax returns for the assessment years 2006-07 and 2007-08 which were processed under section 143(1) of the IT Act. The IRA reopened the assessment for Assessees on the basis of an information received from a document provided by French Government to Indian Government containing details of Foreign Bank Accounts maintained by Indian nationals and residents which had not been disclosed to IRA. The IRA was of the view that Assessees had a foreign bank account but Assessees denied having any knowledge of any foreign bank account. Subsequently, it came to the knowledge of the AO that the said foreign bank account was held by a discretionary trust named Balsun Trust, created by a non-resident named Mr. Dipendu Bapalal Shah (“**Settlor**”) and Assessees were the beneficiaries of that trust.

The AO added the amounts lying in the said account in the hands of the Assessees. It is pertinent to note that in a separate proceeding, the same amount was added in the hands of the Settlor which was later deleted by ITAT in an order dated June 19, 2018 ("**Dipendu**")[2]. The ITAT held that the amount belonged to the non-resident Settlor and in absence of anything on record to suggest that the amounts lying in account had accrued or arisen in India, the amount could not have been taxed in the hands of the Settlor.

> **“Where the discretionary trust has not distributed any amount to the beneficiaries, income of the trust cannot be taxed in the hands of such beneficiaries.”**

ISSUES

Whether the additions in the hands of the Assessees under Section 69A of the IT Act were sustainable?

ARGUMENTS

The Assessees submitted that it was sine qua non for invocation of section 69A of the IT Act that the Assessees must be found to be the owners of money, bullion, jewellery etc. and the IRA have failed to establish that Assessee were the owners of the money in the foreign bank account. Instead, in the case of the Settlor, ITAT had held that Settlor was the owner of the money lying under the said the foreign bank account. Assessees contented that IRA had failed to prove the ownership qua the appellants and could not have shifted the onus of proof on the Assessees under the IT Act. The Assessees further argued that they, being the beneficiaries of a discretionary trust, had not received any distribution from the trust and hence, they could not have been subject to tax on such income of the trust.

The IRA contended that the affidavits of the Assessees, denying the ownership of money in

[1] Deepak B Shah v. ACIT, ITA No. 6065 & 6066/ Mum/2014 (Mumbai ITAT).
[2] DCIT v. Dipendu Bapalal Shah, (2018) 95 taxmann.com 171 (Mumbai ITAT).

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foreign bank account, and the Settlor were self-serving documents without any evidentiary value. The IRA relied on the information received from the French Government and submitted that because Assessees have refused to sign any consent paper, it is proved that Assessees have connection with the said bank account.

DECISION

The ITAT held that additions in the hands of the Assessees under Section 69A were not sustainable. While coming to such a conclusion, the ITAT relied on judicial precedents[3] to hold that Section 69A of the IT Act cannot be invoked unless it was established that assessee was the owner of money, bullion, jewellery or other valuable articles. The ITAT referred to the order in case of Dipendu, wherein it was held that Settlor was the owner of the money lying in the foreign bank account and deleted additions in the hands of the Assessees. ITAT relied on two SC judgments[4] and held that money could not have been taxed in the hands of the beneficiaries of the discretionary trust, unless the money was actually distributed to such beneficiaries by the discretionary trust. ITAT further held that the Assessees were not taxable for the income of the Balsun trust as said trust had neither distributed its income nor did the two Assessees receive any money by way of distribution.

SIGNIFICANT TAKEAWAYS

The ITAT ruling is consistent with the judicial pronouncements on the issue and reaffirms the principle that section 69A of the IT Act cannot be invoked unless it is proved that the assessee is the owner of the money, jewellery, valuable article etc. in question.

Under the IT Act, income of the trust is taxed in the hands of its representative assessee, i.e. the trustees. If the shares of the beneficiaries is specific, specific trust, then the trustee is liable to pay tax at the normal rate of tax as per section 161 of IT Act. However, if the shares of the beneficiaries are unknown or indeterminable as in discretionary trust, then the income is chargeable at maximum marginal rate as per section 164 of the IT Act. In *Neo Trust*,[5] the Gujarat HC held that where a specific trust was having individual and discretionary trust as its beneficiaries, the income of the trust was taxable in the hands of the trustees at maximum marginal rate to the extent of share of the beneficiary discretionary trust and at normal rate to the extent of share of individual beneficiaries.

Section 166 of the IT Act provides that the income taxable in the hands of the representative assessee does not prevent the IRA from directly assessing the person on whose behalf or for whose benefit income referred is receivable. In *Jyotendrasinhji*,[6] the SC after relying on another apex judgment in *C. R. Nagappa's*[7] held that by virtue of section 166 the IRA had an option in the case of the income of a discretionary trust to either make an assessment upon the trustees or upon the beneficiaries.[8] However, it is pertinent to note that the word used in section 166 is 'receivable' and in case of discretionary trust it cannot be said that the income is receivable for beneficiaries, as it is left to the discretion of the trustees to distribute or not to distribute the income to the beneficiaries. Thus, in cases of discretionary trust, income could be taxed in the hands of beneficiary only when such amount has actually been distributed to the beneficiaries. The ITAT ruling is a welcome ruling as it reiterates this principle and provides judicial certainty on the issue.

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[3] Durga Kamal Rice Mills v. CIT, (2003) 130 taxman 553 (Cal HC); CIT v. K.T.M.S. Mohamood, (1997) 92 taxman 169 (Madras HC).
[4] CIT v. Smt. Kamalini Khatau, (1994) 74 Taxman 392 (SC); Commissioner of Wealth Tax v. Estate of HMM Vikramsinhji of Gondal, (2014) 45 taxmann.com 552 (SC).
[5] Neo Trust v. ITO, (2015) 54 taxmann.com 1 (Gujarat HC); SLP granted, (2017) 79 taxmann.com 231 (SC).
[6] Jyotendrasinhji v. S.I. Tripathi, (1993) 201 ITR 611 (SC).
[7] C.R. Nagappa v. CIT, (1969) 73 ITR 626 (SC).
[8] CIT v. Smt. Kamalini Khatau, (1994) 74 Taxman 392 (SC).

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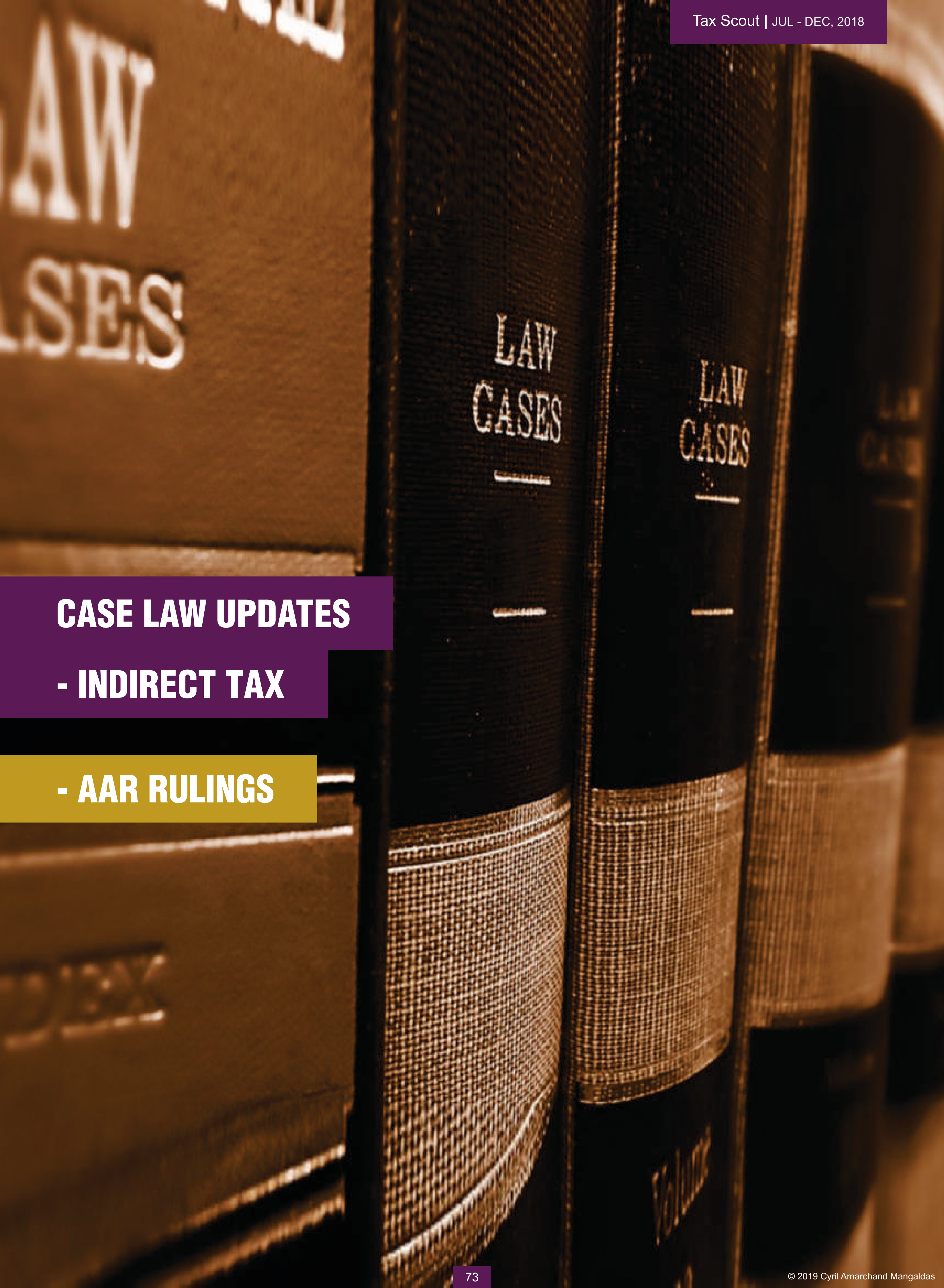

CASE LAW UPDATES

- INDIRECT TAX

- AAR RULINGS

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SUPPLY OF NON-ALCOHOLIC BEVERAGES TO SEZ UNITS DOES NOT QUALIFY AS ZERO-RATED SUPPLY

In ***M/s. Coffee Day Global Limited***,[1] the Karnataka AAR held that supply of non-alcoholic beverages and its ingredients to SEZ units for use in coffee vending machines was not zero-rated supply as defined under Section 16 of the IGST Act.

FACTS

M/s. Coffee Day Global Limited ("**Applicant**") was engaged in the supply of non-alcoholic beverages to SEZ units under two kinds of arrangements:

1. The Applicant prepared beverages using the beverage vending machines ("**Coffee Machine**(s)") installed at the premises of SEZ unit, using its own ingredients and charged on the basis of number of cups supplied.
2. The Applicant charged the SEZ unit for the ingredients supplied by it. The employees of the SEZ unit prepared the coffee themselves using Coffee Machines installed.

ISSUE

Whether the supply of non-alcoholic beverages to SEZ units using Coffee Machine was in the nature of zero-rated supply under the IGST Act?

ARGUMENTS

The Applicant contended that in terms of Section 16 of the IGST Act, all supplies of goods or/and services to SEZ units were to be unconditionally treated as zero-rated supplies. However, refund provisions under Rule 89 of the CGST Rules specified that refund of IGST paid on supplies to SEZ units shall be available only when the inputs supplied, were used for authorised operations of the SEZ unit. It is a settled principle of law that an act prevails over rules. Thus, the conditions mentioned in CGST Rules would not override the provisions of IGST Act.

Additionally, the Applicant relied upon rules of literal interpretation to argue that the phrase "any supplies", in Section 16 of IGST Act, included beverages and ingredients for beverages. Therefore, there was no restriction as to the utility of a supply made to a SEZ unit, in order for it to qualify as a zero-rated supply.

The Applicant also highlighted that the raising of invoice on a SEZ unit necessarily implied that supplies were zero-rated and, refund of input tax credit of IGST paid on such supplies was automatic. Imposition of the said condition as to utilisation for authorized operations was *ultra vires* the IGST Act.

DECISION

The AAR disagreed with the contentions of the Applicant that supply of beverages and its ingredients to SEZ units were to be treated as a zero-rated supply.

Supply of only authorised services and goods for authorised operation of SEZ would be treated as zero-rated supply.

The AAR referred to Section 4(2) of SEZ Act and observed that operations carried out in a SEZ required authorization from the Central Government. It noted that in terms of Section 15(9) and Section 2(c) of the SEZ Act, SEZ related benefits were available only in relation to authorised operations of the SEZ unit. The AAR relied upon Rule 89 of the CGST Rules and concluded that even where the IGST Act was silent on such a requirement, in the case where supplies were made to a SEZ unit/ developer, it was implied that such supplies were to be used for its authorized operations.

Further, the AAR also interpreted the use of the term "any" before the phrase "following supplies" in Section 16 of the IGST Act. It concluded that the word 'any' was used in the context of either (a) export of goods or/and

[1] In re: M/s. Coffee Day Global Limited, 2018 (8) TMI 875.

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services or (b) supply of goods or/and services to SEZ developer/unit, and not to mean any zero-rated supplies.

SIGNIFICANT TAKEAWAYS

It may be noted that a list of pre-approved services such as renting of immovable property, telecommunication services etc. released by the Ministry of Commerce and Industry *vide* Notice F. No. D12/19/2013-SEZ dated January 2, 2018, are, by default considered as being utilized for authorised operations of SEZ units/developers. Accordingly, the suppliers supplying such services to SEZ units/ developers would remain unaffected by the above ruling. However, the said ruling has put the other suppliers of SEZ units/developers, in an adverse position.

The said ruling can be criticised as to the manner in which the AAR has interpreted the legislations. Firstly, Section 16 of the IGST Act deals with the supplies to be treated as zero-rated supplies, whereas Rule 89 of CGST Rules deals with refund of Input Tax Credit or tax paid in relation to such supplies. It is a settled rule of interpretation that in case of conflicting provisions of a statute and its rules, the provisions of the statute shall prevail. Thus, rules cannot contemplate that which is not mentioned in the statute. Secondly, although SEZ Act has overriding effect over other legislations, the SEZ Act has not been amended post the implementation of GST. Given that, benefits in relation to GST are provided for under the GST legislations. Therefore, concluding on the question of availability of such benefits, primarily on the basis of the provisions of the SEZ Act and GST rules, oblivious to the GST Act was neither logical nor in line with sound legal principles. It may also be noted that outdoor catering service is a part of the aforementioned default list of approved services for SEZs. However, the AAR has failed to see the parallelism between the supplies in question to outdoor catering services.

The recent ruling by Maharashtra Appellate AAR in *Merit Hospitality Private Limited*,[2] (“**Merit Hospitality**”) would not be applicable in present factual matrix. The said Appellate AAR ruled that the services of supplying food to the employees of the unit located in the SEZ area, were not covered under zero rated supply. The facts of said case differs with the Applicant's case as in *Merit Hospitality* the service recipient are employees, whereas in Applicant's case, the service recipient is SEZ unit.

Therefore, the issue in question appears to have been decided in a pro-revenue manner, without application of mind, similar to *Gogte Infrastructure Development Corporation Limited*[3] case where the AAR, held the supply of accommodation services by a hotel to an employee/ guests of a SEZ unit/ developer to be an intra-state supply, exigible to GST. Subsequently, the CBIC issued Circular No. 48/22/2018-GST, dated June 14, 2018, to clarify that in such cases, Section 7(5)(b) of the IGST Act is a specific provision relating to supplies of goods or services or both made to a SEZ developer or a SEZ unit, which states that such supplies shall be treated as *interstate* supplies. Thereby, implying eligibility to avail the benefit of zero rated supply.

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[2] In re: Merit Hospitality Private Limited, 2018-VIL-22-AAR.
[3] In re: Gogte Infrastructure Development Corporation Limited, 2018 (5) TMI 759.

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AMOUNT SAVED PURSUANT TO EXPIRY OF REWARD POINTS IS EXIGIBLE TO GST

In ***M/S Loyalty Solutions***,[1] the Haryana AAR held that the value of reward points forfeited on account of the failure of a customer to redeem them within the prescribed validity period was to be treated as additional consideration paid for supply of services and exigible to GST.

FACTS

M/s Loyalty Solutions and Research Pvt. Ltd. ("**Applicant**") managed a reward point based loyalty programme. The Applicant contracted with various companies and issued reward points to customers of such companies on purchase of products. In lieu of managing the loyalty programme, the Applicant was paid management fee by its clients / partner companies. The Applicant discharged the applicable GST on the same.

Reward points had a reimbursable value of INR 0.25. Whenever rewards points were issued to customers, the respective companies paid the applicable issuance charges computed at INR 0.25/point to the Applicant. Such reward points issued could be redeemed by the customers at the time of purchases from recognized stores. Subsequently, at the time of purchase of any products by redeeming such points, the Applicant transferred the money equivalent to such points to the store from where such products were purchased. The validity period of such reward point was 36 months. Failure to redeem such points within the said time lead to the forfeiture of the points and, the Applicant retained the corresponding issuance charges. The Applicant approached the AAR with the following queries:

Value of forfeited reward points is additional consideration for the service of issuance of reward points.

ISSUES

1. Whether the value of points forfeited by the Applicant would be treated as consideration for 'actionable claim'? If yes, whether the same was within the scope of Schedule III of CGST Act read with Haryana GST Act, 2017, and not exigible to GST?
2. Whether the value of points forfeited was to be treated as consideration for any other supply and was exigible to GST?

ARGUMENTS

The Applicant contended that the reward points issued to customers were in the nature of actionable claims and continued to remain same, even after the expiry of reward points. The Applicant relied upon Entry 6 of Schedule III to CGST and State GST Act, which provided that actionable claims other than lottery, betting, gambling were neither supply of goods nor a supply of services. Accordingly, the Applicant submitted that supply of such reward point was neither a supply of goods nor a supply of services. Therefore, GST was not payable on the amount retained for the unutilized reward point.

The department on the other hand submitted that the Applicant did not return the amount of unutilized reward points post the expiry of the validity period. The term 'actionable claim' under Section 3 of Transfer of Property Act, 1882 included two types of claims as follows: (i) a claim to unsecured debt, and (ii) a claim to beneficial interest in movable property not in possession either constructive or actual. The reward points were in possession of customers, therefore such reward points were not actionable claims.

[1] In re: M/S Loyalty Solutions and Research Private Limited, 2018 (7) TMI 1421.

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DECISION

The AAR ruled that the amount retained by the Applicant for the unutilized reward points after the expiry of the validity period was to be treated as additional consideration apart from the management fee received in lieu of the services supplied by the Appellant. In order to determine the same, the AAR referred to the definition of actionable claim. The AAR observed that in order to qualify as actionable claim, legal action could be taken by the claimant in the civil court for granting relief. Accordingly, the AAR observed that prior to expiry of validity period, the reward points were actionable claim, however post expiry, they cannot be considered as actionable claim. The reasoning behind the same was that the customer cannot bring any legal action in connection with enforcement of right of redemption. Therefore, the provisions of Schedule III to CGST Act were not applicable. The amount retained by the Applicant on account of the unutilized rewards points post expiry, was revenue for the Applicant.

In this regard, the AAR also referred to the clauses of the sample agreement. In terms of the said agreement the Applicant was entitled to retain the forfeited amount. The AAR ruled that this amount was to be considered as an additional consideration for the supply of service by the Applicant in the normal course of business.

SIGNIFICANT TAKEAWAYS

Presently, most of the electronic commerce platforms provide its customers with rewards points on purchase of products through their portal. The aforementioned AAR ruling shall significantly impact such service providers and others dealing in the business of providing services of reward points management services. However, such service providers may recover the applicable GST from its partner companies/ clients by including appropriate clauses in the contracts entered into with them.

Accordingly, it is recommended that such service providers must be careful in complying with additional GST compliances *inter alia* raising invoices for such additional consideration if applicable, furnishing the details of the same in their returns, etc. Alternatively, such service providers may revisit their contracts and opt for a different transaction structure.

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ACTIVITIES CARRIED OUT BY EMPLOYEES OF CORPORATE OFFICE FOR OTHER UNITS ARE EXIGIBLE TO GST

In the case of ***Columbia Asia Hospitals***,[1] the Karnataka AAR held that activities performed by the employees at the corporate office in the course of or in relation to employment such as accounting, other administrative and IT system maintenance for the other units of the employer located in other states would be treated as supply between related parties and would be exigible to GST.

FACTS

M/s Columbia Asia Hospitals Private Limited ("**Applicant**") was engaged in providing health care services. The Applicant was operating a chain of modern hospitals providing secondary and tertiary healthcare services across Asia. In India, the Applicant was operating eleven hospitals across six different states. The India Management Office ("**IMO**") of the Applicant was located in Karnataka. The IMO was responsible for carrying out activities such as accounting, administration and IT maintenance for all units located in India. Such activities were performed by the Applicant's employees. In relation to such supplies, by its employees to its other units, the Applicant neither raised an invoice nor discharged any GST thereon.

In relation to certain expenses such as rent paid for equipment and immovable property, travel expenses, consultancy services, etc., the Applicant paid GST to its service provider. Subsequently, such expenses were proportionately invoiced to other units and the Applicant discharged IGST on such supplies.

In terms of Entry 2 of Schedule I to the CGST Act, supply of goods and/or services between related persons or between distinct persons, as specified in Section 25 of the CGST Act, were to be treated as supplies even when made without consideration.

In view of the above, the Applicant approached the AAR in relation to the taxability of its activities in terms of Entry 2 of Schedule I of the CGST Act.

ISSUE

1. Whether the activities performed by the employees at the IMO in the course of or in relation to employment such as accounting, for the units located in the other States would be treated as a supply by IMO to such other units under the CGST Act?

2. Whether allocation of expenditure to other registered units amounted to supply of services between related or distinct persons under the CGST Act?

ARGUMENTS

The Applicant argued that activities carried out by employees from its IMO for accounting and other administrative functions with respect to other units cannot be considered as supply of services due to specific relaxation provided under Entry 1 of Schedule III to CGST Act. The said entry provided that services by an employee to the employer in course of or in relation to his employment was neither a supply of goods nor a supply of services. The Applicant contended that the word 'employee' cannot be restricted to employment with the registered person only, merely on account of the location from where the employment services

No employer-employee relationship exists between the employees of one branch of the employer with the other branches of the same employer.

[1] In re: M/s Columbia Asia Hospitals Private Limited, 2018 VIL 126 AAR.

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were rendered. It contended that the relationship existed between the employee and employer at the legal entity level and was not confined to the location of registered person from where the said employee rendered services. Therefore, the services rendered by the employees towards accounting and other administrative functions pertaining to other units still retained the character of services by an employee to the employer in course of or in relation to its employment and it would not be exigible to GST.

On allocation of expenses in relation to rent, telephone charges, etc. to other registered units by the IMO, the Applicant submitted that it was done only for the purpose of determining the profit of each registered unit and was not in the nature of provision of any service.

DECISION

The AAR noted that as per Entry 2 of Schedule I to the CGST Act, supply of goods or services or both between related persons or between distinct persons (specified in Section 25 of the CGST Act) when made in the course or furtherance of business, would be treated as supply under Section 7(1) of the CGST Act even when the same was made without consideration. Referring to the explanation of Section 15 of the CGST Act, pertaining to "related person", the AAR observed that although all units of the Applicant were distinct entities in terms of Section 25 of CGST Act, they were to be treated as related persons since the IMO controlled such other units. Consequently, any supply of goods and/or services from IMO to such units was a taxable supply, even if made without consideration.

Thus, the AAR concluded that valuation of services supplied by IMO must be done as per Section 15 of the CGST Act. The AAR also stated that employees employed in IMO were providing services to IMO. The other units were distinct from IMO. Accordingly, the employees of IMO had no employer-employee relationship with other units. Hence, the AAR held that such supply of services by employees of IMO of the employer located in Karnataka to the units of employer located in other States was to be treated as a taxable supply as per Entry 2 of Schedule I of the CGST Act.

SIGNIFICANT TAKEAWAYS

The aforementioned ruling would have a significant impact on businesses having offices located in multiple states as such an interpretation would significantly apply in the context of every minute internal assistance provided between related units/office in the form of advisory assistance, supervision services, telephonic support etc. which would be treated as a taxable supply under the CGST Act. Even gifts distributed by the head office to its employees working in its branch office would be exigible to GST on account of transactions between related party even when the value of goods is less than INR 50,000 as such employees of the other branches would not be employees of the head office.

Although, the other branches would be eligible to take the ITC of such GST costs incurred by them, it may lead to credit blockage for branches having limited output supply. Further, this would not only lead to additional compliances burden for the taxpayers but such supplies would be susceptible to the risk of undervaluation.

The said issue was raised by the banking sector at the time of GST implementation. However, the Government has yet not taken the same into account and released an FAQ on Banking, Insurance and Stock Brokers sector reflecting the adverse position. The FAQ had clarified that head office of a bank would be deemed to provide supervision services (eg. management oversight) to other branches and GST would be applicable on the cost of providing such services.[2]

It is also imperative to note that the reasoning applied in this ruling seems to be questionable as the employee-employer relationship cannot be restricted to any location. The reason being, an employee is hired by a legal entity and not a state specific branch, and such employee can also be transferred to any office during the tenure of his employment, and is paid salary by the legal entity and not a specific branch office.

[2] See http://www.cbic.gov.in/resources/htdocs-cbec/gst/FAQs_on_Financial_Services_Sector.pdf.

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NO GST ON MERE TRANSFER OF POSSESSION OF GOODS AGAINST AN ACKNOWLEDGEMENT

In the case of ***Rajarathnam's Jewels,***[1] the Karnataka AAR held that GST was not leviable on the act of depositing diamonds, acknowledged by Electronic Vault Receipt ("**EVR**"). GST was leviable only on the conversion of EVR to obtain e-Units as well as on conversion of e-Units to obtain similar diamonds. The Learned AAR also held that transactions in e-Units were in the nature of transactions in securities, and hence, were outside the scope of GST.

FACTS

M/s Rajarathnam's Jewels ("**Applicant**") was interested in engaging in derivative contracts in diamonds ("**Derivative Contracts**") through a recognized Commodity Exchange Ltd. ("**Exchange**"). The Exchange was to provide a screen-based online trading platform for trading of Derivative Contracts to its registered members. Any person intending to trade in Derivative Contracts had to become a member of the Exchange or trade through an existing member of the Exchange.

Trading in Derivative Contracts through the Exchange by a member, involved the following stages and procedures:

- First, the diamonds were required to be deposited with an accredited grading agency of the Exchange ("**Grading Agency**") for grading / verification of the diamonds.
- Upon clearance of the requisite quality parameters, the Grading Agency would deliver the diamonds to the Exchange accredited vault along with the printed grading report.
- In exchange of the grading report and diamonds, the Exchange was to issue EVR to the member. The EVR was an acknowledgment towards safe deposit of diamonds.
- Upon surrendering of the EVR, such EVR were to be converted into e-Units which were equivalent to the diamonds' cartage/weight in cents.
- Once converted into e-Units, the holder of those e-Units lost its right to obtain the same diamonds which were deposited.

The holder of the e-Units could sell the e-Units to the person who had the open buy position.[2] Such buyer could further sell those e-Units under any subsequent Derivative Contracts, or surrender such e-Units to the Exchange to convert the same into diamonds.

ISSUES

1. Whether mere deposit of diamond with safe vaults acknowledged by EVR would be treated as supply for the purpose of levy of GST?
2. Whether conversion of EVR into e-Units would be treated as supply liable to GST?
3. Whether e-Units would be treated as securities?
4. Whether conversion of e-Units into diamonds would be treated as supply liable to GST?
5. Whether the transfer of e-Units and settlement thereof would be treated as transaction in securities and thereby would remain outside the scope of the GST levy?

ARGUMENTS

The Applicant made following submissions regarding each query raised in relation to the transaction in Derivative Contracts:

Deposit of diamonds

The Applicant submitted that the deposit of diamonds in safe vault in return for EVR could not be treated as supply as the safe vault held the diamonds merely in

[1] In re: M/s Rajarathnam's Jewels, 2018 VIL 121 AAR.
[2] The member of the Exchange who is eligible and in the capacity to buy the e-Units.

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the capacity of a bailee and was obligated to return the same diamonds to the Applicant at any point of time upon furnishing the EVR. Hence, there was no supply of diamond, and accordingly, no GST was leviable thereon.

Conversion of EVR into e-Units

The Applicant noted that the term 'consideration' was defined under Section 2(31) of the CGST Act broadly and could cover e-Units as consideration for supply of EVR. The Applicant further submitted that surrendering of EVR for e-Units as consideration resulted in the transfer of constructive ownership in the diamonds, and therefore, was exigible to GST.

Nature of Derivative Contract in e-Units

The Applicant submitted that e-Units were in the nature of securities as defined under Section 2(101) of the CGST Act, which adopted the definition of securities under Section 2(h) of the Securities Contracts (Regulation) Act, 1956 ("**SCRA**"). The Applicant submitted that this definition of securities *inter alia* included commodity derivatives of the notified goods within its ambit.[3] The Applicant further contended that since diamonds were notified under Section 2(bc) of the SCRA, e-Units would qualify as 'securities' in terms of Section 2(h) of the SCRA.

> **"Derivative Contracts in diamonds are securities with no actual delivery, and are therefore, outside the ambit of GST."**

Conversion of e-Units into EVR

Regarding the conversion of e-Units into diamonds, the Applicant contended that there was supply of diamonds in physical form when the holder of e-Units surrendered them as consideration for supply of actual diamonds. Thus, such supply of diamonds was made for a consideration in the course of or furtherance of business. Hence, conversion of e-Units into diamonds would also be liable to GST.

Transfer of Derivative Contracts into e-Units and settlement thereof

The Applicant contended that as e-Units were in the nature of securities, transfer of such Derivative Contracts into e-Units with the Exchange would also be treated as a transaction in securities. It was therefore, contended by the Applicant that since securities were neither goods nor services, transaction in e-Units was outside the scope of levy under the GST legislations, and thus, there could not be any levy of GST on Derivative Contracts in e-Units.

DECISION

The AAR held that if there was merely transfer of possession of diamonds to the safe vault as bailment, without any consideration, it would not amount to supply of goods for the purpose of levy of GST.

Further, the AAR noted that EVR were the documents representing the title in diamonds lying in the possession of the Exchange. Therefore, transfer of such EVR would amount to transfer of diamonds. Further, the consideration for such transfer would not be in cash, but in e-Units. Hence, it was held that the conversion of EVR amounted to supply of diamonds and accordingly, was leviable to GST.

The AAR also noted that transactions of e-Units which had diamonds as underlying goods were derivative commodities. Derivative commodities i.e. e-Units were to be treated as securities and would, therefore, be outside the scope of GST. Accordingly, the transfer of Derivative Contracts into e-Units would also be regarded as a transfer of securities, and would not be taxable under the GST legislations.

Lastly, the AAR noted that in the course of surrendering of EVR (i.e. document of title to the diamonds) to obtain e-Units, there was a transfer of right to claim the same diamonds kept in safe vaults. Since the diamonds to be obtained by subsequent exchange of e-Units, would not be the same diamonds which were initially deposited by the Applicant, there was a taxable supply. Accordingly, such transaction would be liable to GST on the value of such transaction.

[3] As defined under Section 2(bc) of the SCRA, commodity derivative is a contract for delivery of goods as notified by Central Government and which wasn't a 'ready delivery contract.' As defined under Section 2(ea) of SCRA, ready deliverable contract is a contract which provides for the delivery of goods and the payment of a price therefore, either immediately, or within such period not exceeding eleven days after the date of the contract and subject to conditions specified by the Central Government and the period under such contract not being capable of extension by the mutual consent of the parties thereto or otherwise.

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SIGNIFICANT TAKEAWAYS

The concept of derivative contracts in diamonds is one-of-its kind which has been launched recently by the Exchange in India after receiving requisite approvals from the SEBI. It is to be noted that the CBIC had issued guidelines in the form of FAQs on Banking, Insurance and Stock Brokers Sector ("**FAQ**") which also addressed questionnaires pertaining to derivatives. Therein the CBIC had clarified that a 'derivative contract' is included within the meaning of 'securities' under Section 2(101) of the CGST Act and hence, derivatives are not liable to GST. Thus, there didn't exist any controversy surrounding classification of derivatives as 'securities'. The AAR has also given its findings in line with the FAQ.

However, the structure of the Derivative Contracts in the present matter is very unique as it involves intricate stages of transactions. Despite the fact that the FAQ was in place, there was still no clarity on the other stages of transactions related to these Derivative Contracts such as supply of goods for conversion into derivatives, etc. Since, such Derivative Contracts were launched in India for the first time, there was also no jurisprudence on these issues.

In the absence of any clarity on the position of law under the erstwhile as well as the present indirect tax regime with respect to Derivative Contracts, the ruling of the AAR in the instant case, provides the much needed clarity. The AAR ruling has dealt with each and every leg of the transaction in relation to Derivative Contracts in detail and has also provided clarity on the treatment of bailment arrangements.

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SUPPLY OF FREE COMPLIMENTARY TICKETS IS EXIGIBLE TO GST

In ***K.P.H. Dream Cricket Pvt. Ltd.***[1] the Punjab AAR held that providing complimentary tickets free of charge for business promotion and public relationship is subject to GST.

FACTS

M/s K.P.H. Dream Cricket Pvt. Ltd. ("**Applicant**") was a franchisee of Board of Control for Cricket in India and operated a cricket team, namely Kings XI Punjab, which participated in Indian Premier League ("**IPL**") tournament. The Applicant proposed to provide complimentary tickets for attending some IPL matches as a courtesy/public relationship/ promotion of its business. The Applicant approached the Punjab AAR for a ruling on the following questions.

ISSUES

- Whether complimentary tickets supplied by the Applicant were subjected to GST?
- Whether the Applicant was eligible to claim ITC in relation to the same?

ARGUMENTS

The Applicant argued that a taxable supply took place where the supply was to be made or agreed to be made, for a consideration in the course of furtherance of business or to a related person in absence of consideration. The Applicant referred to the CBIC Circular[2] ("**Circular**") which clarified that providing free of cost supply of moulds and dies by an original equipment manufacturer to a component manufacturer (the two not being related persons or distinct persons) did not constitute a supply as there was no consideration involved and affirmed that there was no requirement for reversal of ITC availed. Basis the Circular, it contended that since the Applicant and the complimentary ticket holder were neither related persons nor was any consideration charged for attending the match, the provision of complimentary tickets was not a taxable supply.

On eligibility to claim ITC, the Applicant argued that only ITC on free supply of "goods" were restricted under Section 17(5) of the CGST Act. The provision of complimentary tickets was in the nature of free supply of "service" and hence, restriction upon availment of ITC under Section 17(5) of the CGST Act cannot be applied to the present case. The Applicant submitted that allowing selected persons to watch the cricket matches for free as a means of business promotion was a necessary business expense and hence, the same was part and parcel of its business cost. The Applicant argued that apportionment of credit upon services in terms of Section 17(1) of the CGST Act only allowed availment of credit for those services that were used for the purpose of business. Hence, it contended that it was eligible to avail ITC of the said supply as it that was in the nature of a business cost.

Additionally, the Applicant argued that since supply of complimentary tickets was not a supply in itself, it could not be considered as exempt supply to deny the ITC thereon. Alternatively, the Applicant argued that even if supply of free tickets were an exempt supply, there was absence of any mechanism for valuation of such supplies and computation of ITC for reversal. Thus, ITC cannot be denied to it on such ground.

DECISION

The AAR observed that the meaning of 'consideration' under Section 2(31) of the CGST Act included non-monetary consideration and monetary value of any acts of forbearance. In providing complimentary tickets, the Applicant displayed an act of forbearance towards those recipients attending the match without

[1] M/s K.P.H. Dream Cricket Private Limited, TS 558 AAR 2018 NT.
[2] Circular No. 47/21/2018-GST dated June 08, 2018.

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paying any money, as opposed to those paying money for attending the match. The AAR held that the monetary value of such an act of forbearance would be naturally fastened to the amount of money charged from others not receiving complimentary tickets. The AAR treated complimentary tickets akin to redeemable vouchers and held that the supply of complimentary tickets for attending the match was a taxable supply.

The AAR observed that provision of complimentary tickets was a supply even in the absence of a consideration by virtue of Entry 5(e) of Schedule II to the CGST Act. In terms of the said Entry, agreeing to the obligation to refrain from an act or to tolerate an act/situation was a deemed supply. It held that upon issuing a complimentary ticket to any person, the Applicant agreed to the obligation of tolerating the act of complimentary ticket holder to attend the match without any monetary consideration. Hence, the AAR held that distribution of complimentary ticket was a supply exigible to GST.

> **Issuing free complimentary ticket displays an act of forbearance by tolerating the person who is receiving the services provided to him without the payment of money.**

On the point of ITC availment, the AAR pointed out that since distribution of complimentary tickets was a taxable supply under GST legislations, the ITC of inputs and input services used in furtherance of business were available.

SIGNIFICANT TAKEAWAYS

Presently, most of the entertainment industry and hotel industry provide complimentary tickets, restaurant services etc. to their existing and prospective clientele for the promotion of their businesses and as a goodwill gesture. The aforementioned AAR ruling shall significantly impact such suppliers.

The said ruling can be criticised as to the manner in which the AAR has interpreted the legislations. The ruling interprets the phrase "by any other person" under Section 2(31)(b) of the CGST Act (which defines consideration) as to include the service provider as well. Interpretation must be restricted to a third party who is not the service provider itself, otherwise it would mean that a service provider can give consideration to itself for a supply made by it. Further, it must be noted that only supplies listed under Schedule I to the CGST Act are deemed to be taxable supplies even when made without a consideration. However, the AAR has considered services inserted under Schedule II to be taxable supplies even when made without any consideration. Such interpretation would render Schedule I as redundant.

The intent of the Parliament is reflected from the fact that post this ruling, Section 7(1) of the CGST Act has been amended retrospectively w.e.f. July 01, 2017 to exclude reference to Schedule II to the CGST Act, which provides for the treatment of certain specified supplies either as supplies of goods or services. The said exclusion appears to be intended towards rectifying a drafting anomaly, which resulted in an interpretation that the activities listed under Schedule II were taxable supplies, even where they did not possess the attributes of a valid supply. Schedule II is now an independent section.[3] Pursuant to the said change, an activity falling under Schedule II would have to qualify as a supply, before being categorized as a supply of services *vis-à-vis* goods.

[3] Section 7(1A) of the CGST Act.

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ONLY A NOTIFIED INDUSTRIAL/FINANCIAL BUSINESS AREA IS ENTITLED TO GST EXEMPTION ON UPFRONT PAYMENT FOR LONG-TERM LEASE

In ***Goa Tourism Development Corporation Ltd.***,[1] the Goa AAR dealt with the levy of GST on one-time concession fee charged on long-term lease of industrial/financial plots for an agreement entered into prior to the implementation of GST and the scope of such industrial / financial plots against which such concession fees are exempted from GST under Notification no. 12/2017-CT (Rate)[2] dated June 28, 2017 ("**Exemption Notification**").

FACTS

Goa Tourism Development Corporation Ltd. ("**Applicant**"), a government company, had executed a concession agreement giving Myrayash Hotels Pvt. Ltd. ("**Builder**") an exclusive right, license and authority to construct, operate and maintain a project at Anjuna ("**Property**") for a period of thirty years (extendable upto further thirty years). The Applicant received an upfront concession fee of INR 25,20,00,000/- from the Builder for a period of sixty years. The Applicant had approached the AAR to confirm if the said concession fee payment was exempted under the Exemption Notification.

ISSUE

Whether the one-time concession fee charged by the Applicant in respect of a long-term lease of sixty years on the Property was exigible to GST?

> **GST exemption is available only in case of upfront amount paid for leasing of industrial plots located in a notified industrial/financial business area.**

ARGUMENTS

The Applicant submitted that the following conditions were required to be cumulatively fulfilled to avail exemption under the Exemption Notification:

a) exemption was for upfront payment;

b) lease was for period of 30 years or more;

c) lease was for industrial plots for development of infrastructure for financial business;

d) lease was granted by State Government Industrial Development Corporation or Undertaking or by any other entity having 50% or more ownership of Central Government, State Government or Union territory.

The Applicant submitted that the aforementioned conditions were fulfilled and consequently, GST was not payable on the said transaction. Additionally, the Applicant also contended that GST provisions were applicable only where the supply of services was made post the implementation of GST. As the agreement for supply of service and the payment thereof – both preceded the implementation of GST, the transaction was subjected to the erstwhile Service Tax regime.

DECISION

The AAR pointed out that in terms of the Exemption Notification the industrial plots must be located in an industrial or financial business area in order to avail the said exemption. The AAR noted that the phrase 'industrial or financial business area' was not defined under the GST legislations and referred to Section 2(g) of Goa Industrial Development Act, 1965 which defined 'industrial area' as an area notified by the State Government by a Notification in the Official Gazette. On review of the same, the AAR concluded that an area could not be considered as industrial or financial

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[1] In re: M/s Goa Tourism Development Corporation Ltd., 2018 VIL 286 AAR.
[2] Notification No. 32/2017-CT (Rate) dated October 13, 2017 amended Entry no. 41 of the Notification.

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business area merely on the ground that it was used for the purpose of industry/finance.

The AAR noted that a notification had not declared the area of the Property as industrial or financial business area. Thus, benefit under Exemption Notification was not available to the Applicant even when the other three conditions were fulfilled.

In relation to the applicability of GST, the AAR noted that services provided post the implementation of GST or in the nature of continuous supply of service were subject to the GST regime in terms of the transitional provisions. Accordingly, the AAR held that as the Property was leased for sixty years, it would categorize the nature of leasing services as a continuous supply and therefore, the same was exigible to GST.

SIGNIFICANT TAKEAWAYS

There are three concerns which arise from a review of the decision. Firstly, the Applicant had submitted that the Property leased was for the 'development of infrastructure for financial business.' Hence, understanding of the term 'financial business area' should have been made the focal point of legal interpretation whereas the AAR based its ruling upon interpretation of the term 'industrial area'. Secondly, the AAR has not provided any clear reasoning for categorizing the said service in the nature of continuous supply. Thirdly, by application of Section 14 of the CGST Act and Point of Taxation Rules, 2011, the time of supply of the said service means the time of receipt of payment or issuance of invoice, whichever was earlier and thus, long-term leasing at hand cannot be considered as a continuous supply. Thus, in the present case, as the payment was received prior to implementation of GST, the same could not be subjected to GST.

On a related topic, ruling of *M/s Punjab Small Industries*[3] by the Chandigarh AAR held that considerations such as transfer fees, extension fees etc. received by State Industrial Development Undertaking/Corporation for ancillary services relating to granting of long-term lease (thirty years or more) such as conversion of leasehold plots to freehold plots, administrative services etc. cannot be treated as “upfront amount” payable in respect of such leasing service. According to the AAR, the exemption under Entry No. 41 of the Exemption Notification was provided only to upfront amount payable in respect of granting long-term lease and the said ancillary services found no specific mention under the relevant Entry. Thus, the AAR ruled that such ancillary services were not exempted services in terms of the Exemption Notification.

The narrowing down of the applicability of the Exemption Notification by the aforementioned rulings would significantly impact the new businesses intending to take industrial plots.

[3] In re: M/s Punjab Small Industries & Export Corporation Limited, 2018 (11) TMI 1076.

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CASE LAW UPDATES

- INDIRECT TAX

- OTHER JUDICIAL PRONOUNCEMENTS

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BENEFIT OF AMBIGUITY IN EXEMPTION NOTIFICATION SHALL BE GIVEN TO THE IRA

In the case of ***M/s. Dilip Kumar and Company***,[1] the Constitutional Bench of the SC held that where there was an ambiguity in the exemption notification under a tax statute, such exemption notification was to be interpreted in a way that benefit of such notification was in favour of the IRA and not the assessee.

FACTS

M/s Dilip Kumar and Company ("**Respondent**") had imported a consignment of Vitamin – E50 powder (feed grade) ("**Product**") *vide* the Bill of Entry No. 8207 dated August 19, 1999. The Respondent classified the Product under Customs Tariff Heading 2309.09 of Schedule I of the CTA i.e. 'prawn feed' and discharged the customs duty at a concessional rate of 5%, by availing the benefit of Notification No. 20/1999-Cus., dated February 28, 1999 ("**Notification**").

However, the Customs authorities ("**Department**") denied the benefit of concessional rate to the Respondent on the ground that the Product contained chemical ingredients which were fit for animal feed, and not for prawn feed. The Department further held that the ratio of *Sun Export Corporation* case,[2] ("**Sun Export**") which was relied upon by the Respondent was not applicable in the matter before them and therefore, levied customs duty at the standard rate of 30% on the import of the Product.

On appeal, the Commissioner of Customs (Appeals) (Import), Mumbai ("**Appellant**") reversed the order of the Department and held that the ratio of *Sun Export* was applicable and hence, in case of ambiguity in tax exemption notification, interpretation favouring the assessee must be adopted. The Department filed the second appeal before the CESTAT against the order of Appellant, which upheld the order of the Appellant. Subsequently, the Department filed an appeal before the SC. The Division Bench of the SC doubted the rationale of *Sun Export*, and observed that the Court in the said case had ignored catena of precedents wherein it was held that exemption notifications were to be strictly construed, and therefore, the *Sun Export* needed reconsideration.

Consequently, the matter was placed before a three-Judge Bench of the SC, which concurred with the views expressed by the Division Bench of the SC, and placed the matter before the Constitutional Bench of the SC for reconsideration.

The burden is upon the assessee claiming the exemption, to demonstrate that its case is covered under exemption notification.

ISSUE

Whether the benefit of ambiguity in the Notification should be given to the Respondent or to the Revenue?

ARGUMENTS

The Appellant argued that a tax exemption notification was to be interpreted strictly. Additionally, the benefit of exemption could be given to an assessee where it was established beyond reasonable doubt that it was covered by such tax exemption notification.

On the other hand, the Respondent argued that the ratio in *Sun Export* was to be considered holistically and not to be given a narrow meaning. It further argued that the Notification which was issued in relation to Customs Tariff Entry had often been interpreted liberally by the Courts. The Respondent also argued that the Product was included under the head 'prawn feed'.

[1] Commissioner of Customs (Import), Mumbai v. M/s. Dilip Kumar and Company and Ors., Civil Appeal No. 3327 of 2007.
[2] Sun Export Corporation, Bombay v. Collector of Customs, Bombay, (1997) 6 SCC 564.

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DECISION

The SC observed that in *Sun Export,* it was held that where there is an ambiguity in an exemption notification, an interpretation favouring the assessee should be preferred. The SC also noted that the other Bench of the SC, in *Surendra Cotton Oil Mills,*[3] had taken a contrary view and had held that in case of interpretation of an exemption notification, the opposite principle would apply wherein interpretation favouring the Revenue should be preferred in case of an ambiguity.

The SC further looked into the general principles of interpretation and summed up that the purpose of interpretation of statutes was to ascertain the intention of the legislature. The SC observed that for construing taxing statutes the Courts had to apply the strict rule of interpretation which would not allow the expansion of the law by implication or equitable considerations. Further, in case of ambiguity in taxing statute where two interpretations were possible, the interpretation which benefitted the assessee had to be adopted.[4]

However, regarding the issue of ambiguity in exemption notification, the SC noted that different Courts had taken different views, and therefore, there existed an unsatisfactory state of law which required constitution of the Constitutional Bench. On analysis of the precedents, the SC held that exemptions from taxation had the tendency to increase burden on the other unexempted class of taxpayers and hence, the person claiming exemption was required to establish that his case squarely fall within the exemption notification. Hence, in case of any ambiguity in the interpretation of exemption notification, the benefit was to be conferred in favour of Revenue. The SC also concurred with the ratio of *Parle Exports*[5] case which held that the question whether an assessee fell within the ambit of an exemption notification or not, had to be strictly construed (strict compliance).

Hence, the SC held that availment of benefit of such exemption notification would only be allowed to those assessees who demonstrated that they were squarely covered within the ambit of the exemption. However, once the applicability issue was resolved, the Court could construe the notification by giving it full play bestowing wider and liberal construction (substantial compliance). The SC held that the burden to demonstrate that it was covered under an exemption notification was on the assessee claiming such exemption.

In light of the above, the SC held that the exemption notification should be interpreted strictly and the benefit of ambiguity was to be conferred in favour of Revenue. The SC ordered to place the matter before the appropriate bench to decide the case on merits.

SIGNIFICANT TAKEAWAYS

This judgment has brought the much-needed clarity on the issue of interpretation of exemption notification and re-affirmed the position that the interpretation to be adopted in case of tax statute would be different from the approach to be adopted for interpretation of exemption notification.

Only time will tell how impactful this jurisprudence would prove to be in case of interpreting exemption notifications under the GST legislations – especially, in light of the pro-revenue approach being adopted by the adjudicating authorities, including the AARs under the GST regime. Because of its pro-revenue approach, it is very likely that the administration would take a strict approach against procedural lapses as well and would deny assessees from the benefits of exemption merely on the grounds of procedural errors, which was never the intention of the SC.

[3] Collector of Customs and Central Excise, Guntur & Ors. v. Surendra Cotton Oil Mills and Fertilizers Co. and Ors., 2001 (1) SCC 578.
[4] *Ibid.*
[5] Collector of Central Excise v. Parle Exports (P) Ltd., (1989) 1 SCC 345.

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RESTRICTION OF CREDIT AVAILMENT AGAINST INVOICES ISSUED PRIOR TO THE CUT-OFF DATE HELD UNCONSTITUTIONAL

In ***Filco Trade Centre Pvt. Ltd.,***[1] the Division Bench of the Gujarat HC held that Section 140(3)(iv) of the CGST Act[2] ("**Impugned Provision**"), by imposing time limit for availment of transitional credit, had restricted the enjoyment of vested right of the assesses retrospectively, without any rational or reasonable basis. Therefore, the Impugned Provision was unconstitutional and liable to be quashed.

FACTS

Filco Trade Centre Pvt. Ltd. ("**Petitioner**") was a first stage dealer engaged in purchase and resale of specialized industrial bearings of various types as well as import of certain goods. Prior to the introduction of the GST, the Petitioner was eligible to avail and pass on the CENVAT credit of the central excise duty and CVD paid on goods subject to fulfilment of the conditions provided under the CCR.

Provisions which are discriminatory and impose burden on assessee without any reasonable justification, are unconstitutional.

However, in terms of Section 140 of the CGST Act and the State specific GST Act, the Petitioner was eligible for availment of input tax credit (transition of CENVAT credit) of the duties paid on finished goods held in stock on the appointed day, subject to the condition that the invoices or other prescribed documents on the basis of which the credit was to be transitioned, would not had been issued earlier than twelve months immediately preceding the appointed day.

Aggrieved by the aforesaid condition, the Petitioner challenged the constitutional validity of the Impugned Provision before the Gujarat HC.

ISSUE

Whether the Impugned Provision, imposing a condition with retrospective effects, was invalid and unconstitutional, and therefore, liable to be struck down?

ARGUMENTS

The Petitioner submitted that in the previous indirect tax regime, first stage dealers and manufactures were treated alike with respect to utilization of CENVAT credit and both could utilize the CENVAT credit upon the respective invoices without any restriction on time limit for utilization thereof. The Petitioner argued that the restriction in relation to the inputs bought or imported prior to twelve months was only imposed on first stage dealers and not on manufacturers. Thus, this restriction put the first stage dealers in a relatively disadvantageous position and therefore, was arbitrary and discriminatory.

The Petitioner further argued that certain benefits were recognized for unregistered dealers without any restriction of time limit upon the date of such invoices. Therefore, the dealers mentioned under the Impugned Provision were in more disadvantageous situation than the manufacturers as well as unregistered dealers.

The Petitioner also argued that the availment of CENVAT credit was a vested right and such a vested right could not be withdrawn with retrospective effect, without any plausible reason or logic.

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[1] Filco Trade Centre Pvt. Ltd. v. Union of India, 2018 VIL 403 GUJ.

[2] Section 140(3)(iv) of the CGST Act restricted first stage dealers from availing the eligible credits of duties paid on inputs held in stock against invoices issued prior to twelve months from the appointed day (date of enforcement of GST).

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The Union of India ("**Respondent**") argued that the Parliament had much greater discretion in relation to a taxing statute and a precise or scientific division for classification of assessees could not be expected. It was also contended that first stage dealers formed a special class and their position couldn't be compared with manufacturers and hence, this wasn't a case of hostile discrimination.

The Respondent further argued that the Petitioner had no vested right to claim CENVAT credit as allowance of such credit was in the nature of concession and the Legislators were well within their powers to impose conditions on the availment of the same. It was also argued that imposition of a reasonable restriction did not result in waiving of a vested right. The Respondent also argued that such a restriction had a definitive purpose, i.e. to accommodate administrative convenience against the condition of establishing a correlation of duty paid purchases of first stage dealers against sales made by them, as existed prior to GST. The Respondent also relied upon *JCB India*[3] judgment ("**JCB India**") wherein the same Impugned Provision was held to be valid and constitutional by the Division Bench of the Bombay HC.

The Respondent argued that the Legislature had the powers to introduce a limitation period for granting any benefit, and merely because such limitation created two separate classes, it could not be held unconstitutional. Lastly, the Respondent argued that merely because the classification caused disadvantage or hardship to the Petitioner itself, it was not a valid ground to invalidate the Impugned Provision.

DECISION

The HC noted the relevant provisions of the erstwhile CCR and observed that the incidence of duty on manufactured goods was not to be borne by first stage dealers. The first stage dealer was eligible to avail and utilize the CENVAT credit on duties paid purchases or imports without any time limitation. However, the HC observed that post the implementation of GST the Impugned Provision imposed the time restriction of twelve months.

The HC ascertained the nature of the right enjoyed by the Petitioner in relation to the availment of CENVAT credit and held that it was a vested right. The Court noted that the condition prescribed under the Impugned Provision had retrospective operation, and thus, it restricted the enjoyment of such vested right. However, the HC held that the mere restriction to the enjoyment of this right was not a sufficient ground to hold the Impugned Provision as unconstitutional in the absence of any hostile discrimination against the first stage dealers on the basis of classification.

However, the HC further observed that there was no just, reasonable or plausible reason for the legislature to take away such a vested right. Additionally, since no time restriction existed in the erstwhile regime, the plea of administrative convenience was not sufficient enough to introduce such restriction.

In light of the above, the HC held that the Impugned Provision had retrospective impact without any rational or reasonable basis, and imposed a burden upon the Petitioner. Therefore, the same was unconstitutional. However, on the request of the Revenue, the HC had stayed the application of the decision till October 31, 2018.

SIGNIFICANT TAKEAWAYS

This judgment of the Gujarat HC gives a great relief to a number of assessees who weren't able to claim their accumulated credit of duties paid on the invoices issued to them prior to June 30, 2016. However, it may be noted that in a recent decision in the case of *JCB India*, the Division Bench of the Bombay HC had taken a divergent view on the same issue and had upheld the constitutional validity of the Impugned Provision. Appeals against the *JCB India* have already been filed before the SC.

It is a settled position of law that the judgment of a HC has only persuasive value for another HC, and the principle enunciated by one HC is not strictly applicable wherein two or more HCs have given contradictory rulings on the same point of law. Therefore, the order of the Gujarat HC would have a binding effect only for the dealers registered and operating in the State of Gujarat. Needless to state

[3] JCB India Ltd. v. Union of India and Ors., W.P. No. 3142 OF 2017 dated March 20, 2018.

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that the SC would have to take cognizance of the legal dichotomy prevailing in this matter and adjudicate upon the same to give a uniform and settled position of law.

What else is to be noted here is that the Gujarat HC in the case of *RSPL Ltd.*[4] upheld the constitutional validity of Section 140(5) of the CGST Act, which only allowed for availment of inputs and input services which were received on or after the appointed day but on which the tax was paid earlier. The HC, in this case, held that the capital goods and inputs used in manufacturing process have also been treated differently and distinct treatment was given in the earlier statutes as well. The Legislators consciously created such distinction and provided the facility of credit in the case of inputs in transit and not capital goods. The HC held that such distinction was in no manner artificial or arbitrary and the same cannot be said to violate Article 14 or 19(1)(g) of the Constitution. The HC also acknowledged the discretionary powers of the legislature in making laws relating to taxing statues and conditions provided to claim tax rebate benefits.

Thus, with such pro-revenue approach and acknowledgment of greater discretion of legislature in enacting taxing statute, there still exists uncertainty for the parties intending to claim benefits of transitional credits under the GST laws.

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[4] RSPL Ltd. v. Union of India, 2018 VIL 477 GUJ.

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RELEVANT LAW FOR IMPOSITION OF TAX IS THE LAW APPLICABLE ON THE DATE OF TAXABLE EVENT

In ***M/s Prosper Jewel Arcade LLP***,[1] the Karnataka HC held that the re-assessment order pertaining to a period prior to the implementation of GST, passed under Karnataka Value Added Tax Act, 2003 ("**KVAT Act**"), cannot be held to be invalid merely because such re-assessment order was passed post the implementation of GST.

FACTS

M/s Prosper Jewel Arcade LLP ("**Petitioner**") was engaged in the business of sale of jewellery and was registered as a dealer under KVAT Act. For the period 2012-13 ("**Relevant Period**"), the Department had passed a re-assessment order dated March 31, 2018 ("**Order**") raising a tax demand of INR 4,42,72,061/- (inclusive of interest and penalty). The Petitioner applied for rectification of the Order, however the said application was rejected by the Department. Hence, the Petitioner filed the present writ petition before the Karnataka HC without availing the available appellate remedy.

> **The taxable events which occurred prior to GST shall be governed by the applicable erstwhile legislations.**

ISSUES

1. Whether the Order passed under KVAT Act, post the implementation of GST, was invalid?
2. Whether Section 174(1)(d) and (e) of the Karnataka GST Act, 2017 ("**KGST Act**") was *ultra-vires* the Constitution of India?

ARGUMENTS

The Petitioner contended that Entry 54 of List II to the Constitution was amended *vide* 101st Constitutional Amendment Act ("**Amendment Act**") *w.e.f.* September 16, 2016, to restrict the power of the states to levy tax on intra-state sale of goods, to only petroleum products. The Amendment Act did not provide any saving provisions for the said Entry in its original form. The Petitioner therefore, argued that since the Order pertaining to the Relevant Period was passed under substituted Entry, it did not legally stand the test of an order passed under the due authority of law and therefore, deserved to be quashed.

The Petitioner further submitted that the imposition of tax, its assessment and collection, were to be in consonance with the currently prevalent law. The Petitioner argued that Section 174 of the KGST Act was not constitutionally valid.

The Department submitted that the Petitioner had alternative remedy of appeal under KVAT Act available to it and therefore, there was no requirement to file a writ petition before the HC. The Petitioner's challenge to the validity of Section 174 of the KGST Act was merely intended to maintain the writ petition filed by it.

The Department further contended that the applicable law governing the Relevant Period was not the KGST Act. The said period was prior to the implementation of GST. The Department relied upon Clause 19 of the Amendment Act, a transitional clause for all provisions under the erstwhile enactments effective immediately prior to the commencement of the said Amendment Act. They also relied upon Article 246-A of the Constitution which empowered the State to make laws for imposition of tax in respect of both goods and services. Accordingly, the provisions of KVAT Act read with Entry 54 were not repugnant and did not affect the re-assessment order.

[1] M/S Prosper Jewel Arcade LLP v. Deputy Commissioner Commercial Taxes (Audit & Recovery), Bangalore, 2018-VIL-483-KAR.

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DECISION

The Karnataka HC held that the question raised by the Petitioner regarding the constitutional validity of Section 174 of the KGST Act on the grounds of lacuna in law, was not applicable to factual matrix of the present case. The HC held that the taxable event under VAT legislations was individual transactions of sale/purchase by the dealer. The law applicable on the date of such taxable event, was the appropriate law for the imposition of tax.

The HC further observed that Section 174 of the KGST Act, saved all the rights, obligations or liabilities acquired, accrued or incurred under the repealed KVAT Act. Accordingly, the law applicable on disputes for the Relevant Period was still the KVAT Act, even though the Order was passed post its repeal. Thus, the said Order was not void in the eye of law.

Further, the HC observed that the Order was appealable before the higher appellate authority, i.e. an alternative remedy was available to the Petitioner. Hence, the Karnataka HC dismissed the said writ petition.

SIGNIFICANT TAKEAWAYS

This decision of the HC is an important decision as it upheld the applicability of a repealed law on the legal proceedings / investigation initiated / adjudicated of matters pertaining to assessment periods when such repealed law was in place.

It is to be duly noted that the HC has once again clarified that the taxable event is the one which on its occurrence creates / attracts liability to tax. The meaning of taxable event is different for different laws based on their respective charging sections. The HC has clearly clarified that the law applicable on the date of taxable event would be the applicable law. Hence, it seems that any case challenging an order passed under repealed laws, cannot be challenged on the ground of lack of legislation so long as such respective taxable events occurred prior the implementation of GST.

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CLEAN ENERGY CESS CANNOT BE SET-OFF AGAINST COMPENSATION CESS

In ***Mohit Mineral Pvt. Ltd.,***[1] the Division Bench of the SC upheld the constitutional validity of the GST (Compensation to States) Act, 2017 and the Rules framed thereunder ("**Impugned Legislations**"). The SC also held that Clean Energy Cess already paid till June 30, 2017 cannot be set-off against the payment of Compensation Cess.

FACTS

Mohit Mineral Pvt. Ltd. ("**Petitioner**") was a trader of imported and locally procured coal and had discharged Clean Energy Cess at the time of removal of raw coal from the mine to the factory. In terms of the Constitution (One Hundred and First Amendment) Act, 2016 ("**Constitution Amendment Act, 2016**") the Parliament was empowered to levy a cess to compensate the States for the loss of revenue on account of GST for a period of five years. Several cesses, including the Clean Energy Cess were repealed prior to implementation of the Impugned Legislations. The Petitioner had also made a representation before the GST Council to seek set-off of Clean Energy Cess against GST Compensation Cess.

The Petitioner had filed a writ petition before the Delhi HC and *inter alia* prayed to declare that:

- the Impugned Legislations were unconstitutional, and
- Notification Nos. 1/2017 and 2/2017-Compensation Cess dated June 28, 2017 were illegal and unconstitutional.

The Delhi HC issued an interim order stating that the Petitioner was not required to pay GST Compensation Cess against those stocks of coal upon which Clean Energy Cess was already paid. A similar interim order was also passed in another writ petition filed before the Delhi HC. Both the interim orders were subsequently challenged by the Union of India ("**Respondent**") before the SC.

Thereafter, the aforesaid two matters along with other such matters were transferred to the SC, to be heard collectively.

ISSUES

The issues framed by SC were as follows:

- Whether the Impugned Legislations were beyond the legislative competence of Parliament?
- Whether the Impugned Legislations violated the objectives of the Constitution Amendment Act, 2016?
- Whether the Impugned Legislations were colourable legislations?
- Whether levy of Compensation Cess and GST on the same taxing event was permissible in law?
- Whether the Petitioner was entitled to set-off payment of Compensation Cess against Clean Energy Cess paid till June 30, 2017?

ARGUMENTS

The Petitioner argued that the Impugned Legislations, while seeking to provide compensation to the States by the Centre for the loss of revenue, imposed a tax (termed as cess), thereby transgressing the limits of its powers.

The Petitioner submitted that the Constitution Amendment Act, 2016 was enacted to subsume various Central and State taxes/surcharges/cess levied upon supply of goods and services. However, by imposing Compensation Cess *vide* the Impugned

[1] Union of India & Anr. v. Mohit Mineral Pvt. Ltd., 2018 VIL 27, SC.

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Legislations, the objective and mandate of the Constitution Amendment Act, 2016 were transgressed. Further, the Petitioner argued that the Constitution Amendment Act, 2016 did not empower the Centre to levy an additional tax/cess on GST. It merely empowered the Parliament to provide compensation to States for loss of revenue on account of GST implementation.

The Petitioner also contended that imposition of the Compensation Cess as well as GST on the same taxable event and same subject amounted to double taxation which was against the principles of taxation. Lastly, the Petitioner submitted that assuming that the Impugned Legislations were valid, the Petitioner should have been entitled to set-off the credit of Clean Energy Cess against the payment of Compensation Cess.

The Respondent argued that the phrase used in Article 246A of the Constitution "with respect to" had wide implication and would allow levy of cess also. The Respondent further argued that the power to levy cess was also traceable from Article 270 of the Constitution that empowered the Legislature to levy cess for a specific purpose under a law made by it.

GST and Compensation Cess are two separate imposts in law and hence, the same does not amount to double taxation.

Additionally, the Respondent argued that the levy of Clean Energy Cess and Compensation Cess did not amount to double taxation as both the cesses were levied on entirely different transactions. The Clean Energy Cess was levied as Excise Duty on the production of coal and was collected at the time of its removal from the mine to the factory whereas the Compensation Cess was levied on supply of specified goods and services. The Respondent argued that both the cesses differed also in terms of their purpose – Clean Energy Cess was levied for the purposes of financing and promoting clean energy initiatives whereas the Compensation Cess was collected to provide compensation to the States for the loss of revenue arising on account of GST implementation. Therefore, Clean Energy Cess could not be set-off against Compensation Cess.

DECISION

The SC noted that Article 246A of the Constitution, as inserted *vide* the Constitution Amendment Act, 2016, gave powers to the Parliament and State Legislatures to make laws with respect to GST imposed by the Union and the States respectively. The SC further pointed out that Article 270 of the Constitution empowered the Parliament "by law" to levy cess for a specific purpose under a law made by it. The SC held that the expression "by law" was of wide import which included levy of any cess for specific purposes. Therefore, the Parliament was competent to enact the Impugned Legislations to levy a cess.

The SC held that the expressed 'power to make laws with respect to GST' under Article 246A of the Constitution, included the power to levy cess on GST as well. The SC agreed that the object of the Constitution Amendment Act, 2016 was to subsume various taxes, surcharges and cesses into one tax, but held that the same did not indicate that henceforth no surcharge or cess would be levied. The SC further held that the fact that Clause 18 of the Constitution Amendment Bill, 2014 (pertaining to additional tax on supply of goods) was not included in the Constitution Amendment Act, 2016, had no implication on the powers of the Parliament to levy Compensation Cess because such powers were traced from Clause 19 of the Constitution Amendment Bill, 2014 (power to enact laws to compensate the States for loss of revenue on account of GST) and the same was retained under Section 18 of the Constitution Amendment Act, 2016. Accordingly, the SC held that the Impugned Legislations did not violate the Constitution Amendment Act, 2016 or its objective and were not colourable legislations.

The SC held that GST imposed under the GST legislations and the levy of cess on such intra-State and inter-State supply of goods and services or both were two separate imposts in law and hence, could not be declared as invalid. Lastly, the SC held that giving credit or allowing the setting off the payment was a

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legislative policy decision which had to be reflected in the legislative scheme, and the Impugned Legislations did not indicate such credit/set-off of the Clean Energy Cess paid till June 30, 2017. Accordingly, the SC rejected the setting-off of Compensation Cess against the Clean Energy Cess paid by the Petitioner.

SIGNIFICANT TAKEAWAYS

One of the biggest hurdles towards GST implementation was the loss of revenue for States and it was only when the States were convinced that the Compensation Cess would be able to reimburse the revenue lost, could the GST regime became a reality. By upholding the constitutional validity of Compensation Cess, the SC has not only given a huge relief to the State Governments but has also given the legal backing to the Legislatures to levy additional cess on their respective GST upon introduction of legislations.

However, it may be noted that the power to levy and collect Compensation Cess under Section 18 of the Constitution Amendment Act, 2016, is limited only up to 5 years from the date of effect of the GST laws. Hence, it would be interesting to see whether another constitutional amendment is introduced to extend the validity thereof, especially when not all the State Governments are successfully meeting their revenue targets from GST collection.

The rejection to set-off of Compensation Cess against the Clean Energy Cess already paid, is also a significant loss to the assessees. However, it is not the first time when the judiciary has upheld the validity of a provision which restricted the availment of credit benefit. Recently, the Gujarat HC upheld that validity of Section 140(5) of the CGST Act that only allowed for availment of credit of the taxes paid on those inputs and input services which were received after the implementation of GST and on which taxes were paid earlier. Under Section 140(5) of the CGST Act, availment of such credit on capital goods was not included.[2] The HC held that the legislatures had the discretionary power to make laws and provide rebate benefits, and they had consciously created a distinction and limited the facility of credit in the case of inputs in transit only and not capital goods.

Further, though the aforesaid judgment is a landmark judgment, it goes against the motto of GST i.e. 'one nation one tax'. The intention of the legislature behind introducing GST was to subsume multiple existing State and Central level indirect taxes and cesses into one tax i.e. GST. However, with the introduction of levy of Compensation Cess and various other cesses proposed by the State or Centre, such as sugar cess, cess to meet the expenses incurred on account of natural calamities etc., fades away the dream of having 'one nation one tax'.

[2] RSPL Ltd. v. Union of India, 2018 VIL 477 GUJ.

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ANTI-PROFITEERING PROVISIONS MANDATE PASSING ON THE BENEFIT IMMEDIATELY ACROSS ALL PRODUCTS

In ***M/s Hindustan Unilever Limited***,[1] the NAA held that M/s Hindustan Unilever Limited ("**HUL / Respondent**") has profiteered by denying the benefit to its customers accrued to it on account of reduction in GST rates.

FACTS

HUL is engaged in the manufacture and supply of consumer goods under four major categories *viz*. home care, personal care, foods and refreshments. The products manufactured by the Respondent were supplied through Redistribution Stockists ("**RSs**"), Modern Trade ("**MT**") and Canteen Stores Department ("**CSD**").

With effect from November 15, 2017, the GST rates applicable on majority of the products (approx. 99.71 of the sales value) manufactured and supplied by HUL were reduced from 28% to 18%. Further, the applicable rate of GST on the remaining 0.29% products supplied by the Respondent was also reduced from 18% to 12%.

On the basis of certain complaints, the DGAP issued a notice of initiation of investigation for the period between November 15, 2017 and February 28, 2018 to the Respondent on January 10, 2018. In the said notice, the Respondent was also asked to *suo moto* determine the quantum of benefit not passed on and intimate the same to the DGAP.

A detailed investigation was conducted by the DGAP and report dated June 15, 2018 along with subsequent reports dated August 31, 2018 and September 25, 2018 were submitted to the NAA for review and for passing an appropriate order in the matter.

No general methodology can be prescribed for computing commensurate reduction in price and the same has to be determined on case to case basis.

ISSUES

- Whether the rates of GST were reduced in respect of the products supplied by the Respondent w.e.f. November 15, 2017?
- If the rates were reduced, whether the benefit of such reduction in GST rate was passed on to the consumers completely in terms of Section 171 of the CGST Act?
- If not, what was the quantum of profiteering made by the Respondent?

ARGUMENTS

The DGAP in its report submitted that the Respondent had admitted that it failed to pass on the benefit of reduction in the tax rates to the customers and had determined the amount of profiteering and deposited the same in the CWF after claiming certain deductions on account of various deployments.

The DGAP contended that Section 171 of the CGST Act mandated that the benefit was to be passed on through reduction in price and did not provide for any other means of passing on the benefit of reduction in the rates of tax or benefit of ITC. Hence, other means opted by the Respondent to pass on the benefits, such as increase in grammage and sales promotion schemes to its MTs were legally not permissible. Therefore, the Respondent, by availing such deductions, failed to comply with Section 171 of the CGST Act.

The DGAP further contended that no deduction on account of loss of refund of GST, in light of withdrawal of area based Excise Duty benefits, was maintainable since there was no loss in absolute terms to the Respondent on this count.

[1] Sh. Ankit Kumar Bajoria v. M/s Hindustan Unilever Limited, Case No. 20/2019 – NAA.

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Further, with respect to the deduction claimed on account of written off packing material, the DGAP contended that the Ministry of Consumer Affairs, Food and Public Distribution had clearly provided that there must be affixing of additional stickers or stamping or online printing for declaring the reduced MRPs. Additionally, the DGAP submitted that such deduction claimed by the Respondent was not supported by any legal provisions under the CGST Act and therefore, was inadmissible.

The DGAP also submitted that the Respondent was duty bound to pass on the credit availed through TRAN-2 in terms of Section 140(3) of the CGST Act, which was not done and hence, the credit carried forward should also be considered towards the amount profiteered by HUL. Lastly, the DGAP submitted that the sharp increase in the profits made by the Respondent in the quarter where the GST rates were reduced indicated that HUL had not passed on the benefit of rate reduction to the customers.

On the other hand, the Respondent contended that the DGAP had taken a very literal and simpliciter meaning of the expression 'commensurate reduction in price'. The Respondent argued that emphasis of the Section 171 of the CGST Act was on non-retention of benefit of tax rate reduction by the manufacturer/dealer and passing it on to the recipient, and not on the mode of such passing on. Accordingly, one could opt for any method such as increase in grammage, price reduction through trade channel, reimbursement of excess payment, promotional schemes etc., which has the effect of passing on the benefits to the recipient.

The Respondent also argued that laying down of the methodology under Rule 126 of the CGST Rules with sufficient clarity and lucidity was of critical importance because that alone could ensure equity, consistency, uniformity and clarity. Therefore, the NAA should take up the matter for adjudication only after formulating the methodology to be followed for passing on the commensurate benefit.

The Respondent further submitted that the term 'profiteering' was not defined under the CGST Act or rules made thereunder and hence referred to the dictionary meanings of the said term. The Respondent submitted that it connoted unethical, immoral, illegal and contumacious conduct on the part of a company whereby it earned disproportionately large and unfair profit. The Respondent also contended that the spirit of the law should be considered before deciding whether the actions taken by HUL were in the best interests of the economy and the consumers.

The Respondent argued that considering the enormity of operations and the logistical difficulties, he did all that was possible to sub-serve the intent of the Government in passing on of the benefits to the customers. However, there was no lead time available for liquidating the pipeline stocks and therefore, it had *suo-moto* determined the amount of excess realization and volunteered to deposit it into the CWF.

The Respondent also argued that in order to comply with the Legal Metrology (Packaged Commodities) Rules, 2011 ("**LM Rules**"), it opted to pass on the benefit on its products through increase in grammage as an alternate manner of passing on of the benefit, which ultimately resulted in reduction in effective price to the recipients.

The Respondent further argued that the deductions claimed by it on account of providing increase in grammage or trade discounts or promotional schemes such as buy one get one free, were to be allowed since such modes were nothing but effective price reduction of its product itself. Further, the Respondent submitted deductions claimed on account of written off packing materials, denial of area based fiscal incentives available at the time of setting up the factory in specific areas and reimbursement made to the modern traders on account of GST rate reduction were also valid deductions.

The Respondent further contended that the DGAP in its computation of profiteering had included the sales made to Central Police Force ("**CPF**") and Central Railway Police Force ("**CRPF**"), which were made at a base price which excluded GST. Hence, these sales were to be deducted from total amount of profiteering computed by the DGAP.

Further, the Respondent argued that the TRAN-2 credit was not a subject matter of this investigation and hence, the same could not be added to the alleged profiteered amount under Section 171 of the CGST

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Act. Additionally, the Respondent had filed for credit for the period between July, 2017 to December, 2017 only in February, 2018 and therefore, the Respondent could not have availed the said credit in the months of November and December, 2017.

Lastly, with respect to increase in profits, the Respondent contended that increase/decrease in the profit of a company was influenced by multiple factors such as volume, mix, cost of materials, inflation and overhead efficiencies etc. and not just sales growth. Further, the Respondent argued that its conduct of coming forward and voluntarily offering the differential tax amount for deposit was misconstrued by the DGAP.

DECISION

The NAA examined the DGAP reports carefully and observed that the Respondent had itself admitted that not only did it increase the base price of its products w.e.f. November 15, 2017, but had also manipulated the software and issued letters to restrain its RSs from passing on the benefits to their customers. Thus, the Respondent had not only denied the benefit of tax reduction itself but had also made his RSs liable for violation of Section 171 of the CGST Act.

Further, the NAA held that the Respondent was bound to reduce the prices on the products being sold by him w.e.f. November 15, 2017 itself, and in case he was not able to do so, he should have immediately deposited the profiteered amount in the CWF. However, the Respondent had failed to do so promptly, and hence would have to bear the consequences of profiteering.

The NAA further observed that the Respondent had denied the alleged computation by DGAP stating that the DGAP had not considered a number of deductions claimed by it. Therefore, to compute the correct amount of profiteering the NAA looked into each of the deductions claimed by the Respondent.

Admissibility of TRAN-2 credit: The NAA held that the TRAN-2 credit was *ipso facto* ITC and furthermore, the proviso to Section 140(3) of the CGST Act required the registered persons to pass on the benefit of availment of TRAN-2 credit to the recipients. Accordingly, Section 171 of the CGST Act was very much applicable and could be invoked to prevent profiteering on account of denial of benefit of ITC. Accordingly, no deduction was allowed on TRAN-2 credit, and the entire balance of TRAN-2 was added to the profiteered amount on the assumption that the same was not passed on to its recipient.

Increase in grammage: The NAA held that while the law required the benefit to be passed on through price reduction, other practical options available to the suppliers of a particular trade could also be taken into consideration as acceptable mode of passing on of the benefit. The NAA noted that the LM Rules restricted the price reduction by a lower denomination and was also a cumbersome and impractical process, and therefore, held that in the instant matter, passing on extra grammage could be one of the modes of passing on the benefit. However, the NAA held that this was considered due to the fact that the anti-profiteering measures were incorporated in the tax laws for the first time. However, in the future, the benefit was to be passed on through commensurate reduction in the prices only, and in case it was not possible to do so, the amount so realised would have to be deposited in the CWF.

Area based fiscal incentives: The NAA denied the deduction claimed on the basis of loss on account of area based fiscal incentives stating that there was no loss in absolute terms to the Respondent. The Respondent was still eligible to get the same proportionate refund of actual CGST/IGST paid in cash as was available to him prior to the reduction in the rates of GST. Further, the NAA held that there was no direct correlation between the MRP of the product (which was same all-over India) and the area based exemption benefit. The products (whether manufactured with or without concessions) were being sold at the same price, and admittedly, these prices were not reduced inspite of rate reductions.

Reimbursement to MTs: The NAA also denied the deduction claimed on account of reimbursement offered to MTs in the absence of documentary evidences to indicate that such benefit was passed on to the end consumer.

Writing off packing material: The NAA held that writing off of packing material and usage of new packing material instead of stickering was a business call of

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the Respondent. The law was very clear when it gave the suppliers the relief to do re-stickering instead of incurring additional cost on new packaging material. Accordingly, no deduction was to be allowed on account of written off packing material.

Sale through CPF and CRPF: The NAA agreed that the goods sold through CSD to CPF and CRPF were exclusive of taxes and held that the profiteered amount should be reduced to the extent of sales made to CPF and CRPF.

In light of the above discussion, the NAA held that in total, the Respondent had profiteered an amount of INR 383.35 crore and directed it to deposit the balance of INR 68.70 crore (post reducing INR 160.23 crore already deposited in CWF) in the Central CWF as well as INR 173.50 crore in the CWFs of the States in accordance with Rule 133(3)(c) of the CGST Rules.

The NAA directed the DGAP to conduct further investigation to ascertain whether the Respondent passed on the benefit of tax reductions in respect of all the products being sold by it in the subsequent period. The NAA also ordered the initiation of separate penalty proceedings in the matter in light of the demand of profiteering being confirmed.

SIGNIFICANT TAKEAWAYS

The decision of the NAA in the case of HUL is one of most significant orders of the NAA till date. The NAA has clearly indicated that no general methodology to compute the commensurate reduction would be laid down. By discussing various elements, the NAA order gives perspective to the industry on the methodology to be adopted for computation of the commensurate benefit to be passed on.

Interesting, this order showcases divergent views on basic issues between NAA and the assessees. In the absence of clear guidelines, the industry has devised its own methods to determine the amount of benefit to be passed on to the recipients by taking into account various commercial factors. However, the NAA appears to be adopting a very stringent interpretation and narrow interpretation of the law. Many elementary factual issues also seem to have been ignored by the NAA, such as the insistence on MRP reduction, even though HUL had reimbursed its recipients during the interim period to ensure that the commensurate benefit is passed on to its customers, i.e. MRs.

Even though the NAA passed such a lengthy order, several issues such as applicability of anti-profiteering provisions on new SKUs, other acceptable ways of passing on of the commensurate benefits, etc. remain unanswered. Since, the NAA has clearly refused to come up with a general methodology, the industry is left with limited options, *viz*. adopt reasonable measures as per their own understanding. Possibly, such measures would require to await the NAA's dictum on the same or the assessees would have to knock the doors of the judiciary to fill in the legislative gaps. Moreover, writ petitions challenging the constitutional validity of anti-profiteering provisions under Section 171 of the CGST are already pending before the Delhi HC and the Bombay HC.

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TOWERS AND SHELTERS IN COMPLETELY KNOCKED DOWN CONDITION USED IN PROVIDING TELECOMMUNICATION SERVICES ARE NOT IMMOVABLE PROPERTY

The Delhi HC in ***Vodafone Mobile Services Ltd. & Others***[1] ("**Vodafone**") held that parts of base transmission systems ("**BTS**") in the form of towers, shelters and accessories in completely knocked down ("**CKD**") condition, qualified as capital goods and inputs eligible for ITC under the CCR.

FACTS

Vodafone Mobile Services Limited ("**Assessee**") and other assesses including Indus Towers Limited, Bharti Infratel Limited, etc., were either cellular telephone services provider or were engaged in providing passive telecom services. They had availed CENVAT credit on the Excise Duty paid on capital goods such as towers, parts and shelters/pre-fabricated buildings ("**PFBs**") purchased by them in CKD condition. The Revenue issued a show cause notice to the Assessee *inter-alia* alleging that it had wrongly availed CENVAT credit upon various items including towers and shelters as they did not qualify either as capital goods or inputs under the CCR. The Assessee *inter-alia* argued that towers and its parts were capital goods, and alternatively, such items were also covered within the definition of 'inputs', and accordingly, were eligible for ITC. The authorities rejected the claim of the Assessees and held in favour of the Revenue.

The Assessee along with various tower owners providing passive telecom services appealed to the CESTAT. In the meanwhile, the Bombay HC, in the case of *Bharti Airtel,*[2] ("**Bharti Airtel**") held that towers and PFBs and their parts were in the nature of immovable goods. In light of the order of the Bombay HC, the division bench of the CESTAT, due to a difference of opinion, referred the matter to a three-member bench of the CESTAT. The three-member bench of the CESTAT agreed with the Revenue's stand and affirmed the position of *Bharti Airtel* that towers and shelters used in providing output services were immovable property. Aggrieved by the said order of the CESTAT, the Assessee along with other tower owners appealed before the Delhi HC.

ISSUES

The questions of law framed by the Delhi HC are as follows:

- Whether the towers, shelters and accessories used by the Assessee for providing telecom services were immovable property?
- Whether the Assessee was entitled to claim CENVAT credit on the towers, shelter as 'accessories' either as capital goods or input under CCR and thereby, were justified, in terms of Rule 4(1) of CCR to claim CENVAT credit?
- Whether the CESTAT erred in applying nexus test with reference to MS Angles and channels? Whether the emergence of an immovable structure at an intermediate stage was a criterion to deny CENVAT credit?

ARGUMENTS

The Assessee contended that the eligibility for the credit would not be impacted merely because the towers and shelters were embedded inside the earth post their receipt on the site. The Assessee also contended that since the telecom services could not be provided without towers and shelters, therefore, they also satisfied the necessity or functionality utility test, for availment of credit of taxes paid thereof. It was further argued that the towers and shelters were accessories for antenna and BTS, respectively, which qualified as capital goods falling under Chapter 85 of

[1] Vodafone Mobile Services Ltd. and Ors. v. Commissioner of Service Tax, Delhi, 2018 (11) TMI 713.
[2] Bharti Airtel Ltd. v. Commissioner Central Excise, Pune – III, 2014 (35) STR 865 (Bom).

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the CETA. The Assessee relied upon "permanency test" laid down in *Solid and Correct Engineering*[3] case to argue that a machine fixed by nuts and bolts to a foundation to provide wobble-free operation, and without the intention to permanently attach the same to earth, cannot be considered as an immovable property.

The Assessee further submitted that accessories of BTS such as towers, MS Angles, channels etc. would qualify as capital good as the BTS itself was a capital good. Alternatively, the Assessee argued that towers and shelters would qualify as 'inputs' under Rule 2(k) of the CCR as the definition of 'input' only mandated the goods to be 'used' for providing output service and did not require the goods to be directly consumed in providing the output service. The Assessee further argued that Rule 4(1) of the CCR allowed credit on inputs immediately upon receipt of goods in the premises of output service provider and it was immaterial if the concerned goods subsequently resulted into immovable property.

"Fixation of machine using nuts and bolts for stability without assimilating the property is not an immovable property."

On the other hand, the Revenue argued that towers and shelters were immovable property as held in *Bharti Airtel*. Further, it was argued that shelters and accessories were not part of the capital goods falling under Chapter 85 of CETA (BTS) and accordingly, did not qualify as 'capital goods'. The Revenue also argued that applying the test of movability and marketability for the levy of Excise Duty, mobile towers and shelters when erected became immovable structures and hence, could not be termed as 'capital goods' to avail CENVAT credit.

Additionally, the Revenue argued that 'input' was defined as goods used for providing output service whereas the towers and shelters were immovable goods and hence, wouldn't qualify as inputs under CCR. Additionally, the items like MS Angles, Channels and PFBs had no direct nexus to the output service of either telecommunication service or business support service, and therefore, could not be considered as inputs. The Revenue further relied upon the marketability test and contended that towers, shelters and their accessories were affixed to the earth and became immovable property and therefore, were non-marketable and non-excisable. Hence, CENVAT credit could not be availed upon the same.

DECISION

The Delhi HC analysed the definition of 'immovable property' defined under Section 3(26) of the General Clauses Act, 1897[4] and 'attached to the earth' as per Section 3 of the Transfer of Property Act, 1882[5] and held that installation of towers and shelters to a civil foundation was necessary to provide a wobble free operation to the machine only and there was no intention to permanently annex the same to the earth. Therefore, the HC held that such an annexed machine could not be said to be permanently attached to the earth and did not fulfil the permanency test. Hence, it could not be termed as immovable property. The HC explicitly held that *Bharti Airtel* and *Vodafone* were contrary to settled judicial precedents such as *Solid and Correct Engineering* and that the CESTAT erred in relying upon *Bharti Airtel.*

On the second issue, the HC noted that 'accessories' referred to any item that added to the convenience or effectiveness but it need not be essential to the main machinery. The HC held that in the instant case, the towers and shelters supported BTS in effective transmission of mobile signals, thereby enhancing its efficiency to provide output service. The towers and shelters plainly acted as components/parts and in the alternative, as accessories to the BTS and would be covered by the definition of "capital goods".

Further, on the alternate argument of the products being inputs, the HC relied upon 'functional utility' test. The HC observed that all goods which were used to provide output service on a commercial scale would qualify as 'inputs'. Accordingly, in the instant case, the HC held that towers and shelters in CKD condition used in conjunction with antenna and BTS equipment

[3] Commissioner of Central Excise, Ahmedabad v. Solid and Correct Engineering Works & Ors., 2010 (5) SCC 122.
[4] Section 3(26) of the General Clauses Act, 1897 reads as follows:
"immovable property" shall include land, benefits to arise out of land, and things attached to the earth, or permanently fastened to anything attached to the earth.
[5] Interpretation clause under Section 3 of the Transfer of Property Act, 1882 reads as follows:-
"attached to the earth" means –
(a) rooted in the earth, as in the case of trees and shrubs;
(b) embedded in the earth, as in the case of walls or buildings; or
(c) attached to what is so embedded for the permanent beneficial enjoyment of that to which it is attached.

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formed an essential part in the provision of telecommunication services, and therefore, qualified as 'inputs'. The HC held that the word 'used' under Rule 2(k) of the CCR was to be widely interpreted to include passive as well as active use and hence, MS Angles and channels that were used to make towers which in turn provided infra-support services/telecom services would qualify as 'inputs'.

The HC noted that eligibility to claim CENVAT credit was to be determined at the time of receipt of goods under Rule 4(1) of the CCR. The HC held that merely because the goods in question were later fixed to the earth for use would not affect the excisable nature of those goods so long as the goods would qualify as inputs/capital goods at the time of receipt and were ultimately used in providing output service.

SIGNIFICANT TAKEAWAYS

The Delhi HC in this case held that interpretation of 'capital goods' in *Bharti Airtel* and *Vodafone* in relation to mobile towers and shelters was contrary to the settled position of law as provided in *Solid and Correct Engineering*. It is important to note that appeals against *Bharti Airtel* and *Vodafone* are pending before the SC. Therefore, it is highly probable that this Delhi HC judgment would also be challenged before the SC. In light of several conflicting decisions, the SC is once again required to step in to resolve the present issue. However, such litigation has a considerably long lifetime.

It must be noted that under the GST regime, Section 17(5)(d) of the CGST Act disallows ITC for goods/services provided for construction of an immovable property (excluding plant and machinery) and telecom towers are specifically excluded from the meaning of the term “plant *and machinery*”. Thus, in the present tax regime, BTS along with their accessories such as telecom towers, PFBs etc. are immovable property, and no ITC shall be available on goods and services utilised for the construction of BTS. Thus, the present law is contradictory to the view taken by the Delhi HC although, the latter pertained to the previous regime. A suitable clarification by the CBIC on this issue will be very helpful. Accordingly, while the tower operators and telecom service providers have got the relief from the Delhi HC, it would be advisable for them to wait for the SC ruling on this matter for a smooth availment of ITC benefits associated with the previous tax regime.

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REGULATORY DIRECT TAX UPDATES

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1. CBDT REVISES MONETARY LIMITS FOR FILING OF APPEALS BY IRA

Through a circular[1] issued in 2015, CBDT had prescribed monetary limits for filing of appeals by IRA before the ITAT and HCs as well as SLP before the SC. The CBDT recently revised the previous monetary limits by issuing another circular in supersession of the above circular.[2]

Appeals/SLPs shall not be filed in cases where the 'tax effect' does not exceed the given monetary limits (not applicable to writ matters and direct tax matters other than income-tax):

Appeals/ SLPs in Income-tax matters before	Monetary Limit (INR)
ITAT	20,00,000
HC	50,00,000
SC	1,00,00,000

CBDT, however, clarified that appeals should not be filed merely because the 'tax effect' exceeds the prescribed monetary limits. Filing of appeals is decided on the merits of the case.

'Tax effect' is the difference between the tax on the total income assessed and the tax that would have been chargeable had such total income been reduced by the amount of income in respect of the issues against which appeal is intended to be filed ("**Disputed Issue**"). Applicable surcharge and cess shall be included when calculating the 'tax effect'. The tax will, however, not include any interest thereon, except where chargeability of interest is under dispute. Where the returned loss is reduced or assessed as income, the tax effect would include notional tax on disputed additions. In case where penalty is disputed, the tax effect would be the quantum of penalty deleted or reduced in order to be appealed against.

The tax effect has to be calculated separately for each AY. Therefore, where the Disputed Issue arises in multiple AYs, appeal can only filed in respect of such AY(s) in which the prescribed monetary limit is exceeded.

In case of composite orders involving multiple AY and common issues in more than one AY, appeals shall be filed for all such AYs, irrespective of the tax effect, if it is decided that an appeal would be filed in respect of the year(s) in which the tax effect exceeds the monetary limit prescribed.

In case of computation of income under section 115JB or 115JC, the tax effect shall be computed as per the formula (A-B) + (C-D) where,

A = the total income assessed as per provisions other than sections 115JB or 115JC (herein called general provisions);

B = the total income that would have been chargeable had the total income assessed as per the general provisions been reduced by the amount of the Disputed Issues under the general provisions;

C = the total income assessed as per section 115JB or 115JC;

D = the total income that would have been chargeable had the total income assessed as per sections 115JB or 115JC been reduced by the amount of Disputed Issues under the said provisions. Where, however, the Disputed Issues are also being considered under general provisions, such amount shall not be reduced from the total income assessed while determining the amount under 'D'.

Where an appeal is not filed only because the tax effect is not as per the prescribed monetary limits, there will be no presumption that IRA has acquiesced in the decision. Thus, the IRA shall not be precluded from filing an appeal against the Disputed Issues in the case of the same assessee for any other AY, or in the case of any

[1] Circular No. 21 of 2015, Revision of Monetary Limits for Filing of Appeals by the Department before Income Tax Appellate Tribunal and High Courts and SLP before Supreme Court – Measures for Reducing Litigation – Reg, dated December 10, 2015.
[2] Circular No. 3/2018, Revision of Monetary Limits Filing of Appeals by the Department before Income Tax Appellate Tribunal, High Courts and SLPs / appeals before Supreme Court – Measures for reducing Litigation – Reg, dated July 11, 2018.

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other assessee for the same or any other AY, if the tax effect exceeds the specified monetary limits.

Where the assesse claims relief on the ground that the IRA had implicitly accepted the decision of ITAT/ HC/ SC in a case for another AY, the IRA representatives or counsels must make every effort to bring to the notice of such ITAT/ HC/ SC that an appeal was not filed or admitted because the tax effect was less than the specified monetary limit and that no inference should be drawn that the decisions rendered therein were acceptable to it.

Further, adverse judgements on issues involving the constitutional validity of the provisions of the IT Act or IT Rules, illegality of CBDT circulars, notifications or instructions, etc. should be contested on merits, irrespective of the tax effect. Where the tax effect is not quantifiable or not involved, an appeal may be filed based on the merits.

Further, the prescribed monetary limit of INR 20 lakhs for filing of appeals before the ITAT would equally apply to cross objections under section 253(4) of the IT Act. It was also clarified that the circular will apply to SLPs/ appeals/ cross objections/ references to be filed henceforth in the SC/ HCs/ Tribunals and it shall also apply retrospectively to pending SLPs/ appeals/ cross objections/ references. Pending appeals below the prescribed monetary limits may be withdrawn/ not pressed.

2. EXEMPTION ON INTEREST INCOME ON MASALA BONDS

Under the IT Act, interest payable by an Indian company or a business trust in respect of rupee denominated bonds (“**Masala Bonds**”), is subject to tax at a concessional rate of 5% (plus applicable surcharge and cess) in the hands of the investors. Such companies or business trusts are also obligated to withhold tax at the said rate, in accordance with section 194LC of the IT Act.

However, pursuant to a review of the Indian Economy by the Prime Minister, the Finance Minister had announced a series of steps with an intention to contain the country's current account deficit and augmenting the foreign exchange inflow. One such step, was exemption from income-tax on interest payable on Masala Bonds.

Pursuant to the above, the CBDT had issued a press release dated September 17, 2018 (“**Press Release**”) which had provided that interest payable by an Indian company or a business trust to a non-resident, including a foreign company, in respect of Masala Bonds issued outside India during the period from September 17, 2018 to March 31, 2019 would be exempt from Indian income-tax. Consequently, no tax would be deducted on the payment of interest in respect of such Masala Bonds under section 194LC of the IT Act.

Please note that the aforementioned exemption is only provided in the Press Release, a legislative amendment to the IT Act to pave way for this exemption in the statue is expected separately. This Press Release is a welcome step towards increasing the inflow of foreign exchange.

3. CBDT NOTIFIES RULES FOR DETERMINATION OF FAIR MARKET VALUE OF INVENTORY

CBDT issued a notification on August 30, 2018, notifying the Income-tax 9th (Amendment) rules, 2018 which are applicable to AY 2019-20 (i.e. FY 2018-19). The notification amended Rule 11U, clause (b), sub-clause (ii) as well as added Rule 11UAB of the IT Rules.

Rule 11U defines the expressions used in determination of fair market value. Rule 11U(b) defines the term “balance sheet”. The aforesaid amendment amends the definition of “balance sheet” as defined under Rule 11U(b). Sub-clause (ii) under the definition clause is now bifurcated into two parts to distinguish between Indian company and non- Indian company. For

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Indian company balance sheet includes balance sheet of the company as drawn up on the date of valuation which has been audited by the auditor appointed by the Company under Indian laws. For non-Indian company, the balance sheet as drawn up on the date of valuation which has been audited by the auditor appointed by the Company as per the laws in force in the country in which the Company is registered or incorporated.

Thus, the distinction has been made solely on the basis of the laws governing the Company for appointment of the auditor.

Further, the amendment also adds Rule 11UAB for determining the fair market value of inventory. This rule has been brought in for the purposes of section 28 clause (via) which provides taxation of profits / gains arising on conversion of inventory into capital assets as 'business income'.

The rule provides that fair market value would be determined as follows:

a) For immovable property – the value adopted or assessed by any authority of the Central Government or a State Government for the purpose of payment of stamp duty on the same.

b) For jewellery, archaeological collections, drawings, paintings, sculptures, any work of art or securities as referred under Rule 11UA – the value determined as per Rule 11UA(1), i.e. price it would fetch in an open market or price paid for acquiring it or as valued by a registered valuer (as the case may be).

c) Any other property other than those mentioned above, the value that the property would ordinarily fetch in the open market.

The date, for valuation purposes, would be the date on which the inventory is converted into or treated as a capital asset. This would be applicable in all the above mentioned cases.

4. CBDT ISSUES NOTIFICATION TO AMEND TAX AUDIT REPORT FORM (FORM 3CD)

Section 44AB of the IT Act provides that certain category of persons carrying on business or profession have to get their accounts audited by a Chartered Accountant. Form 3CD read with Rule 6G(2) of the IT Rules prescribes the statement of particulars required to be furnished in the audit report. Recently, CBDT vide notification[3] has made notable changes in Form 3CD which became effective from August 20, 2018 except the changes relating to GAAR and GST compliance which have been deferred till next year.[4] Some key amendments have been discussed below:

International Tax

Disclosure regarding secondary adjustment

Where a transaction between two AEs is not undertaken at the ALP, the IRA have the power to make a primary transfer pricing adjustment in order to align the actual transaction price with the ALP. If as a result of such adjustment any excess cash is determined to have been paid to the foreign company, which is an AE, then such excess amounts are required to be repatriated back to India. On a failure to do so, the IRA are required to make a secondary adjustment by treating such excess as an advance to the foreign AE and deem notional interest income to be taxable in the hands of the Indian company. The recent amendment in Form 3CD mandates auditors to disclose details regarding these primary and secondary adjustments, as applicable.

Disclosures relating to Thin Capitalization

Section 94B the IT Act provides that deduction of interest paid by an entity to its non-resident AE will be restricted to either 30% of its earnings before interest, taxes, depreciation and amortization ("**EBITDA**") or actual interest paid or payable to such AE, whichever is less. The amendment in Form 3CD mandates the auditor to disclose details of such excess interest

[3] Notification No. 33/2018 dated July 20, 2018.
[4] Circular No. 6/2018 dated August 17, 2018.

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expenditure, quantum of interest involved, EBITDA, etc., as applicable.

Country by Country Reporting (CbCR)

Section 286(2) of the IT Act mandates a resident parent entity or an alternate resident reporting entity to furnish a report in respect of the international group of which is it a constituent, to the Director General of Income tax every year. The amendment in Form 3CD seeks disclosure regarding the requirement of submission and actual submission of such report, other details such as name of parent entity or alternate reporting entity, date of furnishing or report, as applicable.

Domestic Tax

Disclosures relating to GAAR

GAAR is an anti-abuse provision which empowers the IRA to deny *inter alia* tax benefits where the purpose of an arrangement is to obtain tax benefits. The amendment seeks disclosure of all such impermissible avoidance agreements that a taxpayer has entered into and the amount of tax benefit arising in aggregate to all the parties involved in such arrangements.

Determining if a particular arrangement is an impermissible avoidance arrangement requires detailed analysis of the facts, provisions of law and judicial precedents. Also, the amendment puts the cumbersome responsibility on the auditor to disclose tax benefits arising out of such arrangements not only to the relevant taxpayer but also to all the parties involved. Owing to widespread concerns, this reporting requirement has been kept in abeyance till March, 2019. Therefore, tax audit reports filed on or after April 1, 2019 will need to contain these reportings.

Details relating to income from other sources

The amendment requires the auditor to furnish details of income falling under section 56(2)(x) of the IT Act. Section 56(2)(x) prescribes that if any sum of money or property (as prescribed) is received for less than the fair market value as computed, then the difference between the actual consideration paid and the fair market value of such property is chargeable to tax as income in the hands of the recipient.

Details of receipts or payments exceeding the limit specified in section 269ST of the IT Act to be reported

Section 269ST of the IT Act prescribes that no person shall receive any amount of INR 2 lakhs or more otherwise than by an account payee cheque or an account payee bank draft or electronic clearing system through a bank account. If the taxpayer receives or makes any payment which is not in accordance with the above mentioned conditions, then the auditor is required to furnish particulars of such receipts or payments and disclose other related details such as name, address and permanent account number of payer and recipient; nature of transactions; date of receipt etc. by virtue of the proposed amendment.

Disclosure of deemed dividend received

Deemed dividend, as defined under section 2(22)(e) of the IT Act, refers to payments made by certain companies in the form of loan or advance to a specific category of shareholders. This amendment mandates the auditor to disclose details of such dividends received during the previous year, the amount and date of such receipts, etc. as applicable.

Indirect tax related disclosures

The amendment requires taxpayer to disclose GST registration number in addition to disclosures of registration numbers under excise duty, service tax, sales tax customs duty etc., as applicable. The amendment also requires the auditor to furnish break up of total expenditure of entities registered or not registered under GST.

These amendments in Form 3CD are substantial and cast an onerous responsibility on the auditors to comply with higher standards

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of due diligence. Taxpayers are also now required to provide detailed information to the auditors in order to enable them to comply with these reporting requirements. Some of the issues requiring additional reporting requirements such as determination of impermissible avoidance arrangements, payments constituting deemed dividend, applicability of section 56(2)(x), etc are areas requiring an in-depth analysis of the facts and circumstance as well as the ability to interpret the law basis its intention, etc. In absence of settled legal principles and judicial precedents, it would be a strenuous task for auditors resulting in increased exposure to penal liabilities. Obtaining legal opinions with respect to the sticky issues could go long way in addressing these standards and demonstrating the bona fide for any action/decision taken by the auditor in this respect.

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1. CBDT ISSUES GUIDANCE TO THE IRA ON USE OF RULINGS EXCHANGED UNDER BASE EROSION AND PROFIT SHIFTING ("BEPS")

The CBDT has recently issued guidance[1] to its officers on how to deal with rulings exchanged by other jurisdictions under BEPS Action Plan 5 ("**Guidance**"). As part of a transparent framework, India is receiving templates containing information in respect of the following taxpayer - specific rulings from other jurisdictions:

(i) rulings relating to preferential regimes;

(ii) unilateral Advance Pricing Agreements ("**APAs**") or other cross-border unilateral rulings in respect of transfer pricing;

(iii) cross-border rulings providing for a downward adjustment of taxable profits;

(iv) PE rulings;

(v) related-party conduit rulings; and

(vi) miscellaneous rulings that may be included at a later date as decided by the Forum on Harmful Tax Practices.

Guidance on various types of rulings:

Ruling on preference regimes - The Guidance notes that rulings relating to shipping, financing and leasing, holding company regimes, service and distribution centres, banking and insurance, pure equity holdings, fund management, etc. will be covered within this category. The Guidance points out that these activities can be geographically mobile and there is a tendency to set up such businesses in a jurisdiction which has a preferential regime even though substantial activities generating income are not actually performed in such jurisdiction. Thus, the Guidance states that for such activities where the ultimate parent or the immediate parent receiving the ruling is in India or the related party with which the foreign resident enters into transactions, under the relevant ruling is Indian resident, information may be used to identify and assess the extent of economic activity actually reported in India and whether income offered in India is commensurate with such activities.

Unilateral APAs or other cross-border unilateral rulings in respect of transfer pricing - The Guidance specifically draws attention to unilateral rulings in respect of transfer pricing, wherein either the ultimate parent or the immediate parent of the taxpayer receiving the ruling or the related party with which the foreign resident enters into a transaction (that is covered by the APA) is resident in India. The Guidance states that "care has to be taken to ensure that there are no mismatches in how two ends of a transaction are priced and no profits go untaxed resulting in base erosion or profit shifting."

Cross-border rulings providing for a downward adjustment of taxable profits - The Guidance draws attention to rulings where an immediate parent or ultimate parent receiving a ruling is in India or a related party with which a foreign resident enters into a transaction covered by the ruling, is in India. The Guidance additionally provides that "*care has to be taken to ensure that there are no mismatches in how two ends of a transaction are priced and no profits go untaxed resulting in base erosion or profit shifting.*"

PE rulings – The Guidance draws attention to cases where an ultimate parent or immediate parent or head office receiving such a ruling is in India or involves an Indian PE. The Guidance states that information about the non-existence of or attribution of profits to a PE in the country issuing the ruling may be used in assessing the appropriate global profit of the Indian entity.

Related-party conduit rulings - The Guidance states that in case of rulings where an immediate or ultimate parent or a related party or ultimate beneficial owner is in India, information on the arrangement/structuring including transparent entities may be used in assessing the appropriate profit of the Indian entity.

[1] Instruction No. 6/2018 vide F.No. 500/141/2018-FT & TR-V dated December 22, 2018.

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The Guidance further highlights that these rulings will be subject to requirements of confidentiality under the tax treaties. It states that detailed guidelines on maintaining confidentiality provided in Chapter-VII of the Indian Manual of Exchange of Information should be strictly followed. The Guidance also clarifies that, wherever necessary, tax officers can seek further information from a relevant jurisdiction through an exchange of information on request.

2. CBDT CLARIFIES SCENARIOS FOR EXEMPTION FROM LONG TERM CAPITAL GAINS TAXED UNDER SECTION 112A OF IT ACT

Under the erstwhile provisions of IT Act, long term capital gains ("**LTCG**") arising from alienation of assets such as equity shares, units of an equity oriented fund or a business trust, were exempt from capital gains tax, subject to payment of Securities Transaction Tax ("**STT**") in an on-market transaction at the time of transfer and acquisition of such assets. However, CBDT vide Notification dated June 5, 2017[2] clarified that certain acquisitions of shares shall continue to be entitled to claim LTCG tax exemption, and exempted such modes of acquisition of equity shares from the requirement of payment of STT.

However, the Finance Act, 2018 withdrew the LTCG tax exemption and introduced section 112A in the IT Act to levy LTCG tax on gains arising from transfer of aforementioned assets. The said section 112A of the IT Act provides that tax shall be levied at the rate of 10% on capital gains exceeding one lakh rupees on transfer of equity shares or units of an equity oriented fund or a business trust. However, the section clarified that similar to the provisions of section 10(38), the benefit of 10% tax rate under section 112A of the IT Act would only be available where STT was paid at the time of acquisition as well as at the time of transfer. However, this provision created a lot of anxiety and heartburn among taxpayers, especially those who had acquired shares through genuine business transactions where STT was not required to be paid as per the law.

In order to address the concerns of such genuine taxpayers, the CBDT issued certain Frequently Asked Questions ("**FAQs**") and their answers on February 4, 2018 and clarified that for the purpose of section 112A of the IT Act, the CBDT would reiterate the aforesaid notification dated June 5, 2017 so that certain modes of acquisition remain exempt from requirement of paying STT.

In line with the FAQs, the CBDT issued a Notification[3] dated October 1, 2018 ("**Notification**") specifying certain types of acquisitions of equity shares, where provisions of section 112A of IT Act would continue to apply even if no STT is paid at the time of acquisition. It may be interesting to note that as mentioned in the FAQs, this Notification mirrors the exemptions under the earlier notification dated June 5, 2017.

As per the Notification, the requirement to pay STT will not apply for transactions undertaken prior to October 1, 2004 i.e. before the introduction of STT. However, with regard to acquisitions undertaken on or after October 1, 2004, the Notification stipulates three types of acquisitions where STT is required to be paid at the time of acquisition as well, in order to claim the benefit of the provisions of section 112A of the IT Act. These are as follows:

(a) Where shares that are not frequently traded in a recognized stock exchange were acquired through a preferential issue except the following:

   (i) if such acquisition was approved by the SC, HC, NCLT, SEBI or RBI;

   (ii) acquisition was made by any non-resident in accordance with the Foreign Direct Investment ("**FDI**") policy of the Government of India;

   (iii) acquisition was made by any investment fund or a venture capital

[2] Notification No. 43/2017/F. No. 370142/09/2017- TPL SO 1789 (E).
[3] Notification No. 60/2018/F. No. 370142/09/2017- TPL SO 5054 (E).

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fund or a Qualified Institutional Buyer ("**QIB**");

(iv) acquisition of such shares through preferential issue to which Chapter VII of SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 ("**ICDR Regulations**"), (dealing with preferential issues) does not apply.

(b) Where transaction for acquisition was not entered through a recognized stock exchange except the acquisitions done in accordance with provisions of the Securities Contract (Regulation) Act, 1956 and was carried out through any of the following:

(i) acquisition was done through an issue of shares by a company other than a preferential issue;

(ii) acquisition by scheduled banks, reconstruction or securitisation companies or public financial institutions during their ordinary course of business;

(iii) if such acquisition was approved by SC, HC, NCLT, SEBI or RBI;

(iv) acquisition by the employees under an Employee Stock Option Plan;

(v) acquisition by any non-resident in accordance with the FDI guidelines issued by Government of India;

(vi) acquisition in accordance with SEBI (Substantial Acquisition of Shares and Takeovers) Regulation, 2011;

(vii) acquisition from the Government;

(viii) acquisition by an investment fund, venture capital fund or a QIB; and

(ix) acquisition through transactions not regarded as transfer under section 47 of the IT Act, through slump sale under section 50B of the IT Act, through capital contribution under section 45(3) of the IT Act or through distribution of capital assets by way of dissolution under section 45(4) of IT Act, provided the previous owner did not acquire the shares in the modes prohibited in clause (a) or (b) or (c).

(c) Acquisition of equity share of a company from the period of delisting till the time the company is listed again on the recognised stock exchange.

It may be pertinent to note here that the Notification exempts shares acquired pursuant to preferential issue made by the companies (whose shares are not frequently traded in the recognised stock exchanges), provided the issue is not subject to Chapter VII of the ICDR Regulations. Regulation 70 of the ICDR provides that Chapter VII of the ICDR transactions would not apply in cases of (i) preferential issue of shares pursuant to conversion of loans or options attached to convertible debt instruments; (ii) preferential issue of shares pursuant to scheme approved by the HC under sections 230 to 234 of the Companies Act, 2013; and (iii) under a rehabilitation scheme under the Sick Industrial Companies (Special Provisions) Act, 1985 or the NCLT under the IBC, whichever applicable. Thus, gains arising from equity shares acquired pursuant to these transactions would continue to enjoy the benefits of section 112A of the IT Act, even if STT was not paid at the time of such acquisitions.

This is a very welcome initiative where the Government has clarified that taxpayers entering into genuine transactions should not be unduly harmed. This will enable investors and promoters to plan their business transactions in an optimum manner without having any uncertainty regarding their tax treatment. We sincerely believe that this will help in the

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avoidance of unnecessary litigation and provide stability to these new provisions.

3. CBDT ISSUES NOTIFICATION UNDER SECTION 115JG OF THE IT ACT

CBDT issued a Notification[4] dated December 6, 2018, ("**Notification**") specifying conditions for the application of section 115JG of the IT Act. Section 115JG of the IT Act exempts capital gains arising from conversion of an Indian branch of a foreign bank into a subsidiary company of such foreign company. Further, post such conversion, provisions relating to unabsorbed depreciation, set-off or carry forward and set-off of losses, etc. would apply with such exceptions, modifications, etc., as may be specified in the Notification.

CBDT has issued the Notification, specifying the conditions for tax neutral conversion under section 115JG of the IT Act. The conditions are as follows:

(i) Amalgamation of the Indian Branch with the Indian Subsidiary Company is in accordance with the scheme of amalgamation approved by the shareholders of the Foreign Company and the Indian Subsidiary Company and is sanctioned by RBI under the RBI Scheme.

(ii) All the assets and liabilities of the Indian Branch immediately before conversion become the assets and liabilities of the Indian Subsidiary Company;

(iii) Such transfer of assets and liabilities shall be at values appearing in the books of account of the Indian Branch immediately before its conversion. Change on account of revaluation of assets shall be ignored;

(iv) The Foreign Company or its nominee shall hold the whole of the share capital of the Indian Subsidiary Company during the period beginning from the date of conversion and ending on the last day of the Previous Year ("**PY**") in which the conversion took place and continue to hold shares of the Indian Subsidiary Company carrying not less than 51% of the voting power for a period of 5 years immediately succeeding the said PY;

(v) The Foreign Company does not receive any direct or indirect benefit or consideration, other than by way of allotment of shares in the Indian Subsidiary Company.

Further, the provisions relating to unabsorbed depreciation, set off or carry forward and set off of losses, tax credit in respect of tax paid on deemed income relating to certain companies and the computation of income in the case of Foreign Company and the Indian Subsidiary Company, shall *inter alia* apply as follows:

(i) The aggregate deduction, in respect of depreciation on tangible assets or intangible assets allowable to the Indian Branch and the Indian Subsidiary Company, shall be apportioned between the Indian Branch and Indian Subsidiary Company in the ratio of number of days for which the assets were used.

(ii) The accumulated loss and unabsorbed depreciation of the Indian Branch shall be deemed to be the loss or depreciation of the Indian Subsidiary Company for the PY in which conversion was effected. The provisions relating to set-off and carry forward of loss and allowance for depreciation shall apply accordingly. The Notification also defines 'accumulated loss' and 'unabsorbed depreciation'.

(iii) The actual cost of the block of assets of the Indian Subsidiary Company shall be the written down value of the block of assets of the Indian Branch on the date of conversion.

(iv) For other capital assets which have, as a result of conversion, become the Indian Subsidiary Company's property, the cost of acquisition shall be deemed to be the cost for which the Indian Branch acquired

[4] Notification No. 85/2018 dated December 6, 2018.

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it or, as the case may be, the cost for which the previous owner had acquired it.

(v) The tax credit of the Indian Branch shall be deemed to be the tax credit of the Indian Subsidiary Company for the purpose of the PY in which conversion was effected and the MAT provisions shall apply accordingly.

(vi) Where, pursuant to the conversion, the Foreign Company or its nominee receives shares in the Indian Subsidiary Company, section 56(2)(x) shall not apply.

The 'date of conversion' is the date appointed by RBI for the vesting of undertaking of the Indian Branch in the Indian Subsidiary Company under the RBI Scheme.

It may also be pointed out that CBDT issued another Notification[5] on December 6, 2018, amending Rule 8AA of the IT Rules. The new rule provides that where, pursuant to the conversion, a capital asset becomes the Indian Subsidiary Company's property, the period of holding of such asset shall include the period for which it was held by the Indian Branch and by the previous owner, if any, who has acquired the capital asset by a mode of acquisition referred to in section 49(1) or section 115JG (1) of the IT Act.

4. E-FILLING FOR LOWER/NIL TDS AND TCS CERTIFICATE

Section 197 of the IT Act provides that where tax is required to be deducted under certain specified sections, the taxpayer (i.e. the recipient) may make an application to AO, for obtaining a lower/nil withholding certificate. Upon obtaining such certificate, the person responsible for paying any sum would withhold tax at the rates specified in such certificate. This application was earlier required to be made under Form 13 in accordance with Rule 28 of the IT Rules.

However, the CBDT vide its Notification no. 74 / 2018 dated October 25, 2018 ("**Notification**") has amended the said rule and the form, to enable electronic filing of application using digital signature or electronic verification code. The Notification also amends the Rule 28AA of the IT Rules, which prescribes that the AO should issue such low/nil withholding certificates after being satisfied that the lower/nil withholding is justified based on the existing and estimated tax liabilities of the recipient taxpayer. The amended rule now provides that the AO should consider the tax payable for assessed or returned or estimated income of last 4 years instead of 3 years as per earlier provisions, for determining the existing and estimated tax liability of the recipient taxpayer.

Generally, the lower/nil withholding certificate is valid only with regard to the deductors named in the certificate. However, the amended rule provides that where the number of persons responsible for deducting tax is likely to exceed 100 and the details of such persons are not available at the time of making application, the certificate for deduction of tax at lower or nil rate may be issued to the recipient taxpayer. Further, the said notification has done away with the requirement imposed upon specified charitable or religious trust and other institutions of submitting details of deductors from whom amounts were to be received without deduction of tax at source, for obtaining such a certificate.

Similar to section 197(1), section 206C(9) of the IT Act provides that where any payment made by a buyer is subject to TCS, such buyer may make an application to the AO seeking a certificate for collecting tax at a lower rate. The Notification has amended the relevant rules to provide that such application under section 206(9) of the IT Act can be made electronically using digital signature or electronic verification code. Further, the amended rules also prescribe factors which should be considered by AO for estimating existing or future tax liability, similar to Rule 28AA of the IT Rules.

It may be pertinent to note that observing the hardships faced by certain taxpayers and to ensure proper administration of the provisions

[5] Notification No. 86/2018 dated December 6, 2018.

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of section 197 and section 206C of the IT Act, the CBDT, as per the press release dated December 24, 2018, has:

(i) allowed NRIs, who are not able to register themselves on TRACES, to file manual application in Form No. 13 before the TDS officer or in ASK Centers till March 31, 2019.

(ii) allowed resident applicants to file manual application in Form No. 13 before the TDS officer or in ASK Centers till December 31, 2018.

The aforementioned amendments in the Rules would come into effect from the date of publication of the notification i.e. October 25, 2018.

5. DEPARTMENT OF INDUSTRIAL POLICY & PROMOTION ("DIPP") CLARIFICATION ON INCOME - TAX NOTICE TO ANGEL INVESTORS

In light of the concerns raised by the angel investors about receipt of notices from IRA, the DIPP has issued a clarification recapitulating the special mechanism put in place to grant exemption to 'Start-ups' from provisions of section 56(2)(viib) of the IT Act. Section 56(2)(viib) of the IT Act is a deeming fiction which provides that where a closely held company receives any consideration from a resident for issue of shares at more than the face value of such shares, then such consideration as it exceeds the FMV (computed as per prescribed rules) of the shares is taxed in the hands of such company as 'income from other sources'. However, the above-mentioned provision does not apply where consideration is received by a venture capital undertaking from a venture capital company or a venture capital fund; or where consideration is received by a company from a class of persons notified by the Central Government.

The Ministry of Commerce and Industry had issued a notification[6] on April 11, 2018 whereby certain private limited companies which qualify as startups could seek an approval from the Inter-Ministerial Board of Certification ("**Board**") in order to claim exemption from applicability of section 56(2)(viib) of the IT Act. The exemption is available on satisfaction of following conditions:

(i) the aggregate amount of paid up share capital and share premium of the startup after the proposed issue of shares does not exceed INR 10 crores;

(ii) the investor (person subscribing to the issue) has the average returned income of INR 25 lakhs or more for preceding three financial years or the net worth of INR 2 crores or more as on the last date of the preceding financial year; and

(iii) the startup has obtained a report from merchant banker specifying the FMV of shares in accordance with Rule 11UA of IT Rules.

Pursuant to the powers granted under section 56(2)(viib) of the IT Act, the Central Government issued a notification[7] dated May 24, 2018 wherein startups that have sought an approval from the Board were granted exemption from taxability under section 56(2)(viib) of the IT Act. This notification was made retrospectively applicable from April 11, 2018.[8] Recently, CBDT has issued a letter directing that AO should not take any coercive measures to recover the outstanding demand from Startup, if additions have been made under section 56(2)(viib) of the IT Act after rejecting/modifying valuation so furnished under Rule 11UA(2) of IT Rules.

Reportedly, IRA have issued notices to various angel investors and startups despite the exemption available to them. The clarification issued by the DIPP seeks to reinforce the special mechanism put in place for the startups and angel investors. It aims to address the concerns raised by the angel investors and ensure that they are not subjected to litigation with the IRA. The clarification is expected to

[6] Ministry of Commerce and Industry, Notification No. G.S.R. 364(E) dated April 11, 2018.
[7] Notification No. 24/2018 dated May 24, 2018.
[8] F. No. 173/14/2018-ITA-I dated December 24, 2018.

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provide the much needed relief to the *bona fide* investments by investors into the startups. All the startups and investors who wish to claim exemption are advised to seek a prior approval from the Board. Interestingly, in few cases, the IRA has issued notices to valuers seeking clarifications on the assumptions relating to projected valuations under section 56(2)(viib) of the IT Act read with Rule 11UA(2) of IT Rules.

6. CBDT NOTIFIES INDIA-HONG KONG DTAA

CBDT vide Notification[9] dated December 21, 2018 has notified the provisions of DTAA between India and Hong-Kong. The DTAA, signed on March 19, 2018, came into force on November 30, 2018 with the completion of relevant procedures for ratification by governments of India and Hong Kong. The DTAA would be applicable on incomes earned from April 1, 2019 onwards. The DTAA aims at augmenting the flow of investments, technology and personnel between the two countries, preventing double taxation and facilitating exchange of information between the two countries.

Interestingly, as both the nations are signatories to the MLI, some of the provisions of the DTAA are inspired from MLI. For instance, the provision relating to principal purpose test has been incorporated in several articles applicable to specific incomes such as Dividends (Article 10), Interest (Article 11), Royalties (Article 12), FTS (Article 13), Capital Gains (Article 14) and the DTAA also has a general anti avoidance rule which provides that if the main purpose of any person is non-taxation or reduced taxation through tax evasion or avoidance, the contracting states are not required to grant treaty benefits. In addition to the principal purpose test applicable to the above provisions, the DTAA authorizes contracting states to apply domestic law provisions concerning tax avoidance or evasion such as GAAR to deny benefits of the DTAA. The salient features of the DTAA include source based taxation of transfer of shares of a company, however does not cover indirect transfer of Indian assets covered under section 9 of the IT Act. The definition of FTS under the DTAA is broad and does not have a 'make available' clause unlike the US and UK DTAAs based on the nature of the service agreements with a Hong-Kong service provider, taxability of such FTS should be assessed carefully. Investors from Hong Kong looking to invest in India or vice versa should take note of the DTAA as it offers various benefits such as beneficial withholding rates in case of interest, and could prove instrumental in tax structuring of the investments and cross border agreements subject to the above anti abuse provisions warranting a careful and detailed evaluation of the provisions to facts on a case to case basis.

[9] Notification No. 89/2018 dated December 21, 2018.

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REGULATORY INDIRECT TAX UPDATES

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1. REVERSE CHARGE UNDER SECTION 9(4) OF CGST ACT AND SECTION 5(4) OF IGST ACT POSTPONED TILL SEPTEMBER 30, 2019

Section 9(4) of CGST Act and Section 5(4) of the IGST Act provides for the payment of tax on supplies from an unregistered supplier to a registered person on reverse charge basis. CBIC, *vide* Notification No. 22/ 2018 – Central Tax Rate, dated August 6, 2018, and Notification No. 23/2018 – Integrated Tax dated August 6, 2018 has delayed the implementation of said provision till September 30, 2019.

2. CBIC NOTIFIES OCTOBER 01, 2018 AS THE DATE OF IMPLEMENTATION OF TAX COLLECTION AT SOURCE (“TCS”) AND TAX DEDUCTION AT SOURCE (“TDS”)

CBIC *vide* Notification No. 50/2018-Central Tax dated September 13, 2018 and Notification No. 51/2018-Central Tax dated September 13, 2018 has appointed October 01, 2018 as the date for implementation of Section 51 of the CGST Act dealing with TDS and Section 52 of the CGST Act dealing with TCS.

The following category of persons have *inter alia* been notified as those who are required to deduct tax from the payment made or credited to the supplier of taxable goods and/or services:

(a) Public sector undertakings,

(b) Society established by the Central Government or the State Government or a Local Authority under the Societies Registration Act, 1860,

(c) Authority or a board or any other body, -

  (i) Set up by an Act of Parliament or a State Legislature; or

  (ii) Established by any Government, with fifty-one per cent or more participation by way of equity or control, to carry out any function.

3. CLARIFICATION REGARDING 'PRINCIPAL-AGENT RELATIONSHIP' UNDER GST LEGISLATIONS

Circular No. 57/31/2018 - CGST dated September 04, 2018 has clarified that the essential characteristic for covering a person within the ambit of the term “agent” under the GST legislations is the representative character identified as per the definition of “agent” under the Indian Contract Act, 1872.

In terms of Entry 3 of Schedule I to CGST Act, the supply of goods between principal and agent is treated as supply even in the absence of consideration. The objective criteria for determining the applicability would be whether the invoice for the further supply of goods on behalf of the principal is being issued by the agent or not. In other words, the decisive point is whether or not the agent has the authority to pass or receive the title of the goods on behalf of the principal. Accordingly, where the invoice for further supply is being issued by the agent in his name or the invoice is issued in the name of the agent then, any provision of goods between the principal and the agent would be treated as supply even in the absence of consideration.

4. CBIC CLARIFIED THE PROCEDURE TO BE FOLLOWED FOR RECOVERY OF ARREARS

Initially, CBIC *vide* Circular No. 42/16/2018-GST, dated April 13, 2018 had clarified that recovery of arrears shall be recovered as central tax to be paid through the utilization of the amount available in the electronic cash ledger of the registered person and the same shall be recorded in Part II of the Electronic Liability Register (FORM GST PMT-01).

At present, the electronic portal is not ready to record such transactions. Therefore, CBIC *vide* Circular No. 58/32/2018-GST, dated September 04, 2018 has clarified that as an alternative method, taxpayers may reverse the wrongly availed CENVAT credit under the existing law

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and inadmissible transitional credit through Table 4(B)(2) of FORM GSTR-3B which deals with ITC reversal. Additionally, the applicable interest and penalty shall also be paid and represented in column 9 of Table 6.1 of FORM GSTR-3B which deals with payment of tax.

5. CLARIFICATION ON LEVY OF GST ON PRIORITY SECTOR LENDING CERTIFICATES

Circular No. 62/36/2018-GST dated September 12, 2018 has clarified that for the period July 01, 2017 to May 27, 2018, the GST liability for supply of Priority Sector Lending Certificates would be paid on forward charge basis by the seller bank.

Separately, the GST liability for supply of Priority Sector Lending Certificates post May 27, 2018 would be paid on reverse charge basis.

6. CBIC ISSUES INSTRUCTION FOR DIRECTING THE OFFICERS TO FINALISE THE PROVISIONAL ASSESSMENT AND TO LEVY AND COLLECT SAFEGUARD DUTY ON THE IMPORT OF SOLAR CELLS

Instruction No. 14/2018 dated September 13, 2018 has been issued to withdraw earlier Instruction No. 12/2018, dated August 13, 2018. The earlier instruction provided for the provisional assessment of safeguard duty on the import of solar cells and its clearance on the basis of execution of a simple letter of undertaking/ bond by the importer.

Thus, the new instruction provides for the following:

(a) Finalization of all the provisional assessments done pursuant to the earlier instruction, and

(b) Levy and collection of safeguard duty on the import of solar cells (whether or not assembled in modules or panel) from China PR and Malaysia, in terms of Notification No. 1/2018 – Customs (SG) dated July 30, 2018.

7. EXTENSION OF EXEMPTION ON LEVY OF IGST AND COMPENSATION CESS ON GOODS IMPORTED UNDER ADVANCE AUTHORISATION, EXPORT PROMOTION CAPITAL GOODS ("EPCG") SCHEME AND EXPORT ORIENTED UNIT ("EOU") SCHEMES, ETC., UP TO MARCH 31, 2019

Notification No. 52/2003- Customs dated March 31, 2003 exempted the import of goods by EOU from the levy of IGST and compensation cess under sub-sections (7) and (9), respectively of Section 3 of the CT Act till October 2, 2018. *Vide* Notification No 65/2018-Customs dated September 24, 2018, the CBIC has extended the benefit of such exemption to importers under the EOU schemes till March 31, 2018. The relevant clauses of the FTP have also been amended *vide* Notification No. 35/2015-2002 dated September 26, 2018 to extend similar benefit to the Advanced Authorisation, EPCG and EOU schemes under the FTP.

8. PERMISSION TO USE STICKERS / STAMPING / ONLINE PRINTING FOR REVISING THE MRP OF PRE-PACKAGED COMMODITIES.

Post the reduction of GST rates effective July 27, 2018, the Ministry of Consumer Affairs *vide* its Notification No. WM-10(31)/2017 dated July 27, 2018, granted the permission to affix an additional sticker or stamping or online printing, for declaring the reduced MRP on the packages, up to December 31, 2018.[1] It further clarified the earlier label/sticker of MRP should continue to be visible on the package.

The said Notification also requested the State Legal Metrology Controllers to assist the GST officer Legal at State level, and further directed the Legal Metrology Officers to assist the local

[1] Rule 6(3) read with Rule 33(1) of the Legal Metrology (Packaged Commodities) Rules, 2011.

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GST officers at district level, in ensuring that the benefit of the reduction of the GST rates is passed onto the customers.

9. STATE LEVEL LEGAL METROLOGY OFFICERS WILL ASSIST GST OFFICERS AT STATE LEVEL TO ENSURE THE PASSING ON OF BENEFIT OF TAX REDUCTION OR ITC.

In pursuance to the Notification Nos. WM-10(31)/2017 dated July 27, 20018 and August 6, 2018, the GST Council, *vide* its Office Memorandum dated August 28, 2018, clarified that the State Legal Metrology Controllers would be assisting the GST officers at the State level to cross-verify the revised MRP of the pre-packaged commodities to ensure that the benefits of GST rate reduction or increased ITC are passed on to the consumers.

10. AMENDMENT TO RULES 89(4B) AND 96(10) OF THE CGST RULES

Rule 89(4B) of the CGST Rules

Rule 89(4B) of CGST Rules provided for refund of ITC for inputs and input services to the extend they were used in making export of goods where

(i) the person receives supplies, on which the supplier has availed the benefit of concessional rate of tax (i.e. merchant exporter), or

(ii) the person receives supplies, on which the supplier has availed the benefit by virtue of being holder of export oriented unit, software technology park unit, EPCG, advance authorisation scheme ("**Scheme Benefit**").

This caused prejudice to person holding Scheme Benefit, prior to October 9, 2018, as they were unable to take refund.

Notification No. 54/2018-Central Tax dated October 9, 2018 has made amendment to the said rule. Now, where the person receives supplies, on which the supplier has availed the benefit of concessional rate of tax (i.e. merchant exporter) and the person who has availed the Scheme Benefit, can claim the refund of ITC in respect of such inputs received for export of goods and ITC in respect of other inputs and input services to the extend they are used in making such export of goods.

Post the said amendment, even the person holding Scheme Benefit, would be able to take refund.

Rule 96(10) of the CGST Rules

Notification No. 53/2018-Central Tax dated October 9, 2018 has made amendments to Rule 96(10) of the CGST Rules. The said amended rule was effective between October 23, 2017 and October 8, 2018. In terms of the said amendment, the rule restricted the person for claiming refund of IGST paid on export of goods or services by certain person:

(a) Person who has received the goods on which the supplier has availed the benefit of deemed export, concessional rate of tax (i.e. merchant exporter) ("**Supplier Benefit**");

(b) Person who has received the goods on which the supplier has availed the Scheme Benefit.

Thus, where the exporter who himself imported goods taking the Scheme Benefit shall be eligible to claim refund of IGST paid on export. The same has been further clarified *vide* Circular No. 70/44/2018-GST dated October 26, 2018.

Consequently, for the period starting from October 9, 2018, Rule 96 (10) was amended *vide* Notification No. 54/2018-Central Tax dated October 9, 2018. In terms of the said amendment, the present rule restricts the person for claiming refund of IGST paid on export of goods or services by certain person:

(a) Person who has received the goods on which the supplier has availed the Supplier Benefit except the EPCG holder

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where it makes domestic procurement of capital goods;

(b) Person who has availed the Scheme Benefit except the EPCG holder where it has imported goods covered by a valid authorisation.

Thus, where the exporter has himself imported goods taking the Scheme Benefit, except EPCG scheme, it shall not be eligible to claim refund of IGST paid on export post October 9, 2018.

11. CBIC CLARIFIES PROCEDURE REGARDING RETURN OF TIME EXPIRED DRUGS/MEDICINES

Circular No. 72/46/2018-GST dated October 26, 2018 has specified procedure to return pharmaceutical drugs/medicines which have crossed their date of expiry ("**Expired Drugs**") back to wholesaler/manufacturer. The person returning the Expired Drugs may avail either of the following options using the procedure prescribed therein:

(a) ***Fresh supply***

(i) Where the Expired Drugs are returned by a registered person (other than a composite taxpayer) as a fresh supply, such taxpayer shall raise an invoice to its wholesaler/manufacturer, as the case may be. The invoice must represent the value of the Expired Goods. The value at which goods were supplied in the first place may be taken as the value of fresh supply. The ITC shall be available to wholesaler/manufacturer, as the case may be. However, where such Expired Drugs are destroyed, the ITC availed on such fresh supply, must be reversed.

(ii) Where the Expired Drugs are returned by a composite taxpayer as a fresh supply, such taxpayer shall raise a bill of supply to its wholesaler/manufacturer, as the case may be, and pay applicable GST at the rate applicable to composite taxpayer. No ITC shall be available to wholesaler / manufacturer, as the case may be.

(iii) Where the Expired Drugs are returned by an un-registered taxpayer as a fresh supply, such taxpayer shall raise a commercial document without charging GST to its wholesaler/manufacturer, as the case may be.

(b) Credit Note

Where the Expired Drugs are returned by the recipient of drugs to its supplier, i.e. wholesaler/manufacturer, the supplier shall raise a credit note to the recipient and the recipient shall raise a delivery challan. There is no time limit for issuance of a credit note, however, the adjustment of tax liability can be done only when the credit note is issued prior to the month of September following the end of financial year. Where the credit note is issued within such time period, the supplier shall adjust the tax liability, subject to the condition that the recipient (i.e. person returning the Expired drugs) has either not availed ITC or has reversed the availed ITC. Where credit note is not issued and Expired Drugs are not returned within such time period, there is no requirement to adjust the tax liability.

Where such Expired Drugs are destroyed, the ITC attributable to manufacture such Expired Drugs, must be reversed.

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1. INCREASE IN VALIDITY PERIOD OF ADVANCE AUTHORIZATION

Prior to amendment in Para 4.41(c) of HBP, by Public Notice No. 63/(2015-2022) dated December 27, 2018, the Regional Authority was empowered to grant one revalidation for six months from the date of original Advance Authorization on request of authorization holder. Pursuant to this amendment, the Regional Authority may grant a second revalidation for six months from the expiry date of the first revalidation on request of authorization holder. Such second revalidation has been provided for making import proportionate to export obligations already fulfilled.

2. INCREASE IN VALIDITY AND UTILISATION OF NORMS RATIFIED BY NORMS COMMITTEE IN RESPECT OF ADVANCE AUTHORIZATION WHERE STANDARD INPUT OUTPUT NORMS DO NOT EXIST

Prior to amendment in Para 4.12(vi) of HBP, by Public Notice No. 64/(2015-2022) dated December 27, 2018, the validity of norms ratified was two years from the date of ratification. Now, the validity of norms ratified post March 31, 2015 by any Norms Committee of DGFT has been extended upto March 31, 2020 or three years from the date of ratification, whichever is later.

Additionally, other applicants of Advance Authorization are also eligible to get authorization based on ratified norms on repeat basis during the validity of such norms available as decisions of Norm Committee's minute on DGFT website.

3. RELAXATION IN IMPORT/EXPORT OF EXHIBITS REQUIRED FOR NATIONAL AND INTERNATIONAL EXHIBITIONS/FAIRS

Public Notice No. 58/(2015-2020) dated December 12, 2018 has amended Para 2.63(a) of HBP to allow the import/export of exhibits, including construction and decorative materials, which are 'free', 'restricted', and for Star Trading Enterprises as per ITC-HS of export and import, required for the temporary stands of foreign / Indian exhibitors at exhibitions or fairs or similar show or display for a period of six months on re-export/re-import basis, without an Authorisation on submission of a bond / security to Customs or ATA Carnet. Only items in the 'prohibited' or SCOMET[1] List cannot avail such benefit.

4. CLARIFICATION ON ELIGIBILITY OF FIRMS PROVIDING EDUCATIONAL SERVICES UNDER SERVICES EXPORTS FROM INDIA SCHEME ("SEIS")

Policy Circular No. 13/2015-2020 dated October 05, 2018 clarifies that benefits under the SEIS of the Foreign Trade Policy 2015-2020 shall be available to Indian institutes providing educational services to NRI students. It also clarifies that educational services provided to Indian students sponsored by NRIs would not be considered for SEIS benefits as such students cannot be considered as foreign consumers.

5. RATE REVISIONS PURSUANT TO THE 31ST GST COUNCIL MEETING (W.E.F. JANUARY 01, 2019)

(a) *Changes to GST rates on goods*

Notification No. 24/2018-Central Tax (Rate)[2] dated December 31, 2018 amended Notification No. 1/2017-Central Tax (Rate) dated June 28, 2017 and introduced *inter alia* "lithium-ion accumulators (other than battery) including lithium-ion power bank" under HSN code 8507 at effective rate of 18% GST; natural cork and articles of natural cork (HSN 4502 00 000 and 4503 respectively) at effective rate of 12% GST; marble and natural coke (HSN 2515 11 00 and 4501 respectively) at effective rate of

[1] Special Chemical, Organisms, Materials, Equipment and Technologies.
[2] Similar rate changes on the same goods have also been made under UGST Act and IGST Act *vide* Notification Nos. 24/2018-Union Territory (Rate) and 25/2018-Integrated Tax (Rate) both dated December 31, 2018.

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5% GST. Video games, table games such as billiards and casino games (HSN 9504) and parts and accessories of motor vehicles (HSN 8711) such as motorcycles etc. would now attract effective rate of 18% and 28% GST, respectively.

(b) *CGST rates on various new services notified*

Notification No. 27/2018-Central Tax (Rate)[3] dated December 31 2018 made several amendments to Notification No. 11/2017-Central Tax (Rate) dated June 28, 2017. It *inter alia* inserted under S. No. 15 item no. (vi) third party insurance of "goods carriage" and item no. (vii) as a residuary entry with effective GST rate of 12% and 18%, respectively. A new entry pertaining to construction/ engineering/ installation and related technical services to set up bio-gas plant, solar power based devices etc. is inserted at an effective rate of 18% GST.

(c) *Amendments to list of exempted goods*

Notification No. 25/2018-Central Tax (Rate)[4] dated December 31, 2018 has *inter alia* exempted supply of gift items received by the President, Prime Minister, Governor or Chief Minister or any public servant on account of public auction by the Government, if such proceeds are used for public/charitable cause. Thereby, Notification No. 2/2017-Central Tax (Rate) dated June 28, 2017 is suitably amended.

6. CLARIFICATIONS REGARDING APPLICABLE GST ON SUPPLY OF LIQUEFIED PETROLEUM GAS ("LPG") FOR DOMESTIC USE AND ON INTER-STATE SUPPLY OF TOWER CRANES AND RIGS

Circular No. 80/54/2018-GST dated December 31, 2018 has *inter alia* clarified that LPG supplied in bulk, whether by a refinery / fractionator to Oil Marketing Company or by one Oil Marketing Company to another for bottling and further supply for domestic use, shall fall under S. No. 165A of Notification No. 1/2017-Central Tax (Rate) dated June 28, 2017 and shall attract effective GST rate of 5% w.e.f. January 25, 2019.

It is also clarified that any inter-state movements of goods such as tower cranes, rigs, concrete pumps and mixers (without mounted on wheels) etc. but required as regular means of conveyance by companies in infrastructure business would not constitute supply if two conditions are met. Firstly, such goods are provided by the service provider on his own account. Secondly, there must be absence of the intention to further supply goods by way of transfer of title in goods or stock transfer to distinct person. It is in tandem with Circular No. 21/21-2017-GST dated November 22, 2017 which clarified that no GST would be levied upon inter-state movement of rigs/tools/spares and all good on wheels.

7. GST ON REVERSE CHARGE BASIS IN RELATION TO SERVICES OF BUSINESS FACILITATOR ("BF") / BUSINESS CORRESPONDENT ("BC"), SECURITY SERVICES AND RELATED CLARIFICATION

Vide Notification No. 29/2018-Central Tax (Rate)[5] dated December 31, 2018, three new entries are inserted in Notification No. 13/2017-Central Tax (Rate) dated June 28, 2017 upon which GST will be paid on reverse charge basis w.e.f. January 01, 2019: (i) services provided by BF to a banking company located in India; (ii) services provided by an agent of BC to a BC located in India and (iii) security services provided by way of supply of security personnel to a registered person. If the security services are provided to Govt. departments and local authorities that are registered only for TDS collection or to a registered person paying tax under composite scheme, GST is not applicable on these on reverse charge basis.

[3] Similar rate changes on the same services have also been made under UGST Act and IGST Act *vide* Notification Nos. 27/2018-Union Territory (Rate) and 28/2018-Integrated Tax (Rate) both dated December 31, 2018.
[4] Similar exemptions upon goods have also been made under UGST Act and IGST Act *vide* Notification Nos. 25/2018-Union Territory (Rate) and 26/2018-Integrated Tax (Rate) both dated December 31, 2018.
[5] Similar exemptions upon goods are provided under UGST Act and IGST Act *vide* Notification Nos. 29/2018-Union Territory (Rate) and 30/2018-Integrated Tax (Rate) both dated December 31, 2018.

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It is *clarified* by Circular No. 86/05/2019-GST dated January 01, 2019 that where a banking company collects service charges from its customers for providing BC/BF services to them, it is liable to pay GST as a service provider on the entire value of service charge/fee charged to customers, whether or not received *via* BF or BC. It is also clarified that to avail exemption upon services provided by BC/BF to banking company in relation to "accounts in its rural areas branch" *vide* S. No. 39 of Notification No. 12/2017-Central Tax (Rate) dated June 28, 2017, it must be satisfied that such services are provided with respect to accounts in rural area branches and should fall under Heading 9971. In this regard, the classification adopted by banks as per RBI guidelines would be acceptable.

8. CLARIFICATION ON GST LEVY ON CONSIDERATION RECEIVED FOR EXPORT OF SERVICES WHEREIN PORTION OF THOSE EXPORTED SERVICE WAS OUTSOURCED

Circular No. 78/52/2018-GST has noted that when export of services involves outsourcing portion of such services, two supplies take place: (i) supply of services from the exporter in India ("**Exporter**") to the recipient of services outside India ("**Service Recipient**") for full contract value and (ii) import of services by the Exporter from the supplier of services located outside India ("**Outsourcing Supplier**") for the outsourced portion of the contract.

It is clarified that the Exporter is liable to pay IGST on reverse charge basis on the import of services mentioned as supply (ii) above and shall be eligible to claim ITC for the IGST so paid. It is further clarified that if the Service Recipient directly pays the portion of consideration to the Outsourcing Supplier for the services provided to it (i.e. not received in convertible foreign exchange in India), that portion of the consideration shall also be deemed to have been received for the export of service as per Section 2(6)(iv) of the IGST Act. However, two conditions must be satisfied:

(a) IGST is paid by the Exporter on the said consideration for the outsourced services.

(b) RBI has allowed that a part of the consideration for such exports can be retained outside India.

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GLOSSARY

ABBREVIATION	MEANING
AAR	Hon'ble Authority for Advance Rulings
AAAR	Hon'ble Appellate Authority for Advance Rulings
ACIT	Learned Assistant Commissioner of Income Tax
AE	Associated Enterprises
AO	Learned Assessing Officer
AY	Assessment Year
Customs Act	Customs Act, 1962
CBDT	Central Board of Direct Taxes
CBIC	Central Board of Indirect Taxes and Customs
CCR	CENVAT Credit Rules, 2004
CEA	Central Excise Act, 1944
CENVAT	Central Value Added Tax
CESTAT	Hon'ble Customs, Excise and Service Tax Appellate Tribunal
CETA	Central Excise Tariff Act, 1985
CGST	Central Goods and Service Tax
CGST Act	Central Goods and Service Tax Act, 2017
CGST Rules	Central Goods and Service Tax Rules, 2017
CIT	Learned Commissioner of Income Tax
CIT(A)	Learned Commissioner of Income Tax (Appeal)
CRISIL	Credit Rating Information Services of India Limited
CST	Central Sales Tax
CST Act	Central Sales Tax Act, 1956
CTA	Custom Tariff Act, 1975
CVD	Countervailing Duty
DCIT	Learned Deputy Commissioner of Income Tax
DGAP	Directorate General of Anti-Profiteering
DGFT	Directorate General of Foreign Trade
DRP	Dispute Resolution Panel
DTAA	Double Taxation Avoidance Agreement
FA	The Finance Act, 1994
FMV	Fair Market Value
FTP	Foreign Trade Policy
FTS	Fees for Technical Services
FY	Financial Year
GAAR	General Anti-Avoidance Rules
GST	Goods and Service Tax
GST Compensation Act	Goods and Services Tax (Compensation to States) Act, 2017

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ABBREVIATION	MEANING
HBP	Handbook of Procedure
HC	Hon’ble High Court
IBC	Insolvency and Bankruptcy Code, 2016
IGST	Integrated Goods and Services Tax
IGST Act	Integrated Goods and Services Tax Act, 2017
INR	Indian Rupees
IRA	Indian Revenue Authorities
IT Act	Income Tax Act, 1961
ITAT	Hon’ble Income Tax Appellate Tribunal
ITC	Input Tax Credit
IT Rules	Income Tax Rules, 1962
Ltd.	Limited
MAT	Minimum Alternate Tax
MLI	Multilateral Convention to Implement Tax Treaty related measures to prevent Base Erosion and Profit Shifting
MRP	Maximum Retail Price
NAA	National Anti-profiteering Authority
OECD	Organization for Economic Co-operation and Development
PCIT	Principal Commissioner of Income Tax
PE	Permanent Establishment
Pvt.	Private
R&D	Research and Development
RBI	Reserve Bank of India
SC	Hon’ble Supreme Court
SEBI	Security Exchange Board of India
SEZ	Special Economic Zone
SGST	State Goods and Services Tax
SGST Act	State Goods and Services Tax Act, 2017
SLP	Special Leave Petition
ST Rules	Service Tax Rules, 1994
TCS	Tax Collected at Source
TDS	Tax Deducted at Source
TPO	Transfer Pricing Officer
UK	United Kingdom
USA	United States of America
UTGST	Union Territory Goods and Services Tax
UTGST Act	Union Territory Goods and Services Tax Act, 2017
VAT	Value Added Tax
VAT Tribunal	Hon’ble VAT Tribunal

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