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TAX SCOUT

A quarterly update on recent developments in Taxation Law

JULY 2019 – SEPTEMBER 2019

FOREWORD

As a part of our regular quarterly update exercise, we are pleased to present the direct and indirect tax updates covering the material changes that took place during the period from the 1st of July to 30th of September, 2019. We have also covered the judicial precedents covering some of the important decisions rendered by the Indian judiciary during this period.

As the cover story, we have identified that the e-assessment scheme formulated by the Government to increase transparency within the Income Tax department and make tax assessment a seamless and faceless process. The scheme is a very important initiative by the Government aimed at reducing the interaction of the tax authorities with the taxpayers so that the tax assessments are undertaken more fairly, with lesser likelihood of corruption. We have tried to discuss in greater detail the salient features of the scheme and the procedure of e-assessment. This has the potential to transform the manner in which tax assessments are conducted in India. This would also bring in mandatory e-communication between the taxpayer and the tax-authorities, and thus, prove to be a watershed movement in moving towards a paperless scrutiny.

In addition to the above cover story, we have also dealt with other important developments and judicial precedents in the field of taxation.

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

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COVER STORY

MOVING TOWARDS PAPERLESS SCRUTINY: A WATERSHED MOMENT

Keeping in mind the technology-driven era, the Central Government has been putting efforts to facilitate regulatory filings through the electronic media. In furtherance of such efforts, in order to make the assessment proceedings in India convenient, on September 12, 2019, the CBDT has launched the much anticipated 'E-assessment Scheme, 2019' ("**Scheme**") which came into effect from the same day. The Scheme comes as a flagship of the efforts taken by the Central Government to increase transparency within the income tax department and make tax assessments a faceless and seamless process. The Scheme is taxpayer-friendly as not only will it be efficient and faster but more importantly, it is aimed at reducing the interaction of the tax authorities with the taxpayers so that the tax assessments are undertaken more fairly, with lesser likelihood of corruption.

The tax assessments carried out under the Scheme will not require physical presence of the tax payer in front of authorities as the entire correspondence will take place via e-mails. The Scheme mandates formation of separate units such as assessment units, technical units or verification units, etc. dealing with different aspects, however, all the communication between such units are supposed to be routed through the National E-assessment Centre formed under the Scheme. Further, even the selection of cases for scrutiny are allotted to assessment units electronically through an automated allocation system (determined by an artificial intelligence and machine learning based advanced algorithm). Therefore, the assessment unit may be from a completely different region. Some of the salient features of the Scheme are discussed in the ensuing paragraphs.

BACKGROUND

There has been discontent and heartburn among the taxpayers because of the highhandedness of the tax authorities during assessment proceedings. It was also observed that the interaction between taxpayers and tax administrators take place during the meetings in the course of assessment proceedings. Hence, the Government has been mulling over a plan of action that reduces or obliterates the extent of human interaction between both sides. In this regard, it may be noted that Section 143(3A) of the IT Act empowers the CBDT to enact any scheme regarding assessment of total income or loss of the assessee in order to impart greater efficiency, transparency and accountability by, *inter alia, "eliminating the interface between the Assessing Officer and the assessee in the course of proceedings to the extent technologically feasible"*. Accordingly, the CBDT has introduced the Scheme which has been defined as assessment proceedings being conducted electronically by electronic modes of communication through the assessee's registered account in a designated portal, so as to eliminate the requirement of physical interface between the assessee and the assessing authority. In order for such e-assessment to be possible, the CBDT has been empowered to specify the territorial area, or persons or class of persons, or income or class of income, or cases or class of cases for whom assessment shall be made under this Scheme. Accordingly, the CBDT had identified 58,322 cases for scrutiny and had sent the notices for AY 2018-19.[1]

FEATURES OF THE SCHEME

1. Structure

The CBDT would set up multiple e-assessment centres and units and they would be required to undertake specific functions as mentioned hereunder:

a. **National E-Assessment Centre ("NAC"):** The NAC would be responsible for keeping the system centralized and all the communication between the units and the assessee or any other person for the purposes of the e-assessment would be routed through it;

b. **Regional E-assessment Centre ("RAC"):** The RAC would facilitate and conduct e-assessment proceedings in the cadre controlling region of a Principal Chief Commissioner;

c. **Assessment Units ("AU"):** The AU would make the assessment including identifying issues for determination of liability and seeking information and clarification on the basis of material shared by the assessee. It will also be required to maintain communication with the NAC as any further information that is sought by the AU has to be routed through the NAC.

[1] https://pib.gov.in/newsite/PrintRelease.aspx?relid=193667.

d. **Verification Units ("VU"):** The VU would verify which includes enquiry, cross verification, examination of books of accounts, examination of witnesses and recording of statements, etc.

e. **Technical Units ("TU"):** The TU would provide technical assistance including any assistance or advice on legal, accounting, forensic, information technology, valuation, transfer pricing, data analytics, and management, etc.

f. **Review Units ("RU"):** The RU would review the draft assessment order including checking whether the relevant and material evidence has been brought on record, whether the relevant points of fact and law have been duly incorporated in the draft order, whether the issues on which addition or disallowance should be made have been discussed in the draft order, whether the applicable judicial decisions have been considered and dealt with in the draft order, checking for arithmetical correctness of modifications proposed.

The AU, the RU, the VU & the TU shall have following authorities:

a. Additional Commissioner or Additional Director or Joint Commissioner or Joint Director, as the case may be;

b. Deputy Commissioner or Deputy Director or Assistant Commissioner or Assistant Director, or Income-tax Officer, as the case may be;

c. Such other income-tax authority, ministerial staff, executive or consultant, as considered necessary by the Board.

2. Procedure for e-assessment

All communication among the units or with the assessee or any other person with respect to making of an assessment shall be through NAC:

a. The NAC shall serve a notice to the assessee under Section 143(2) of the IT Act, specifying the issues for selection of her/his case for assessment. The assessee shall have 15 days from the date of the receipt of the notice to file a response to the NAC;

b. The NAC shall assign the case to an AU of any of the RACs through an automated allocation system. The following is the information on what may be sought by the AU to the NAC and the corresponding action by the NAC:

Request of the AU for	Corresponding action by NAC
Obtaining further information, documents or evidence from assessee or any other person.	Issue appropriate notice or requisition to the assessee or other specified person to furnish such information, etc.
Conducting certain enquiry or verification by the VU	The NAC shall assign the request to a VU through an automatic allocation system
Seeking technical assistance from the TU	The NAC shall assign the request to a TU in any RAC through an automatic allocation system

c. Subsequent to receiving all the material, the AU shall make the draft assessment order (including details of penalty proceedings), and send the same to the NAC;

d. The NAC, upon receiving the draft assessment order, shall examine the same in accordance with the risk management strategy of CBDT (including by way of an automated examination tool) and decide the following:

   i. Finalise the draft order and serve it to the assessee along with notice to initiate penalty proceedings, if any, and the demand notice; or

   ii. If modification is proposed by the AU, the NAC shall serve a show cause notice to the assessee and the assessee will have to furnish its reply to NAC on or before the date and time as prescribed in the notice; or

   iii. Conduct review of such order by assigning the draft order to a RU of any RAC.

e. The assigned RU, after reviewing the order, may decide to:

The RU's decision	Corresponding action of the NAC
Concur with the draft assessment order	Follow the procedure prescribed in sub clause (i) & (ii) of clause d
Suggest modifications to the draft assessment order and send it to the NAC	Communicate such suggestions of modifications to the NAC, which, in turn, shall communicate the same to the concerned AU

f. The AU, after considering the suggestions of the modifications from the RU through the NAC, shall send the final draft order to the NAC.

g. The NAC after receiving the final draft order from the AU shall follow the procedure prescribed in sub clause (i) & (ii) of clause d.

h. The NAC shall:

   i. in case it doesn't receive any reply from the assessee against the show cause notice, it may finalise the draft assessment order as per the procedure laid down in sub clause (i) of clause (d).

   ii. in any other case, forward the response received from the assessee to the AU.

i. The AU, after considering the response from the assessee, shall make a revised draft assessment order and send it to the NAC.

j. The NAC shall, upon receiving the revised draft order:

   i. If the proposed modification in the revised draft order is not prejudicial to the interest of the assessee, shall finalise the assessment as per the procedure of sub clause (i) of clause d.

   ii. If the proposed modification in the revised draft order is prejudicial to the interest of the assessee, shall provide an opportunity to the assessee as per the procedure of sub clause (ii) of clause d.

   The response furnished by the assessee shall be dealt as per the procedure laid down in clauses g, h, and i.

k. After the completion of the assessment, the NAC shall transfer all the electronic records of the case to the AO having jurisdiction over such case for imposition of penalty / collection and recovery of demand / rectification of mistakes / giving effect to appellate orders / submission of remand report / sanction and launch of prosecution proceedings. The NAC also has the power to transfer the case to jurisdictional AO at any stage of the proceedings.

3. Penalty for non-compliance

Any e-assessment unit can send recommendations to the NAC for initiation of penalty proceedings against the assessee or any other person under Chapter XXI of the IT Act, for non-compliance of any notice, order or direction issued under this Scheme. The NAC, on such recommendations, shall issue a show cause notice to the assessee and the response to the notice by the assessee shall be conveyed by the NAC to the respective unit. The said unit after considering the response may:

a. Make a draft order of penalty and send the copy to the NAC for onward forwarding to the assessee; or

b. Drop the penalty proceedings after recording reasons and inform the NAC.

4. Other relevant features:

a. **Exchange of Communication:** All communication between NAC and assessee or his/her authorised representative or other e-assessment units shall be made exclusively by electronic mode.

b. **Authentication of Electronic Record:** An electronic record shall be authenticated by the originator:

   i. by electronic signature or electronic authentication technique, in case the originator is an assessee or any other person;

   ii. by affixing digital signature, in any other case.

c. **No personal appearance in the e-assessment units:** A person shall not be required to appear personally or through authorised representative with respect to any proceedings at any of the e-assessment units. In case of a show cause notice issued to an assessee, he/she shall be entitled to seek personal hearing in any unit through video conferencing by any software supporting video telephony. Examination or recording of statement of assessee/any other person (other than statement recorded in the course of survey proceedings) shall also be conducted through video conferencing.

d. **Application of the scheme to other provisions of the IT Act:** A separate notification has been issued to provide for such exceptions, modifications & adaptions on various provisions of the IT Act while applying to the e-assessment proceedings. The additional notification covers the power of Joint Commissioner to issue directions under Section 144A, reference to DRP under Section 144C, penalties imposable under Chapter XXI, estimation of value of assets by valuation officer under Section 142A, power regarding discovery, production of evidence under Section 131, power to call for information under Section 133, etc. of the IT Act.

WAY FORWARD

Although several steps have been taken for facilitating the assessment proceedings, yet it seems that there could be a lot of confusion, at least during the initial few years, as all the communication is expected to be routed through the NAC. While the purpose behind such a centralised system is understandable and much desirable, the AUs must be given more power to deal with the assessees on their own for certain insignificant demands for the purposes of the assessment. Such multi-tier communication may not help in making the process bureaucratic and lengthier instead of faster and smoother, defeating the purpose of bringing in such a Scheme. It is interesting to note that customarily assessments have been completed in meetings with tax authorities and the authorised representatives of the taxpayers. As communication in electronic mode may not necessarily help the authorities to understand the explanation offered by the taxpayer, hence, it would be vital to have an opportunity of personal hearing in the matter for efficacious assessments when the taxpayer and the tax authorities agree that the matter warrants a personal hearing. Instead of taking a rigid stance, the tax authorities should take a conciliatory and softer approach so as to avoid litigations. While the Scheme is intended to increase transparency and reduce litigation, one potential collateral damage, could be compromise on the consistent treatment. In the absence of the objective parameters, it is possible that different officer assessing the taxpayer in different years could end up taking diametrically opposite views, which could work in favour of the taxpayer or against it, based on case history.

However, it cannot be ignored that considering the orders passed will be reviewed and the quality of the assessment will improve because of transparency, the Scheme indeed has tried to include an inherent checks and balance system to avoid e-assessments contrary to the settled principles of law, which involve frivolous additions. Additionally, the taxpayers would be in a better position as the AO's powers would be restricted as the recovery is expected to be undertaken in accordance with the Scheme, leading to reduction in the AO' discretion. In addition, there is a geographical dissection, considering the assessment for a taxpayer may be conducted from any part of the country and in this light, it is expected that the video conferencing, when required, takes place smoothly. Due to all these reasons, the Scheme will help in reducing the abuse of power by the AO and corruption that may be present in certain interactive assessments due to the very nature of physical meeting and interaction with the AO.

Additionally, it will be a task for officers to maintain the digital documentation and there will be no room for technical glitches as a lot of data would be involved in the process. Needless to mention, the authorities also have to ensure that the e-mail IDs and the mobile numbers are also updated and the automated system is working well for the communication with the taxpayers. As it seems from the working of the CBDT which has already posted officers in the units in accordance with the Scheme, the way forward under the Scheme seems promising for the taxpayers. It will have to be seen as to how the tax authorities should be able to come up with a plan of action that is neither considered pervasive nor obtrusive and the huge machinery of the tax administrators are employed gainfully so as to enhance the tax revenues for the Government.

If the Scheme is adopted successfully and is accepted even by the taxpayers as it is in other countries such as Singapore, UK, Brazil, and Germany etc., it could become the watershed moment for the taxpayers that they have been waiting for a long time!

CASE LAW UPDATES - DIRECT TAX

CASE LAW UPDATES - INTERNATIONAL TAX

KARNATAKA HC HOLDS CONCEALMENT PENALTY CAN BE IMPOSED ON THE ADDITIONS DETERMINED UNDER MUTUAL AGREEMENT PROCEDURE

In the case of ***Toyota Kirloskar Auto Parts Pvt. Ltd.,***[2] (the "**Assessee**") the Karnataka HC has held that penalty proceedings cannot be invalidated merely because addition is made pursuant to Mutual Agreement Procedure ("**MAP**").

FACTS

The Assessee is engaged in the business of manufacture and trade of passenger cars and multi-utility vehicles and is a subsidiary of a Japanese company ("**J Co.**"). During the relevant tax year, the Assessee entered into certain international transactions with J Co. The IRA questioned the arm's length price ("**ALP**") of these transactions and an adverse order was passed. Additionally, the IRA also initiated penalty proceedings.

The Assessee filed an appeal against the IRA in respect of the assessment order with the ITAT. Simultaneously, J Co. seeking redetermination of the transfer pricing ("**TP**") adjustment made by the IRA, initiated a MAP under the DTAA. As per MAP proceedings, the Competent Authorities ("**CAs**") of India and Japan reduced the TP adjustment to INR 980 million against the INR 2,400 million originally proposed by the IRA. Upon withdrawal of appeal before the ITAT, the IRA re-determined the income as per MAP resolution. On the adjustment made basis MAP, the IRA imposed concealment penalty against the Assessee alleging that the Assessee had concealed income. Aggrieved, the IRA appealed against the penalty order. It also filed a writ petition before the HC challenging the constitutional validity of the application of penalty provisions under Indian tax laws to adjustment made pursuant to MAP proceedings between two sovereign nations under the DTAA, which does not specify any predetermined penalty.

> **Karnataka HC upholds the supremacy of IT Act even for cases covered under MAP on levy of penalties.**

ISSUE

Whether concealment penalty could be levied on a TP adjustment made pursuant to MAP resolution? And whether the concealment penalty in respect of addition made pursuant to MAP resolution under Indian tax law, is *ultra vires* the Constitution of India?

ARGUMENTS

It was contended by the Assessee that initiation of the penalty proceedings was incorrect, in relation to the final decision of MAP, which was arrived on the basis of the negotiations between CAs of the two nations. Further, it was stated that there was no pre-determined penalty in the MAP order and the question of penalty would not fall within the scope of the provisions under the IT Act and IT Rules. In addition, it was stated that Article 253 of the Constitution of India grants the power to the parliament to make any whole or part of the territory for implementation of a treaty, agreement or convention with any country or any decision made at any international conference. The Government of Japan and Union of India have entered into a DTAA to avoid double taxation. They have also mutually agreed for a procedure to resolve disputes and the same is provided under Section 90 of the IT Act.

Thus, that being the position, the penalty under Section 271(1)(c) was levied in respect of an agreement between two sovereign states which has

[2] Toyota Kirloskar Motor Ltd v. Union of India, in WP No. 57865/2015 C/W and WP No. 56348/2015 (Bombay HC, June 11, 2019).

been directed to be implemented by AO based on an adjudication made by the TPO under Section 92C of the IT Act. It was contended to be contrary to the provisions of the DTAA and would be *ultra vires* Article 253 of the Constitution of India.

The IRA, on the other hand, contended that MAP is a mechanism for resolution of disputes to the extent provided under the terms and conditions of the DTAA. The purpose of MAP is alleviation of economic double taxation of the taxpayer, and it does not absolve the penal consequences of concealment of income. Referring to Article 3(d) of the India-Japan DTAA, the IRA further contended that the same deals with tax and not penalty. Levy of penalty is dependent on facts of the case and is governed by Section 271(1)(c) of the IT Act. MAP order does not bar the levy of penalty.

DECISION

The HC stated that imposition of concealment penalty on TP adjustment based on the amount determined on the basis of MAP resolution cannot be said to be *ultra vires* the Constitution of India. It redirected the matter to the CIT(A) to decide the levy of penalty based on the merits of the case. The HC noted that the MAP resolution was silent on the issue of penalty imposition and unless a specific provision is made in MAP agreement, the penalty provisions of the Indian domestic law will continue to prevail. The HC also observed that the onus is on the Assessee to establish that the adjustment agreed in MAP was not due to concealment of income. Further, the HC also held that the penalty provisions of the domestic tax law does not empower the tax authority to levy penalty automatically without application of mind and the conditions provided in the IT Act for levying penalty would have to be satisfied.

The HC further held that although there are provisions under the Constitution of India for enacting any law for implementing any agreement with foreign countries and the India-Japan DTAA provides for MAP resolution, it cannot be held that a concealment penalty levied in respect of addition made pursuant to MAP resolution under the Indian tax laws, is *ultra vires* the Constitution of India.

SIGNIFICANT TAKEAWAYS

While the decision of the HC prima facie may a stands correct, the same is bound to create several problems for the taxpayers in the long run. The intent behind taxpayers opting for MAP procedures is to find an alternative to undergoing the ordeal of tax litigations. Any settlement reached between the CAs over the dispute may not be indicative of taxpayer's intent that they agreed with the allegations of the tax authorities. If a penalty is going to be levied on the additions agreed upon under the MAP, it may dissuade many taxpayers to pursue the path of MAP proceedings. Having said that, it appears that the categorical finding of the ITAT about the applicability of penalty provisions under the IT Act should provide the requisite guidance following the path resolution through MAP.

AUDI DOES NOT HAVE A PE IN INDIA

In the case of ***Audi AG***,[3] the Mumbai Bench of the ITAT held that the non-resident company did not have either a fixed place PE or an agency PE in India as the Indian AE undertook a separate activity of further sales after purchasing cars outside India from the non-resident company, and both the entities had a principal to principal relationship.

FACTS

Audi AG ("**Assessee**"), was a German company engaged in the business of manufacturing of cars. The Assessee had entered into agreements with its Indian AEs for selling fully built-up cars and its accessories. Pursuant to such agreements, the Assessee used to provide sell-parts or accessories to Skoda India for manufacturing or assembling cars. Volkswagon Group Sales ("**VWGS**"), another Indian company, being the sole distributor, used to purchase those cars from the Assessee directly or from Skoda India in order to further sell such cars to dealers. The AO, in the draft assessment order, held that under Articles 5(1) and 5(2) of the India-Germany DTAA, VWGS is a fixed place PE and agency PE of the Assessee in India on the basis of the activities undertaken by VWGS allegedly on behalf of the Assessee and on account of their exclusive relationship.

Accordingly, in the said order, the AO attributed 35% of the total income of the Assessee to the PE in India. The Assessee appealed against the draft assessment order to the DRP. The DRP held that considering the range of functions such as storage, promotion, after sale services, etc., that are undertaken by VWGS on behalf of the Assessee, it can be considered as a PE of the Assessee. Being aggrieved by the decision of the DRP, the Assessee preferred an appeal with the ITAT.

> **"The Indian entity was not doing any activity for which profits of a non-resident entity can be attributed and hence, it was not a PE of the non-resident."**

ISSUE

Whether VWGS can be construed as a fixed place PE or an agency PE of the Assessee in India?

ARGUMENTS

Fixed Place PE

In order to constitute a fixed place PE, it has to be established that the Indian AE was conducting business activities in India for the foreign entity and such activities were undertaken from a fixed place which was at the sole disposal of the foreign entity. The DR argued that VWGS was only an extended arm of the Assessee as it was the exclusive distributor of the Assessee and it did not have any alternate source of income. Further, the DR supported his claim by stating that the sales targets of both the Assessee and VWGS were established together, and a range of activities such as marketing, storage, after sales services and support, supply of spare parts and accessories, etc., were performed by VWGS on behalf of the Assessee.

The Assessee, on the other hand, contended that sale of vehicles had already taken place outside India and the nature of the activities of both the Assessee and VWGS differed as the Assessee undertook manufacturing, quality control, etc., and VWGS undertook import, marketing, etc. VWGS paid tax separately on the income resulting from its activities in India.

Agency PE

In order to constitute an agency PE, it has to be established that the Indian AE is working solely on behalf of the foreign entity. Accordingly, the DR, in addition to their argument regarding constitution of a

[3] Audi AG v. ADIT, ITA Nos. 7335/Mum/2012 and 1781/Mum/2014 (ITAT Mumbai, September 03, 2019).

fixed place PE, also argued that since 100% of business relating to trading of cars manufactured by the Assessee was being done by VWGS, it constituted an agency PE of the Assessee in India. The Assessee, on the other hand, argued that the manufacturing and sale of the cars took place outside India, and it constituted a separate independent activity from VWGS' activity of further sales in India. Therefore, VWGS was not acting on behalf of the Assessee and the sale by Assessee to VWGS was on a principal to principal basis.

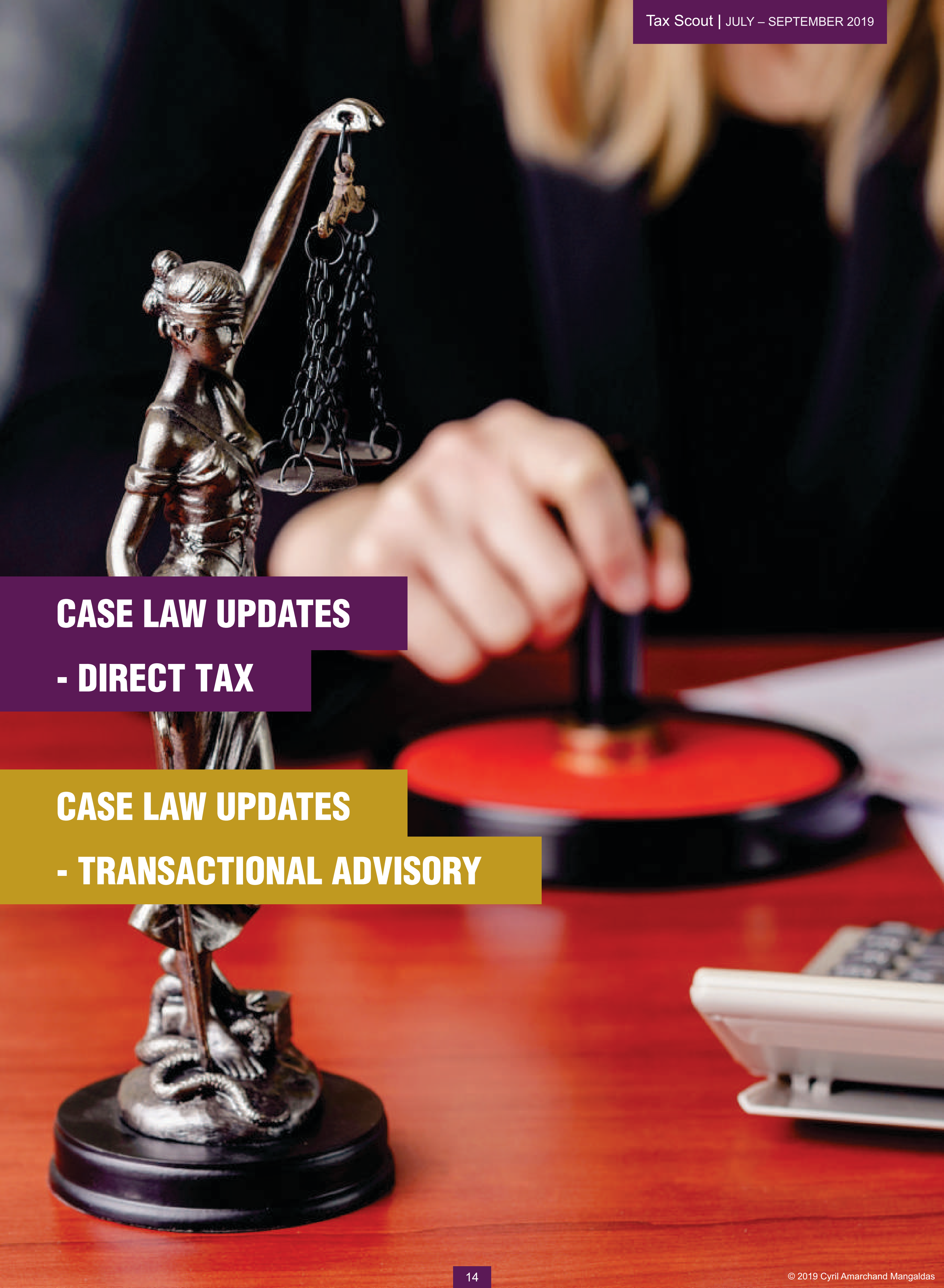
DECISION

The Mumbai Bench of the ITAT placed reliance on its previous decision in ***Daimler Chrysler AG***,[4] wherein on similar facts, it was held that the Indian AE did not work as a warehouse of the foreign entity since the Indian AE was purchasing the product from the foreign entity. Therefore, the Indian AE could not be constituted as the foreign entity's PE in India. Accordingly, the ITAT held that since the sale of cars took place outside India and was a separate and independent activity. It also held that the Indian AE was acting for a non-resident company on an arm's length basis and since it was not doing any definite activity to which profit can be attributed, VWGS should not be regarded as a fixed place PE or an agency PE of the Assessee in India.

SIGNIFICANT TAKEAWAYS

The Mumbai Bench of the ITAT upheld certain factors for the determination of a PE of a non-resident in India. These factors include place of negotiations and signing of contracts, responsibilities of the Indian AEs, and in case of sale of goods, the place of passing of the title in such goods. Therefore, it is relevant to note that the ITAT focused on finding a definite activity which the Indian AE was doing for the non-resident company in order to establish a PE.

[4] DCIT v. Daimler Chrysler AG, (52 SOT 93).



CASE LAW UPDATES - DIRECT TAX

CASE LAW UPDATES - TRANSACTIONAL ADVISORY

SC HOLDS RECEIPTS OF SUBSCRIPTION MONEY FOR INVESTMENT SCHEMES ARE CAPITAL RECEIPTS

In ***Peerless General Finance and Investment Company Ltd***,[5] the SC held that the receipts of subscription money towards investment schemes cannot be considered as revenue receipts and hence, not taxable as income.

FACTS

The Peerless General Finance and Investment Company Ltd. ("**Assessee**") had floated three schemes including Endowment Certificate Scheme ("**Scheme**") in which a principal amount had to be paid annually for a period of 10 to 30 years. Thereafter, the subscriber received back the entire principal, with some interest. In cases where the subscriber defaults the Scheme even before paying the first two installments, then the Assessee would forfeit the entire subscription amount. In cases of default after the payment of two installments, the Assessee would only pay back the 90% of the total amount paid by the subscriber.

> **Subscription money procured from subscribers of investment schemes is not revenue receipt, but capital receipts.**

At the time of completing the assessment for the AYs 1985-86 to 1996-97, the AO had treated the entire subscription amount that had been received towards the Scheme as income for these years, because the Assessee had inadvertently credited the same in its Profit & Loss Account. On the other hand, the Assessee argued that such amount was in the nature of capital receipts and that it had inadvertently credited the same in the Profit and Loss Account earlier. Accordingly, the Assessee appealed to the CIT(A) and on dismissal, to the ITAT. The ITAT allowed the appeal of the Assessee by holding that the amount was indeed in the nature of capital receipts by holding that the subscription amount does not belong to the Assessee unless the same had actually been forfeited. Therefore, it was held there was no income in the hands of the Assessee.

Further, an appeal was filed in the HC of Calcutta by the IRA. The HC rejected the appeal stating that it did not raise any substantial question of law. Being aggrieved by the order of the HC, IRA filed an SLP with the SC pursuant to which the SC directed the HC to decide the case on merits. After taking into arguments from both sides, the HC held in favour of the IRA by holding that since there was an option of forfeiture, the amount should be treated as income and not as capital receipts.

Being aggrieved by the HC, the Assessee preferred the instant appeal to the SC.

ISSUE

Whether the subscription money received by the Assessee against an investment scheme should be regarded as business receipts and should be offered to tax in the relevant period?

ARGUMENTS

The Assessee argued that the option of forfeiture had subsequently been taken away from it by the RBI vide the Residuary Non-Banking Companies (Reserve Bank) Directions, 1987 ("**1987 Directions**") under Section 45J and 45K of the Reserve Bank of India Act, 1934 ("**RBI Act**"). It had also been pointed out that the Assessee had never forfeited any amount. In addition, with regard to crediting the amount in its Profit and Loss Account, the Assessee argued that it was incorrect to go by the accounting system, when law clearly stated that such amounts were in the nature of capital receipts.

On the other hand, the IRA argued that the 1987 Directions were prospective in nature, and hence, would not be applicable in the instant case. In addition, it was also argued that the principle of estoppel should

[5] Peerless General Finance and Investment Company Ltd. v. CIT, (2019) 309 CTR 321 (SC).

be applicable in the instant case and since the Assessee had itself treated the subject amount as its income by crediting it to the Profit & Loss Account, it cannot now claim that the same was in nature of capital receipts.

DECISION

The SC observed that the Assessee did not forfeit any subscription money at any point of time and the surrendered money was not a part of this appeal. Further, the SC upheld the general principle that the amount received for the purposes of investment schemes was in the nature of capital receipts and therefore, concluded that subscription money received by the Assessee was in the nature of capital receipts. With regard to entry of credit in Assessee's Profit & Loss Account for the subscription money, the SC, by referring to its previous decisions such as ***India Discount Co. Ltd.,***[6] ***Godhra Electricity Co. Ltd.,***[7] and ***Chowringhee Sales Bureau P. Ltd.,***[8] held that the entries in the book of accounts are not decisive of the nature of the entries. It was also decided by the SC that entries reflected in the books of accounts of the Assessee did not determine the taxability of such income. On the basis of facts, the SC held that the subscription amount was not liable to tax since it was in the nature of a capital receipt.

SIGNIFICANT TAKEAWAYS

It was to be noted that the subscription money received by the Assessee towards the Scheme were required to be returned to the subscribers at the end of the maturity period, along with the interest. As such, the Assessee could not have claimed ownership of the said subscription amount. It is akin to the money received by chit funds/insurance companies from its subscribers, wherein the obligation to return the amount, based on the returns it generated on the investments, at the end of maturity period are inherently imbibed.

Therefore, the SC correctly applied the general principle to hold that the subscription money is in the nature of capital receipts. The SC also held that the amount that might have been forfeited by a company before the 1987 Directions could have been construed as income in the hands of the Assessee, since there was no obligation to return the subscription amount.

[6] CIT v. India Discount Co. Ltd., [1970] 75 ITR 191 (SC).
[7] Godhra Electricity Co. Ltd. v. CIT, [1997] 225 ITR 746 (SC).
[8] Chowringhee Sales Bureau P. Ltd. v. CIT, [1973] 87 ITR 542 (SC).

SC UPHOLDS THE CONSTITUTIONALITY OF THE LEVY OF ADDITIONAL INCOME ON THE SUPERRICH WHOSE DIVIDEND INCOME IS MORE THAN INR 1 MILLION

In ***Shilpin Tater & Ors.,***[9] the SC dismissed the SLP filed against the decision of the Delhi HC in ***Rajan Bhatia,***[10] thereby upholding the constitutional validity of Section 115BBDA of the IT Act.

FACTS

Shipin Tater and Ors ("**Assessee**") had filed a writ petition requesting the Delhi HC to issue a writ in order to quash the proviso to Section 10(34) of the IT Act, which gives effect to a non-obstante clause, i.e. Section 115BBDA in order to tax the income, by way of dividends in excess of INR 1 Million, in the hands of 'specified assessees'. The phrase 'specified assessees' is defined in the Explanation to Section 115BBDDA to *inter alia* include individuals, partnership firms, etc. The HC dismissed the petition and upheld the constitutionality of these Sections and thereafter, an SLP was filed before the SC.

ISSUE

Whether Section 115BBDA of the IT Act is ambiguous and is unconstitutional?

ARGUMENTS

The Assessee approached the HC challenging the constitutionality of proviso to Section 10(34) read with Section 115BBDA of the IT Act on the basis of two grounds: (a) Section 115BBDA was ambiguous; and (b) Section 115BBDA was arbitrary and was *ultra vires* Article 14 of the Constitution of India, 1950 ("**Constitution**").

Regarding the first ground, the Assessee argued that Section 115BBDA was ambiguous because it was not clear whether the tax would be charged on the entirety of the dividend amount or on the amount which is in excess of INR 1 Million. Regarding the second ground, the Assessee argued that the provision makes hostile discrimination between a resident assessee and a non-resident assessee, as the provision only applies to a resident assessee. It had also pointed out that the provision excludes from its ambit any domestic company and prior to September 14, 2018, the provision was not applicable to association of persons as well.

DECISION

The SC upheld the decision of the HC by rejecting the SLP. The HC, with regard to the first ground, had placed reliance on the wording of Section 115BBDA and the Explanatory Notes to this provision of Finance Act, 2016 (which inserted Section 115BBDA) to state that there was no doubt that the tax would be charged only on the amount which is over and above INR 1 Million. The Explanatory Notes explicitly stated that any income by way of dividend in excess of INR 1 Million in the hands of individuals, HUF or a firm would be taxed at the rate of 10%.

> **"The classification of the payers for the purpose of levying additional tax is not unconstitutional."**

On the second ground, the HC had held that plea of hostile discrimination is again without any merit and is predicated on the wrong notion that in tax legislation in order to tax one group, the legislation must tax all. In a taxation legislation, the legislature and the executive have right to identify the persons who have to be taxed. It held that the concept of equality enshrined in Article 14 of the Constitution, as elucidated in ***Pannalal Bansilal Pitti,***[11] does not require that every

[9] Shilpin Tater & Ors. v. Union of India Writ Petition (Civil) No. 1044/2019, (Supreme Court, August 30, 2019).
[10] Rajan Bhatia v. Central Board of Direct Taxes and Anr., Writ Petition (Civil) No. 4089/2017, (Delhi High Court, January 17, 2019).
[11] Pannalal Bansilal Pitti v. State of A.P, [1996] 2 SCC 498.

law must have universal application for all persons who are not by nature, attainment or circumstances in the same position, as varying needs of different classes of persons often require separate treatment. It is inexpedient and incorrect to think that all laws are uniformly applicable to all people at one go. It had also relied on the decision of ***Anwar Ali Sarkar***,[12] to hold that if the legislature takes care to reasonably classify persons for legislative purposes and if it deals equally with all persons belonging to a well-defined class, it is not open to the charge of denial of equal protection on the ground that the law does not apply to other persons.

In view of the said decisions, the HC had held that under-classification was not a sufficient ground to prove discrimination under Article 14 of the Constitution. It also observed that taxation is a matter of policy and the court does not comment on the wisdom of such decisions. The SC confirmed this decision by the HC and proceeded to hold that it did not create any arbitrary distinction as non-residents and residents can be taxed differently. Therefore, the SC upheld the constitutionality of Section 10(34) read with Section 115BBDDA of the IT Act.

SIGNIFICANT TAKEAWAYS

The Finance Act, 2016 had imposed additional tax on the super-rich whose dividend income is in excess of INR 1 Million. This additional tax created a furore amongst the tax payers as the dividends are paid from the net profits of the company, which is arrived at after the payment of corporate taxes. Further, the company also pays a Dividend Distribution Tax on such dividends under Section 115-O of the IT Act around when it is distributed among the shareholders. Therefore, the imposition of additional tax on the persons whose dividend income is more than INR 1 Million by virtue of the aforementioned Section 115BBDA of the IT Act, had been construed as double taxation and had affected the sentiments of high net-worth individuals.

The instant case seem to have been instituted on the basis of aforesaid discomfort. However, as the HC had rightly pointed out, taxation is a matter of policy and that if the tax legislature, in its wisdom, had decided to impose additional tax on the certain class of people, the same cannot be said to be creating inequality. Therefore, it cannot be said to be in violation of Article 14 of the Constitution.

It may be noted that in view of this particular additional taxation, several listed companies opted not to distribute dividends and instead distributed the surplus money of the company by buying back the existing shares from the shareholders. Since when the buyback is conducted through tender offer route on proportionate basis, the profit is treated as long-term gains which was exempt in the hands of shareholders until the FY 2018-19. Moreover, even after the re-introduction of long-term capital gains on listed securities with effect from FY 2018-19, buy back of shares was preferred against the dividend payouts, since the taxes were levied only on the gains made (i.e. the difference between the cost of acquisition and the sale price) and at the concessional rate of 10% as against the additional tax on dividends, wherein the tax was levied at the rate of 10% on the total gross amount received, in addition to the DDT already paid at the rate of 20.56%.

However, vide Finance Act, 2019, the Government plugged the beneficial tax treatment available for buybacks against dividend payouts, by introducing buyback tax for listed companies as well under Section 115QA of the IT Act. In accordance to which 20% tax will be levied at the company level on the difference between the issue price and the buyback price of the share.

[12] State of W.B. v. Anwar Ali Sarkar, AIR 1952 SC 75.

PROCEEDS FROM EXERCISE OF STOCK OPTIONS TO BE TREATED AS CAPITAL GAINS OR BUSINESS INCOME – SC LEAVES THE QUESTION OF LAW OPEN

In the case of ***Mahindra and Mahindra Employee Stock Option Trust***,[13] the question in relation to treatment of the proceeds received by the employee stock option trust on exercise of stock options by the employees arose. The SC has dismissed the SLP filed by the department against the Bombay HC judgment, where the HC had upheld the ruling of the ITAT that the employee stock option trust was not holding shares as business assets, as it is holding shares in fiduciary capacity as an extension of the settlor company.

FACTS

Mahindra and Mahindra Employees' Stock Option Trust ("**Assessee**") was a trust established in March, 2001 by Mahindra and Mahindra Limited ("**Company**") for the purpose of welfare of the employees of the Company, and the activities of the Assessee included investing in the equity shares of the Company, to hold such shares and to administer the fund as instructed by the compensation committee of the Company. The Assessee granted options to the eligible employees i.e. the right but not obligation under the Employee Stock Option Scheme ("**ESOP Scheme**") to apply for acquisition from the Assessee a specified number of equity shares of the Company at a future date at exercise price. During AY 2010-11, several employees exercised their respective options and the proceeds received were shown as long term capital gains by the Assessee in its return of income. The AO held that; (i) The income arising from sale proceeds of these shares pursuant to exercise of the options was to be determined under the head income from business and not capital assets; (ii) The shares held by Assessee on behalf of the Company were not capital assets; and (iii) The income was to be assessed as per Section 164(1) of the IT Act which provides for tax at the maximum marginal rate, as the trust deed did not bear the individual shares of the beneficiaries, hence was classified as indeterminate trust. Furthermore, the AO denied the benefit of Section 112 of the IT Act dealing with taxability of long term capital gains. The CIT(A) upheld the findings of the AO. The Assessee appealed against the order of the CIT(A).

ISSUES

1. Whether the shares held by the employee stock option trust on behalf of the employer company could be regarded as capital assets?
2. Whether proceeds received by the employee stock option trust on exercise of stock options by the employees could be treated as business income or as capital gains?

ARGUMENTS

The AO in his order had held that the options were not shares and would not qualify as capital assets under Section 2(14) of the IT Act, and hence, the income realized by the Assessee trust on exercise of the options by the eligible employees could not be regarded as capital gains. The AO's order had also mentioned that the activity of the Assessee has been carried on for years on a regular basis in a systematic manner and had the characteristics of a business activity.

The Assessee argued that shares are covered under definition of capital assets under Section 2(14) of the IT Act, and it relied on SC's judgment in ***Poddar Cement Ltd.,***[14] where it was held that "*every owner does not possess all the rights and ownership may be restricted by law or by any agreement made by the*

[13] PR Commissioner of Income Tax-17 v. Mahindra and Mahindra Employee Stock Option Trust, SLP Civil Diary No. 21937/2019, (Supreme Court, July 12, 2019).
[14] Poddar Cement Ltd., 226 ITR 625, 640.

parties inter se". Therefore, contractual restriction do not change the character nor defeat ownership in the asset i.e. the shares held by the Assessee.

The Assessee argued that in order to counter AO's argument, the objective of setting up a trust by the settlor company will have to be looked into. It argued that business activity cannot be judged merely on the basis that such activity is carried on a regular basis in a systematic and organized manner but will have to also consider whether such activity had been carried out with a view to earn income. In the current fact situation, the trust wasn't functioning for the purpose of making profits as it was not deciding when the options would be exercised by eligible employees and also at what price. The Assessee was carrying on the activity of administering the ESOP scheme and transferring the shares as and when the options were exercised.

The AO while passing its order had relied on the fact that the Assessee had purchased shares from the secondary market. The Assessee countered this reliance by stating that in a span of ten years only five such purchase were made and which also constituted only 4.09% of the entire holding of the company at the end of the year under appeal. Therefore, it argued that such purchase could not have the attributes of a trader buying stock in trade for the purpose of reselling them.

> **"The proceeds received by the employee stock option trust on exercise of the stock options will be assessed under the head of capital gains not as business income."**

DECISION

The IRA filed a SLP before the SC which was dismissed, however, the question of law was left open. The Bombay HC had agreed[15] with the ITAT's observation and dismissed the appeal field by the IRA against the order of the ITAT by holding that no substantial question of law arises.

The ITAT in its ruling[16] relied on the case of ***Tata Services Ltd.,***[17] wherein the Bombay HC had observed that the word 'property' used in Section 2(14) of the IT Act is an expression of widest amplitude,[18] and, therefore, any right which can be called a 'property' will be included in the definition of 'capital asset'.

Upon perusal of the clauses of trust deed of the Assessee and the ESOP Scheme, the ITAT observed that the Assessee was *de facto* controlled by the Company as its' decisions were governed by the instructions provided by the compensation committee of the Company, e.g., the authority to formulate and implement the plans, the exercise price as per trust deed meant exercise price for equity share as decided by the Assessee in accordance with the recommendation of the compensation committee at the time of grant of options. Thus, the Assessee was holding the shares in the fiduciary capacity.

The ITAT further observed on the basis of the above that the Assessee was not acting like a trader as it is not free or authorized to sell the shares, held by it on behalf of the Company, to any person in the free market at fair market price. In the event the Company would have issued these shares directly in the name of the employees at a value higher than their face value, then the difference amount would have been share premium in the hands of Company, and undisputedly, the same would be treated as capital receipt in its hands. The Assessee is merely an extended arm of the Company and the shares held by the Assessee cannot be categorised as "stock- in-trade" of the Assessee.

The ITAT held that the action of the AO in not providing the benefit of Section 112 of the IT Act dealing with taxability of long term capital gains read with Section 164 of the IT Act, to the Assessee with regard to the capital gains is contrary to law. The ITAT relied on the case of ***Jamsetji Tata Trust,***[19] wherein it was held that the *"short term capital gain on sale of shares already subjected to STT, is chargeable to tax at maximum marginal rate which cannot exceed the rate provided u/s 111A of the Income Tax Act"*. The ITAT held that the long term capital gain on shares is chargeable to tax at maximum marginal rate which cannot exceed the rate provided u/s 112 of the IT Act.

[15] Pr Commissioner Of Income Tax-17 v. Mahindra and Mahindra Employee Stock Option Trust, MANU/MH/0908/2019.
[16] Mahindra & Mahindra Employees" Stock Option Trust v. ADCIT, Range-12(2), Mumbai-20, ITA No.2389/Mum/2015.
[17] Tata Services Ltd., 122 ITR 594.
[18] PNB Finance Ltd. v. CIT 252 ITR 191 (Delhi).
[19] Jamsetji Tata Trust v. JDIT (Exemption) 148 ITD 388.

SIGNIFICANT TAKEAWAYS

The SC has left the question of law open but it is a defensible position that the when the employee stock option trust is controlled by the employer company and the trust is not acting like a trader and is not free or authorized to sell the shares, the proceeds received by the assessee trust on exercise of the stock options by the employees will be assessed under the head of capital gains and not as business income and will be taxed as such under Section 112 of the IT Act. The decision outlines the importance of having proper mechanism and clauses under the trust deed in relation to decision making of stock option trusts.

Given, implementation of the stock option schemes are undertaken widely through trusts set up for the benefit of the employees, it is vital that these structures are reviewed from a tax perspective. The judgment highlights the importance of robustness of the trust deed in relation to power of the trustee to deal with the shares. While the SC has dismissed the SLP filed by the IRA, it is vital to note that the question of law regarding whether such an employee welfare trust can be liable to pay tax on business income has been left open.

HC HOLDS ARTIFICIAL SPLITTING OF SHARE CONSIDERATION BY THE TAXPAYER AS A DEVICE TO EVADE TAXES

In the case of ***M.P Purushothaman***,[20] the Madras HC held that in the facts and circumstances of the case, the non-compete fee paid to the taxpayer, along with the consideration for sale of shares, was a colourable device to evade taxes and would be taxed as part of the sale consideration.

FACTS

Mr. Purushothaman ("**Assessee**"), along with his family, held controlling interest in three entities, namely Empee Distilleries Ltd., Empee Breweries Ltd.("**Empee Brew**") and Empee Sugar and Chemical Ltd. ("**Empee Sugar**"). The Assessee and some of his family members sold there shareholding in Empee Brew to Mcdowell Alcobev Ltd. ("**Buyer**"), at ~INR 14 per share and the Assessee also received a non-compete of INR 10 crores. The Assessee filed its returns for the relevant FY and claimed the non-compete fee as not taxable under the IT Act.

The AO, pursuant to the material recovered during a search of the Assessee's premises and relevant companies, observed that in addition to the shares transferred by the Assessee, the Buyer and Empee Distilleries Ltd. also sold their shareholding in Empee Brew to Empee Sugar for INR 10 per share. Subsequently, Empee Sugar in turn transferred the newly acquired shares of Empee Brew to the Buyer at the rate of INR 127 per share. The AO also noted that the Empee Sugar had huge amounts of carried forward losses, which could be set off against the capital gains which arose in its hands pursuant to the aforementioned sale share.

> **"Colourable device cannot be a part of legitimate tax planning."**

Thus, in light of the above, the AO held that given the vast difference in the sale consideration paid to the Assessee and Empee Sugar for the same shares, the Assessee had resorted to artificial splitting of consideration into consideration for shares and payment of non-compete fee for the purposes of evading tax. Accordingly, the AO held that the non-compete fee should also be added to the sale consideration received by the Assessee. In appeal, the CIT (A) held that though the non-compete fee was not taxable in the hands of the Assessee, but a portion of sale consideration paid to Empee Sugar should be treated as sale consideration received by the Assessee. However, when the issue went in appeal before the ITAT, it was held that the price at which the Assessee sold the impugned shares was justified and allowed the Assessee's claim. Being aggrieved of the ITAT's order the IRA approached the Madras HC.

ISSUE

Whether, in the facts and circumstances of the case, the non-compete fee paid by the Buyer to the Assessee, along with the sale consideration from transfer of shares, was a device to evade taxes?

ARGUMENTS

It was argued on behalf of the IRA that the fact that there was a huge difference in the consideration received by the Assessee and Empee Sugar for the same shares and that no explanation was offered in relation to such price, establishes that the price charged was not genuine. Further, it was argued that

[20] CIT v. M.P Purushothaman Tax Case Appeal No. 568 of 2008 (Madras HC).

in light of the facts of the case, the non-compete fee received by the Assessee, in addition to the sale consideration, was merely a colourable device deployed by the Assessee to evade taxes.

At the same time, it was contended on behalf of the Assessee that the non-compete fee paid to the Assessee was genuine and was paid under a non-compete agreement on the basis of the commercial discussions between the parties and it contained a negative covenant restricting the Assessee from carrying out similar business. Therefore, it was argued that there was no basis for arguing that the non-compete fee was a colourable device deployed to evade taxes and accordingly, such fee would not be taxable under the IT Act. The Assessee in this regard placed reliance on the SC judgment in the case of ***Guffic Chem P. Ltd.,***[21] where the SC had held that non-competition fee under a negative covenant was a capital receipt and not taxable under IT Act.

DECISION

The HC rejecting the argument of the Assessee held that merely because the non-compete fee was made under a non-compete agreement would not absolve the Assessee, as the IRA may still look into the relevant factors for determining the taxability of such payment. The HC also observed that the non-compete agreement pursuant to which the non-compete was paid, was an unregistered instrument and it did not specify the name of the authorized signatory signing the agreement on behalf of the Buyer.

The HC observed that nothing was bought on record and no explanation had been offered by the Assessee for selling the shares of Empee Brew at a low price. Further, the HC also noted that the higher price charged by Empee Sugar benefited the company, as it had huge accumulated losses and which could be set off against such capital gains. Accordingly, the HC held that the lowering and splitting up of the consideration for shares and non-compete fee, were merely a device employed by the Assessee to evade tax. The HC also clarified that because the non-compete fee paid was a colourable device to evade taxes and the SC decision in the case of **Guffic Chem P. Ltd.,** which held that non-compete fee are not taxable, would not be applicable in the instant case.

Consequently, it held that the finding of the ITAT that the sale consideration received by the Assessee was justified, was erroneous and it upheld the order of the AO.

SIGNIFICANT TAKEAWAYS

The HC in this decision pointed out that the Courts while dealing with issue of tax avoidance, "*are now concerning themselves not merely with the genuineness of a transaction, but with an intended effect of it for* <u>*fiscal purposes*</u> *and no one can now get away with a tax avoidance project with the mere statement that there is nothing illegal about it.*"

Thus, it appears that in order to prove the genuineness of the transaction, the taxpayer may be questioned on the fiscal purpose of the impugned transaction. Therefore, it would be pertinent for the taxpayer to maintain proper records and documents, substantiating the commercial rationale of the transaction. This requirement to maintain proper paper trail for justifying the commercial purpose of the transaction, has assumed a greater importance with the advent of General Anti Avoidance Rules, whereby the taxpayer may be required to prove that the transaction is backed by proper commercial rationale and is not undertaken for the main purpose of obtaining tax benefit.

[21] Guffic Chem P. Ltd. v. CIT (2011) 239 CTR 225 (SC).

MADRAS HC HOLDS DELAYED FILING OF REVISED RETURNS IN AMALGAMATION NOT AN AUTOMATIC RIGHT:REINFORCES PROCEDURES GIVEN UNDER IT ACT

In the case of ***Dalmia Power Ltd.,***[22] the division bench of the Madras HC has held that the approval of the Scheme of Arrangement ("**Scheme**") by NCLT does not provide automatic exemption from following the statutory procedure laid down for condonation of delay in filing of revised return of income under the IT Act and procedures given in the IT Act are required to be mandatorily followed.

FACTS

Dalmia Cement (Bharat) Limited, had entered into schemes of arrangement and amalgamation, with effect from the appointed date, i.e., January 01, 2015 which were duly approved by NCLT. Similarly, Dalmia Power Limited had also entered into scheme of amalgamation, with effect from the appointed date, i.e., January 01, 2015, which was duly approved by NCLT.

Dalmia Cements Limited and Dalmia Power Limited (Together, "**Assessee**" or "**Company**") tried to file their revised returns on the basis of the order of the NCLT which sanctioned the Scheme. However, the AO refused to complete the revised assessment for the Assessee by stating that the returns have been filed post the prescribed statutory period for filing the revised return of income and have not been filed in the prescribed manner.

The Assessee filed a writ petition before the Madras HC for directing the IRA to complete the revised assessment with respect to AYs 2015-16 and 2016-17 on the basis of the revised returns filed by it post the Scheme. The Madras HC issued a writ and directed the IRA to assess the revised returns filed by the aforementioned entities. Aggrieved by the same, the IRA filed writ appeals before the Division bench of the Madras HC allowing for filing of the revised returns.

ISSUES

1. Whether the IRA are bound to accept the revised returns filed after the prescribed time, without an application filed under Section 119(2)(b) of the IT Act requesting for the condonation of delay?
2. Whether the Scheme is binding on the IRA and if it is binding, to what extent?

ARGUMENTS

The counsel for the IRA argued that NCLT order sanctioning the Scheme specifies that the same was binding on the shareholders, creditors and employees. He submitted that this implied that the order was not binding on the statutory authorities like the IRA. Further, it was contended that the NCLT order specified that necessary permissions must be sought. Accordingly, in this case, as per Section 139(5) of the IT Act, the revised returns could be filed within one year from the end of the relevant AY or before the completion of the assessment, whichever was earlier. As the revised returns had not been filed within the time limit specified under the IT Act, the Assessee was required to file an application requesting to condone the delay in filing the revised returns under Section 119(2) of the IT Act read with Circular No. 9 of 2015. As per Rule 12(3) of the IT Rules, the revised returns of income have to be filed electronically and, therefore, filing of revised returns manually is contrary to the aforementioned rule. In cases where the returns were filed beyond the prescribed time limit, the aforementioned procedure for condonation of delay was required to be followed and hence, the revised returns filed by the petitioner were invalid.

[22] The Assistant Commissioner of Income Tax v. M/S Dalmia Power Ltd & Ors., W.A. (MD)Nos.566 to 569 of 2019 and C.M.P(MD) Nos.4710 to 4713 of 2019 (Madras High Court) [TS-383-HC-2019(MAD)].

On the other hand, the counsel for the Assessee argued that despite service of notice, the IRA did not raise any objection against the passing of the Scheme. Upon sanction by the NCLT, the Scheme attains statutory force and becomes binding on statutory authorities like the appellant IRA. On the basis of para 64(c) of the Scheme, it was contended that the taxpayers were entitled to file revised returns even beyond the prescribed timeline. It was also contended that CBDT circular No.9/2015 issued under Section 119(2)(b) of the IT Act was not applicable to the instant case since revised returns had not been filed on the ground of genuine hardship but has been filed only pursuant to the amalgamation order passed by the NCLT. Compliance with Rule 12(3) of the IT Rules was not possible as the income tax website did not allow for the submission of revised returns beyond the timeline prescribed in Section 139(5) of the IT Act. It was submitted that the CBDT under Section 119(2)(b) of the IT Act is exercising only an administrative authority and therefore, the CBDT cannot sit on judgment over the statutory exercise of power by the NCLT. Based on this, the counsel for the Assessee contended that the order of the single bench of this court must be upheld.

Sanction of scheme of amalgamation by the NCLT does not automatically mean that the procedures laid for compliance under the other statutes need not be followed by the companies getting amalgamated.

DECISION

The NCLT exercises supervisory jurisdiction (and not appellate jurisdiction) while discharging the responsibility of sanctioning of schemes. The NCLT is not responsible to examine the scheme minutely with a tooth comb and it merely validates that the scheme is not opposed to public policy or law. The scheme has a binding effect on the shareholders and creditors as they are the ones who approve the scheme at the specially convened meetings and also on the employees in case the scheme provides the employees with terms not inferior than the current terms. The statutory authorities formed under the IT Act who do not object to the scheme are put to notice about the same, including the appointed date and would be bound to accept the revised returns filed in pursuance of the scheme provided the revised returns are filed in accordance with the statutory procedure laid down. It cannot be said that once the scheme is sanctioned, statutory authorities are bound to give effect to all its clauses by waiving statutory requirements. Applying these broad principles, the Madras HC stated that in the instant case, the Assessee was required to comply with the procedure laid down under the IT Act to file revised return of income. Upon the Assessee filing the application requesting for condonation of delay and complying with the procedures as laid down in the IT Act, the IRA should consider the application bearing in mind the principles discussed in the judgement.

SIGNIFICANT TAKEAWAYS

This is a significant ruling in as much as it provides valuable guidance with regard to scope of NCLT's power while sanctioning the scheme. It states that the NCLT exercises only supervisory jurisdiction when sanctioning a scheme of arrangement and does not examine the scheme minutely. The scope of NCLT's review is limited to merely inquiring if the scheme is opposed to public policy or law.

Further, this ruling clarifies the extent of binding value of scheme of arrangement sanctioned by NCLT on the statutory authorities vis-à-vis the IT Act. It also clarifies that the sanction of the Scheme does not automatically mean that the procedures laid for compliance under the other statutes need not be followed by the Assessee. Hence, the Company shall be required to comply with the procedure provided in the IT Act. Even under corporate law, procedural compliances provided under the Companies Act, 2013 will have to be undertaken and will not be assumed to be complied suo-moto.

MUMBAI ITAT ALLOWS MAT CREDIT OF DEMERGED UNITS FOR A PERIOD PRIOR TO DEMERGER, TO THE ASSESSEE

In the case of ***TCS E-service International Ltd.,***[23] the Mumbai ITAT allows MAT credit pertaining to demerged units, to the Assessee, for pre-demerger period.

FACTS

TCS E-serve International Ltd. ("**Assessee**") is engaged in the business of IT enabled services ("**ITES**") and Business Process Outsourcing Services ("**BPO**"). The customers of the Assessee were mostly from banking, financial services and insurance sectors. More specifically, the operations of the company included delivery of core processing services and support services for both data and voice services.

> **Mumbai ITAT allows pre-demerger MAT credit of demerged units to the Assessee.**

In October 2012, the Assessee proposed a demerger of 3 of its SEZ undertakings, through a composite scheme under Section 391 to 394 of Companies Act, 2013. The said scheme was approved by Bombay HC in September, 2013, post which, the SEZ units of Assessee were demerged to TCS Ltd., with effect from April 01, 2013 (AY 2014-15) and the balance operations were continued by the Assessee.

For AY 2014-15, the Assessee filed its return of income declaring total income of INR 78.49 crores under normal provisions of IT Act and book profit of INR 78.26 crores under Section 115JB of IT Act. The Assessee also claimed set off of MAT credit of INR 10.27 crores (out of the available MAT credit of 55.94 crores) under Section 115JAA of the IT Act.

During assessment proceedings for AY 2014-15, the AO asked for a unit-wise break up of MAT credit available for set off, with respect to each of the SEZ units. Thereafter, the AO disallowed the carry forward and set off of MAT credit against the tax liability to the extent it pertained to the demerged SEZ units. Therefore, out of the total MAT credit claimed of INR 10.27 crores, MAT credit of INR 9.87 crores, which was pertaining to the demerged SEZ units, was disallowed and only balance MAT credit of INR 39.84 lacs was allowed. The Assessee filed an appeal before the CIT(A) against the order of the AO. The CIT(A) took note of the observations of the Bombay HC, at the time of approving the scheme of demerger, wherein the Bombay HC had held that all the tax, including income tax paid or payable by the Assessee, before the date of appointment i.e. April 1, 2013, shall be on account of the Assessee and after the date of appointment, shall be on account of TCS Ltd. Basis this observation, the CIT(A) allowed the carry forward and set off of MAT credit to the Assessee and reversed the order of the AO.

Thereafter the IRA came on appeal before the ITAT.

ISSUES

Whether the available MAT credit, prior to demerger coming into effect, should be available to the Assessee, even if such MAT credit pertained to the demerged units of the Assessee?

ARGUMENTS

The IRA argued that the CIT(A) was incorrect in directing AO to allow carry forward and set off of MAT credit to the Assessee by merely relying on a portion of Bombay HC order without looking into the totality of facts and circumstances and law, considering that

[23] DCIT v. TCS E-serve International Pvt. Ltd.; 2779/Mum/2019.

such MAT credit specifically pertained to the demerged units of the Assessee, the benefit of which could not be taken by the Assessee.

On the other hand, the Assessee argued that the order of the Bombay HC, sanctioning the demerger scheme, had clearly stated that all taxes with respect to period before the appointed date from which the demerger had to come into effect, shall be to the account of the Assessee. With respect to applicability of orders of Bombay HC, the Assessee relied on the jurisdictional HC's judgement only in the case ***Sadanand S Varde***.[24] wherein it was held that a scheme of arrangement approved by a HC becomes a statutory law and would be operational as law. Given the said judgement, the reliance placed by CIT(A) on the order of Bombay HC, to allow MAT credit to the Assessee, should be upheld.

Further, the Assessee also submitted that under the scheme of taxation, MAT credit is available to a person who had paid the MAT tax in the earlier FYs. Considering that Assessee paid the MAT tax in the earlier FYs, the credit for the same should be available to Assessee for carry forward and set off in future years. The Assessee also relied on the decision of the Mumbai ITAT in the case of ***Brandon & Co.,***[25] wherein the ITAT held that the MAT credit is available to the entity which had paid excess tax under the MAT provisions over normal provisions.

DECISION

The ITAT held that it is an admitted fact that MAT credit is representative of the excess tax paid by the Assessee over tax under normal provisions, in the past years. Given the same, the credit should be available to the Assessee who has paid the excess tax, and not to the demerged units. That said, the ITAT agreed with the argument of the Assessee that the order of the Bombay HC, approving the scheme of demerger, has an operation of law. Thus, even if there is no specific provision under the IT Act pertaining to set off and carry forward of MAT credit by the demerged units, the specific directions of Bombay HC shall apply. Therefore, the MAT credit, arising as a result of taxes paid prior to the appointed date of demerger, shall be available to the Assessee, even if they pertain to the demerged SEZ units. The ITAT also observed that the resulting company, TCS Ltd., had not claimed the disputed MAT credit in their return of income and the AO of TCS Ltd. had categorically stated in his order that the MAT credit of the Assessee shall be available to the Assessee only and that MAT credit should go to the entity paying the tax and not with the resulting company. Given the same, the ITAT upheld the order of the CIT(A) and dismissed the appeal of the IRA.

In its cross objections to the appeal filed by the IRA, the Assessee had taken an additional plea of allowing the carry forward of unutilized MAT credit by the Assessee to subsequent years. As stated above, the Assessee had MAT credit of INR 55.94 crores out of which MAT credit amounting to INR 10.27 crores only was utilized by the Assessee in AY 2014-15. Thereafter, balance unutilized MAT credit of INR 45.67 crores, still remains.

On this point, the ITAT held that once the allowability of MAT credit has been decided in favour of the Assessee, the issue of carry forward and set off of unutilized MAT credit in subsequent years is merely consequential. Therefore, ITAT took the view that no dispute arises on carry forward and set off of unutilized MAT credit in the subsequent year. In this regard, the ITAT remanded the matter back to the AO to make necessary enquiries to verify the availability of unutilized MAT credit of INR 45.67 crores. Once the same is verified, the ITAT directed the AO to allow carry forward of unutilized MAT credit to subsequent years for the Assessee.

SIGNIFICANT TAKEAWAYS

The lack of clarity around availability of MAT credit in business re-organizations, poses a major accounting challenge. In the present case, the ITAT has followed the fundamentals of MAT credit i.e. the entity paying the excess tax over tax under normal provisions, gets to claim the credit of MAT. Given the same, the Assessee in the instant case gets the benefit of MAT credit.

[24] Sadanand S Vard v. State of Maharashtra; 2247 ITR 607.
[25] DCIT v. Brandon & Co. (P) Ltd.; 1972/ MAT/2017.

However, this cannot be followed as a strict principle under all business re-organization schemes. For instance, in the case of ***Adani Gas Ltd.,***[26] on bifurcation of MAT credits between demerged company and resulting company, where the scheme of arrangement was silent on it, the Ahmedabad ITAT held that MAT credits arising from excess tax paid prior to demerger, were to be assigned to the resulting company on a pro rata basis qua those relating to undertaking demerged into the resulting company. Thus, the rationale followed by Mumbai ITAT in the instant case of TCS E-serve is quite opposite to the rationale of Ahmedabad ITAT. However, in this case it may be noted that the demerged company had ceased to exist post demerger.

Similarly in the case of ***SKOL Breweries***,[27] the Mumbai ITAT allowed MAT credit of the amalgamating company to the amalgamated company, since the amalgamating company ceased to exist, while rejecting the argument that amalgamated company was not entitled to MAT credit since excess tax was not paid by it. The rationale of Mumbai ITAT to do the same was that in absence of explicit provisions, the existing provisions have to be interpreted in a manner that benefits the assessee. Given the same, where amalgamated company was no longer in existence, the benefit of unutilized MAT credit was given to assessee i.e. the amalgamating company.

Given the varied positions and rationales taken by Courts over time, it is important that express provisions on availability of MAT credit be enacted for the purposes of business re-organization schemes.

[26] Adani Gas ltd. v. ACIT, Circle – 1 , 2241 & 2516/Ahd/ 2011.
[27] SKOL Breweries v. ACIT, 313/Mum/07.

CASE LAW UPDATES - MISCELLANEOUS

SECOND PROVISO TO SECTION 40(A)(IA) IS RETROSPECTIVE IN NATURE

In the case of ***S M Anand ("Assessee")***,[28] the Karnataka HC held that the second proviso to Section 40(a)(ia) of the IT Act, which provides that an assessee who does not deduct tax at source is deemed to have deducted the same in case the resident payee has accounted for such non-deduction in his return, is retrospective in nature.

FACTS

The Assessee, an individual, was engaged in the business of civil construction and was awarded certain government contracts for the purpose of construction of canals, etc. Accordingly, the Assessee hired two sub-contractors for such construction and paid them the agreed amount without deducting tax at source. After the scrutiny for the AY 2005-06, the AO, in his assessment order, disallowed the Assessee's claim of expense deduction for such amounts on the ground that Assessee did not deduct tax at source. Thereafter, the Assessee filed an appeal with the CIT(A) and on dismissal, to the ITAT. The ITAT, however, decided in favour of the Assessee by stating that the second proviso to Section 40(a)(ia) of the IT Act which provides relief to the taxpayers who have not deducted tax at source but their respective payees have shown the relevant amounts in their tax returns, is applicable with retrospective effect. Aggrieved with this order, the IRA filed an appeal with the Karnataka HC.

> **Beneficial provisions conferring benefits to the taxpayers shall have retrospective applications.**

ISSUE

Whether the second proviso to Section 40(i)(ia) of the IT Act can be applied retrospectively?

ARGUMENTS

The IRA argued that it was specifically provided in the Finance Act, 2012 (which inserted the concerned proviso) that the said proviso would come into effect on April 1, 2013 and therefore, the provision could not be given retrospective application. On the other hand, the Assessee argued that the amount paid to the sub-contractors was offered to tax, therefore, there was no loss to the revenue. On retrospectivity, the Assessee argued that considering the proviso was inserted for the benefit of the Assessee, it was curative in nature and must be given retrospective application from the time Section 40(i)(ia) came into effect i.e., April 1, 2005.

DECISION

The Karnataka HC discussed the decisions of other HCs and benches of the ITAT which have delivered decisions on this issue, and it heavily relied on the SC's Constitution Bench decision in ***Vatika Thownship Private Ltd.,***[29] ("**Vatika**") where the SC had discussed general principles concerning retrospectivity. In the case of ***Vatika***, the SC had held that for the interpretation of a legislation, unless there appears a contrary intention, there is a presumption against retrospectivity. However, it was also held that the provision might be applied retrospectively based on the principles of fairness, and specifically for provisions which confer benefits to the taxpayers, it would be presumed to have retrospective application. In addition to its reliance on ***Vatika***, the Karnataka HC held that the proviso must be given retrospective application by citing the Delhi HC decision which reasoned that considering there is no loss to the IRA and the proviso cures the shortcomings of Section

[28] CIT v. S M Anand, ITA No. 100056/2014 (Karnataka HC, August 23, 2019).
[29] CIT v. Vatika Thownship Private Ltd., ([2014] 367 ITR 466 (SC)).

40(i)(ia), the proviso must be treated as being retrospective in nature.

SIGNIFICANT TAKEAWAYS

It is relevant to note that the Karnataka HC ignored the express language given in the Finance Act, 2012 which states that the proviso would come into effect on April 1, 2013. It goes on to show that, in case of provisions aimed at correcting certain shortcomings in a legislation, the Courts can ignore the text using purposive construction on the basis of principle of fairness. The HC has also gone on to confirm that the retrospective application of such provisions that are beneficial to the taxpayers.

HC DENIES LONG TERM CAPITAL GAINS EXEMPTION ON SALE OF PENNY STOCK

In the case of ***Suman Poddar***,[30] the Delhi HC held that long term capital gains booked by the taxpayer were bogus in nature, as they arose pursuant to the sale of penny stock. The HC accordingly, denied the (erstwhile) long term capital gains exemption to the said taxpayer.

FACTS

Suman Poddar ("**Assessee**") had acquired certain shares in a public company, which was eventually merged into another public company ("**Company**"). The Assessee disposed of the shares of the Company, acquired pursuant to the merger, and claimed the long term capital gains exemption in relation to such gains. The AO on consideration of various replies and responses of the Assessee, was of the opinion that the capital gains booked by the taxpayer were bogus in nature as the shares of the Company could be regarded as a penny stock company. Accordingly, the AO denied the long term capital gains exemption and made the relevant additions. In appeal, both the CIT(A) and the ITAT, upheld the order of the AO. The Assessee approached the HC.

> **"A bank statement by itself is not sufficient proof of the genuineness of the transaction."**

ISSUE

Whether the ITAT was justified in regarding the shares of the Company as 'penny stock' and denying the long term capital gains exemption arising from such shares?

ARGUMENTS

The Assessee produced various documents to prove that the Assessee had acquired the relevant shares through proper banking channels and argued that there was no basis to conclude that the transaction entered into by the Assessee was bogus. The IRA on the other hand placed reliance on the financial statements of the Company and argued that in absence of any evidence of the financial growth or operations of the Company, the astronomical returns accruing to the Assessee from the shares of the Company establishes that the Company was a penny stock company. The IRA further argued that the Bombay Stock Exchange had also listed the Company as being used for generating bogus long term capital gains.

DECISION

The HC relied on the findings of the ITAT and observed that the share prices of the Company sky rocketed by 491% in a short period of 5 months, in absence of any evidence of operation or financial growth. It also noted that the Assessee had also failed to furnish any evidence of sale of the shares of the Company, except for the contract notes issued by broker. Further, it was observed that the Bombay Stock Exchange had also listed the Company as being used for generating bogus long term capital gains. Thus, based on the aforementioned findings the HC upheld the order of the ITAT and held the impugned transaction to be bogus.

SIGNIFICANT TAKEAWAYS

This issue of denying capital gains tax exemption in relation to penny stocks has been litigated before the courts at numerous instances. Even recently, this issue has been discussed by various benches of the ITAT,[31] where they have rejected the capital gains exemption owing to the failure of taxpayers to prove the genuineness of the impugned transaction in

[30] Suman Poddar v. ITO ITA No. 841/2019 (New Delhi HC).
[31] Harish Kumar HUF v. ITO TS-306-ITAT-2019(Chennai ITAT); Rajkumar B. Agarwal v. DCIT TS-5-ITAT-2019 (Pune ITAT).

relation to petty stocks. Similarly, in a recent case of ***Narendra Shrikishan Agrawal***,[32] the Pune Bench of ITAT regarded long term capital gain claim by the assessee as a bogus transaction and disallowed such claim owing to his dubious intention unearthed by an investigation. However, it may be noted that in certain cases such ***Smt. Vandana Sankhala***,[33] and ***Mool Chand Jagwayan***,[34] the ITATs have held that the mere investment in penny stock would not lead to the denial of any exemption, if there is sufficient evidence on the record to establish the genuineness of the transaction. Thus, in light of these judgments, it would be pertinent for a taxpayer to ensure (i) a proper paper trail of the acquisition and sale of shares; and (ii) that there is proper commercial justification for the consideration being charged.

[32] Narendra Shrikishan Agrawal v. ACIT, [TS-670-ITAT-2019(PUN)].
[33] Smt. Vandana Sankhala v ACIT (TS-647-ITAT-2018(Chennai ITAT)).
[34] Mool Chand Jagwayan v ITO (TS-326-ITAT-2019(Kolkata ITAT).

LOSS SUFFERED ON UNSUCCESSFUL OVERSEAS VENTURE ALLOWABLE AS BUSINESS LOSS

In the case of ***Zoom Entertainment Network Limited***,[35] Mumbai ITAT held that the loss suffered by the TV channel on account of investment done in unsuccessful overseas venture has been held to be allowable as a business loss, instead of a capital loss.

FACTS

Zoom Entertainment Network Limited ("**Assessee**") was looking for an opportunity to acquire an existing channel called TV Asia that was running in the USA. It entered into a stock purchase agreement ("**Agreement**") with the owners of the said channel Asia Star Broadcasting Inc. ("**ASB**") in May, 2008. Thereafter, it set up a subsidiary, ZEN International Inc. ("**Subsidiary**") in the state of Delaware in the USA and remitted a sum of USD 1 million to its Subsidiary as consideration for issuance of 10,000 equity shares of face value of 0.01 in September, 2008. The Assessee assigned the Agreement to its Subsidiary but it remained liable for the performance of the obligation under the Agreement.

> **Mumbai ITAT characterizes losses on unsuccessful overseas venture as business losses.**

In view of the global crisis and the worsening market conditions in the USA, the management of the Assessee decided not to go-ahead with the purchase of the channel and thus, the Agreement was terminated in January, 2009. Under the terms of the Agreement, the party who terminates shall be liable to pay USD 500,000 and thus, the said amount was paid by the Subsidiary. Accordingly, in the books of the Assessee, the value of investment in Subsidiary was impaired and a provision for diminution in the value of investment in equity shares amounting to INR 22.6 million was made by the Assessee in its books for the year ended March 31, 2009. This amount was not claimed as loss for filing of return of AY 2009-10.

After liquidation of the Subsidiary in USA, the Assessee thereafter obtained the permission of RBI to write off the balance investment amount of INR 22.6 million and the same was granted in AY 2011-12. The Assessee thus, claimed the loss as long term capital loss or alternatively as business loss in AY 2011-12.

The AO held that there is no movement or transfer of asset and hence, no capital loss arose. He thus, disallowed the amount. The CIT(A) observed that the written off investment is a loss of capital and is not a business loss. He also noted that the amount was shown as capital investment in the balance sheet and hence, writing it off cannot be claimed as a revenue expenditure (business loss). The Assessee thus, filed an appeal before ITAT.

ISSUES

Whether the loss suffered by the Assessee on account of investment done in unsuccessful overseas venture was a business loss or a capital loss?

ARGUMENTS

Before the ITAT, the Assessee argued that it invested in Subsidiary for acquiring shares of ASB which was into the same business of operating TV channel. It was envisaged that there would be synergies as they are in same business but as the proposal could not be implemented, the Assessee ultimately incurred loss. The Assessee referred to another decision of ITAT Mumbai in the case of ***Colgate Palmolive India Ltd.,***[36] where in loss incurred on sale of shares in strategic subsidiary was held as incidental to business and was allowed as business expense. As an additional ground, the Assessee also submitted that the loss may alternatively be allowed as short term

[35] M/s. Zoom Entertainment Network Limited v. ACIT; ITA No. 3454/ Mum/ 2016.
[36] CIT v. Colgate Palmolive India Ltd.; ITA No. 548/Mum/2009.

capital loss and in support of this argument, Assessee placed reliance on Gujarat HC judgment in the case of ***Jaykrishana Harivallabhdas***.[37]

DECISION

The ITAT noted that from AY 2009-10 to AY 2011-12, no case was made out by the AO that the amount sent to Subsidiary was not for business purposes or business expediency. Accordingly, no addition on account of interest or payment to AE not being at arm's length was made out by the AO. The ITAT referred to the judgment of Bombay HC in the case of ***KSS Ltd***,[38] wherein sum advanced to AE for a specific purpose of acquisition of distributorship of films was held as advance for business purposes. Applying the above case, the ITAT held that money was spent through overseas intermediary for a business purpose - i.e. acquisition of TV unit/ business in USA which is on same line as Assessee's business and it aligned with its intention to expand in overseas market. The Subsidiary was only a method by which the Assessee spent the amount of USD 1 million for its business purpose. When the amount spent was for business purpose, the loss incurred thereon is also a business loss.

SIGNIFICANT TAKEAWAYS

The difference between capital loss and business loss often is a thin line of difference in cases such as these. The CIT(A) and the AO considered the loss incurred by the Assessee to be revenue loss taking into account the investment made through stock purchase only. As against this, the ITAT focussed on the intent of the Assessee, which was to acquire the TV channel in USA and to expand its existing line of business overseas.

The ITAT held that investment done in subsidiary, which is an actual business investment, will be considered as that made for business purposes and consequently, any loss on sale of shares of such a subsidiary is admissible as business losses, as against capital losses. For this purpose, the ITAT also relied to the decision of ***Colgate Palmolive India Ltd.,*** cited by the Assessee wherein it was held that any investment in a subsidiary which was engaged in assisting a company in its own business was justified for pure commercial consideration. The decision is a good example of how the intent of the entire transaction and not manner of investment has to be looked into for determining whether a particular loss is business loss or capital loss.

[37] CIT v. Jaykrishana Harivallabhdas; 231 ITR 108.
[38] K. Sera Sera Productions Ltd. v. DCIT; ITA No. 476 of 2006.

ITAT HOLDS CREDIT OF TDS TO BE ALLOWED IN THE YEAR IN WHICH INCOME CORRESPONDING TO SUCH TDS IS ASSESSABLE

In the case of ***Mahesh Software Systems Pvt. Ltd.,***[39] the Pune bench of ITAT held that credit of TDS should be allowed in the year in which income corresponding to such TDS is assessable.

FACTS

M/s. Mahesh Software Systems Pvt. Ltd. ("**Assessee**") is engaged in the business of providing software services. For AY 2011-12, the Assessee claimed credit for TDS of INR 8.41 lakhs which was not appearing in Form 26AS. According to Assessee, it had raised an invoice on Ashok Leyland in March, 2011 for an amount of INR 84.10 lakhs, the TDS for which was deducted/deposited by Ashok Leyland in April 2011 i.e. AY 2012-13. It may also be noted that Ashok Leyland showed it as an expenditure in their books in AY 2012-13.

> **ITAT allows TDS credit to be claimed in the year in which the corresponding is assessable to tax.**

The AO rejected the contention of the Assessee on the basis of Rule 37BA(1) of IT Rules, which states that credit for taxes deducted at source shall be given on the basis of information relating to deduction of tax furnished by the deductor to IRA i.e. AY 2012-13.

The order of the AO was upheld by the CIT(A) as well. The CIT(A) rejected the claim of the Assessee on the basis of Rule 37BA(4) of IT Rules which states that credit of TDS deducted shall be granted on the basis of – (i) Information relating to deduction of tax furnished by the deductor to IRA; and (ii) Information in return of income in respect of claim of credit.

Being aggrieved by these orders, the Assessee filed an appeal before the ITAT.

ISSUES

Whether the credit for TDS should be given in the FY in which the corresponding income is recorded or in the FY in which the TDS deducted and deposited with the exchequer?

ARGUMENTS

The Assessee produced its sale register which depicted total sales for AY 2011-12 amounting to INR 36.9 million. The sales records included an invoice dated March 28, 2011, of amount INR 84.10 lakhs. On such amount Ashok Leyland deducted taxes at the time of payment, amounting to INR 8.41 lakhs. However, it was only in the month of April, 2011 that the taxes were deducted and deposited with the exchequer, because of which the said dispute arose. Given the same, the Assessee argued that the benefit of TDS should be given in the year in which the Assessee has recorded the corresponding income.

As against this, the IRA argued that the benefit of TDS is to be given only in the year in which the said TDS is deducted and deposited with the IRA. The contention of the IRA is based on Rule 37BA(1) and Rule 37BA(4) of IT Rules, as discussed above.

DECISION

The ITAT allowed the appeal of the Assessee stating that while Rule 37BA(1) provides for credit of TDS to be given at the time when information relating to TDS is furnished by the deductor, what is material for sub-rule (1) is the beneficiary of credit for TDS, which is Assessee in the instant case. As per ITAT, the point of

[39] Mahesh Software Systems Pvt. Ltd. V. ACIT, Circle 11(2) Pune; ITA No. 1288/ Pun/ 2017.

time at which the benefit of TDS is to be given is governed by sub-rule (3) of Rule 37BA, which provides that credit for TDS deducted and paid to IRA, is to be given for the AY in which such income is assessable.

Given the same, since income of INR 84.10, corresponding to which TDS in dispute was deducted, was assessable in AY 2011-12, the ITAT held that the benefit of TDS should be allowed in AY 2011-12 only.

SIGNIFICANT TAKEWAYS

Section 199 of the IT Act provides that where any TDS is deducted and paid to Central Government in accordance with the provisions of IT Act, it would be considered as taxes paid on behalf of the assessee, for whom taxes have been deducted. The credit for such TDS is given as per the guidelines laid out in Rule 37BA of IT Rules.

Rule 37BA of IT Rules provide multiple basis on which credit for TDS deducted is to be allowed. While Rule 37BA(1) and (4) clearly state that such credit is to be allowed on the basis of the information furnished by the deductor to the IRA, of such taxes deducted. On the contrary, sub-rule (3) unambiguously states that credit for TDS deducted and paid to Central Government, has to be given in the year in which income corresponding to such TDS is assessable. These sub-rules may have conflicting effect in situation, as in the instant case, where the year in which such income is assessable is different from the year in which information relating to such TDS is furnished.

Technically, Ashok Leyland should have credited the amount due to the Assessee in its books of accounts on March 28, 2011 itself since the invoice was raised on the said date and in such a case, the liability to withhold TDS would have arisen in its hands in AY 2011-12 instead of AY 2012-13. In the instant case, it appears that Ashok Leyland has recorded the entry in its books in the AY 2012-13, which had resulted in the instant mismatch in the hands of Assessee.

Be that as it may, as per the accrual method of accounting, the Assessee is liable to offer the invoice amount as its receipts in the AY 2011-12 and therefore, the TDS credit corresponding to such invoice should be given to the Assessee in the same FY but not as per the entries made in the books followed by payer. The rationale for Rule 37BA(3) is also derived from the same. The instant decision of the ITAT has put an end to the controversy surrounding the same.

MADRAS HC REAFFIRMS THE DOCTRINE OF DIVERSION OF INCOME BY OVERRIDING TITLE

In the case of ***Kumar Rajaram***,[40] (the "**Assessee**") the Madras HC held that earmarked donations from sale of property on the basis of directions contained in 'Will' are not to be regarded as 'application of money' but as 'diversion of income by over-riding title'. Based on this, the Madras HC observed that since the Assessee was never entitled to receive the entire sale proceeds, the Assessee must be allowed to deduct the amount which stood diverted from the sale consideration for the purpose of computation of capital gains from sale of property.

FACTS

The Assessee was a non-resident individual who during the AY 2012-13 derived income from capital gains and interest income assessed under the head 'other sources'. The Assessee's father owned land and residential house at Bangalore and he died on June 11, 2011 leaving his last will and testament dated October 30, 2008 (the "**Will**"). The Assessee's father appointed an executor to execute the directions contained in the Will. In accordance with the Will, the property at Bangalore was sold on November 10, 2011 for INR 88,000,000.

The Will contained a direction to the executor that upon sale of the property, a sum of INR 10,00,000 was to be paid to Sri Sai Spiritual Center Trust, a sum of INR 25,00,000 to Helpage India, Bangalore, a sum of INR 15,00,000 to CRY - Child Rights and You, Bangalore and a sum of INR 10,00,000 to Sri Ramana Ashram, Thrivannamalai. Apart from these payments, there was a direction that the executor will be entitled to receive a sum of INR 50,000. The balance amount was to be paid to the Assessee.

> **For the application of the doctrine of 'diversion of income by overriding title', what is significant is that the property/income should have been diverted even before it reached the hands of the Assessee and there must not be any obligation on the Assessee to make the distribution of income/property.**

Accordingly, the Assessee received a sum of INR 81,950,000. The Assessee filed his return of income admitting total income of INR 6,22,63,973 comprising of long term capital gains computed as INR 5,99,21,346 arising on sale of the Bangalore property by adopting the sale consideration as INR 8,19,50,000 and claiming a sum of INR 7,52,500 as expenditure incurred in connection with the sale. The AO completed the assessment under Section 143(3) of the IT Act considering the sale consideration as mentioned by the Assessee in his return of income, namely, INR 8,11,97,500 (INR 8,19,50,000 – INR 7,52,500). The CIT issued a show cause notice under Section 263 of the IT Act proposing to disallow the sum of INR 6,802,500, being the payment made to charitable institutions and the claim of the expenditure of INR 8,02,500.

The CIT vide order dated July 02, 2015 disallowed the exclusion of INR 6,802,500 and directed the AO to re-compute the total income and tax thereon. The Assessee filed an appeal before the ITAT which affirmed the order of the CIT holding that the exclusion of the payment made by the Assessee by holding that the diversion of income by overriding title cannot be allowed. Therefore, the Assessee filed an appeal before the Madras HC under Section 260A of the IT Act.

ISSUE

Whether the ITAT was right in law in holding that the exclusion of payment to charities by applying the principle of diversion of income by overriding title cannot be allowed?

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[40] Kumar Rajaram v. The Income Tax Officer, Madras HC, [TS-504-HC -2019].

ARGUMENTS

The counsel for IRA stated that the Will dated October 20, 2010 had stated that the Assessee's father bequeathed entire sale consideration received from the sale of the Bangalore property to the Assessee. He submitted that the sale consideration was received by the Assessee out of which payments were made to the charitable institutions, etc. Therefore, the payments cannot be considered as diversion by overriding title or as expenditure incurred wholly and exclusively in connection with the transfer.

On the other hand the counsel for the Assessee argued that the sale was to be executed by the executor of the Will who was required to distribute the money to respective organisations, defray the expenses, pay the property tax, deduct his professional fee and the remaining amount was directed to be paid to the Assessee. Therefore, interpreting the Will in any other manner will be injustice to the intention of the testator of the Will.

DECISION

The HC observed that major portion of the sale consideration from the sale of the property stood diverted before it reached the hands of the Assessee. The Assessee at no point of time was entitled to receive the entire sale consideration and under the Will, there was no obligation cast upon the Assessee to distribute the same in the manner desired by the testator. The testator bequeathed part of sale consideration for the Assessee which was left behind after meeting the commitments mentioned in the Will. Therefore, the capital gains of the Assessee will only be calculated on the amount that was received by the Assessee and not on the entire sale consideration.

SIGNIFICANT TAKEAWAYS

The concept of 'diversion of income by overriding title' is an old and well debated concept. The decisions of the SC in the case of Privy Council in ***Raja Bejoy Singh Dudhuria,***[41] and ***Sitaldas Tirathdas,***[42] form the basis for this concept and continue to be referred in recent cases. The judgement of Madras HC in this case is significant as it reinforces the doctrine of 'diversion of income by overriding title'. The Madras HC clarified that for the application of the doctrine, what is significant is that the property/income should have been diverted even before it reached the hands of the Assessee and there must not be any obligation on the Assessee to make the distribution of income/property. Further, it must be noted that in case the distribution was to be made either by the Assessee or after the income/property was in the hands of the Assessee, the aforementioned doctrine will not apply and in such a case, deduction for the purpose of computation of capital gains may not be permitted.

[41] Privy Council in Raja Bejoy Singh Dudhuria v. CIT [(1933)1 ITR 135 (SC)].
[42] Commissioner of Income Tax, Bombay City II vs. Sitaldas Tirathdas [(1961) 41 ITR 367 (SC)].

SC HOLDS SUPPORTING MANUFACTURERS NOT AT PAR WITH DIRECT EXPORTERS FOR CLAIMING DEDUCTION UNDER SECTION 80HHC OF THE IT ACT

In the case of ***Carpet India***,[43] the SC held that supporting manufacturers cannot be treated at par with direct exporter for the purpose of deduction under Section 80HHC of the IT Act.

FACTS

M/s. Carpet India, Panipat ("**Assessee**") had derived income from manufacturing and sale of textile goods as supporting manufacturer. The Assessee received export incentives as duty draw back (DDB), Duty Entitlement Pass book (DEPB) and claimed deduction of the same, under Section 80HHC of the IT Act. In the returns of income, the Assessee claimed that they are at par with the direct exporter and claimed export incentives which are available to direct exporters as deduction under Section 80HHC of the IT Act.

> **Direct manufacturers are not to be treated at par with the supporting manufacturer for the purpose of deductions under Section 80HHC of the IT Act.**

ISSUE

The issue before the SC was whether supporting manufacturers who sold goods to export house or trading house are to be treated at par with the direct exporters vis-à-vis claim of deductions available under Section 80HHC of the IT Act specifically available for direct exporters?

ARGUMENTS

The counsel for IRA contended that as the Assessee is working as a supporting manufacturer and there is no direct export of the goods to the foreign constituents by the Assessee, it is not entitled to claim the deduction which are specifically available to a direct exporter under Section 80HHC of the IT Act. It was also stated that the HC had erred by treating the export incentive at par with premium paid by export houses to the supporting manufacturer in light of the statutory scheme under Section 80HHC of the IT Act.

On the other hand the counsel for the Assessee argued that the assessee was working as a supporting manufacturer, exporting the goods to foreign parties through the export houses or trading houses and was, therefore, entitled to legitimately claim deduction of export incentives under Section 80HHC of the IT Act just like the benefits available to the direct exporter.

DECISION

SC stated that it is not disputed that the taxpayer is not a direct exporter and is a support manufacturer. As per the statutory scheme under Section 80HHC of the IT Act, a direct exporter stands on a completely different footing from that of a supporting manufacturer, as the parameter and the scheme for deductions in relation to direct exporter under sub-Section (1) and (3) is completely in variance with that of supporting manufacturers, provided in sub-Section (1A) and (3A) of Section 80HHC of the IT Act. The SC observed that the reliance placed by the HC on the case of ***Baby Marine***,[44] was misplaced as in that case the issue pertained to eligibility of export house premium for inclusion in the business profits for deduction, which is not related to the issue in the instant case.

SIGNIFICANT TAKEAWAYS

This decision of the SC clarifies that direct manufacturers are not to be treated at par with the

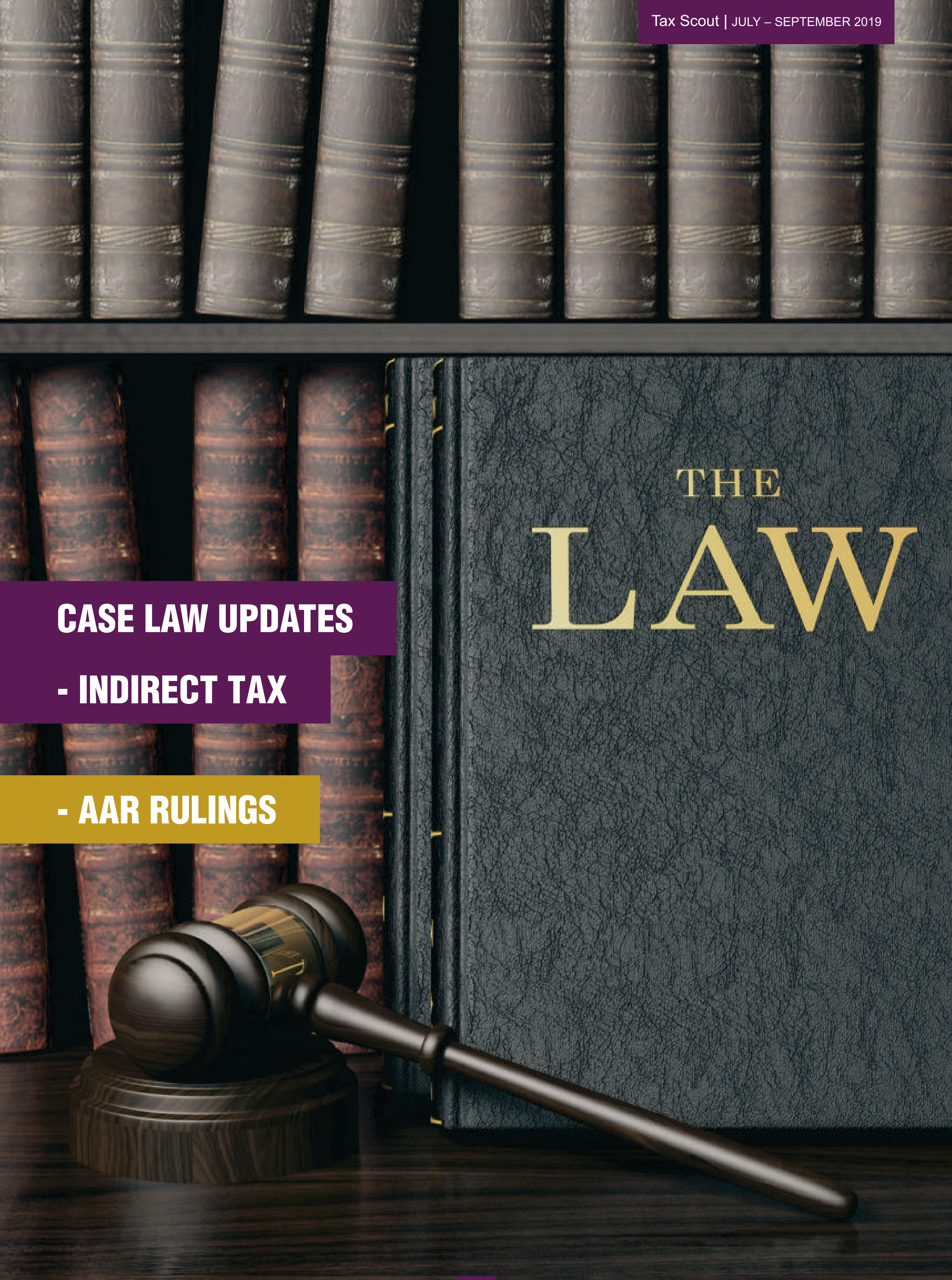
[43] Commissioner of Income Tax v. Carpet India, [2019] 109 taxmann.com 35 (SC).
[44] CIT v. Baby Marine Exports [2007] 290 ITR 323 / 160 Taxman 160 (SC).

supporting manufacturer for the purpose of deductions under Section 80HHC of the IT Act. This settles the confusion created by the decision of the SC in the case of ***CIT v. Sushil Kumar Gupta,***[45] wherein the issue before the SC was whether 90% of export benefits disclaimed in favour of a supporting manufacturer (Assessee herein) have to be reduced in terms of Explanation (baa) of Section 80HHC of the IT Act, while computing deduction admissible to such supporting manufacturer under Section 80HHC(3A) of the IT Act. In that case, the SC had, after erroneously placing reliance on ***Baby Marine (supra)***, decided the issue in favour of the assessee, in essence placing the support manufacturers at par with direct exporters for the purpose of deductions under Section 80HHC of the IT Act. The SC has now overruled that decision.

The present judgment by the SC has now cleared any ambiguity on the treatment to be made while calculating the deduction for export incentives available under Section 80HHC of the IT Act for a supporting manufacturer vis-à-vis a direct manufacturer. This may be relevant for ongoing litigation matters on this issue before the ITAT.

Further, the SC remanded the matter to the ITAT to enable taxpayer to avail deduction under Section 80HHC(1) read with Section 80HHC(3) of the IT Act in cases where they could prove they were direct exporters.

[45] Commissioner of Income Tax v. Sushil Kumar Gupta, [2012] 25 taxmann.com 368 (SC).



CASE LAW UPDATES

- INDIRECT TAX

- AAR RULINGS

PROFIT SHARING AGREEMENT BETWEEN AN EMPLOYEE AND THE SHAREHOLDERS OF THE EMPLOYER COMPANY IS NOT LEVIABLE TO GST

In re ***Venkatasamy Jagannathan,***[46] the Tamil Nadu AAR ("**TNAAR**") clarified that Profit Sharing Agreement ("**PSA**") between an employee and the shareholders of a company was an actionable claim and therefore, not taxable under the GST regime.

FACTS

Shri. Venkatasamy Jagannathan ("**Applicant**") was the Chairman and Managing Director ("**CMD**"). The Applicant was also a stake holder of the Star Health and Allied Insurance Company Limited ("**SHIA**") by virtue of his employment as the CMD of SHIA. In this regard, the Applicant had entered into a PSA with the shareholders of SHIA. As per the PSA, the Applicant was entitled to a profit on the event of a strategic sale where at least 51% of the paid up equity share capital of SHIA was sold for not less than INR 75 per equity share or an Initial Public Offering ("**IPO**") where the midpoint of the price band reflecting in the red-herring prospectus was not less than INR 75 per share. The Applicant approached the TNAAR with respect to the applicability of GST on the PSA, and the profits it would render in the Applicant's hands.

> **Profit Sharing Agreement between an employee and the shareholders of the employer is an actionable claim not taxable under GST.**

ISSUE

Whether benefit arising under the PSA between the Applicant and the shareholders of SHIA was exigible to GST?

ARGUMENTS

The Applicant argued that the he was entitled to benefits under benefit arising under the PSA by virtue of his employment as the CMD of SHIA. Therefore, any benefit arising out of the same was covered under employer/employee activities and exempt from the levy of GST in terms of Schedule III of the CGST Act and the Tamil Nadu GST Act, 2017 ("**TNGST Act**"). The Applicant also submitted that the right to receive remuneration under the PSA was given for achieving results through aggressive efforts under the Applicant's employment with SHIA; the same stood terminated on the date of termination of employment. Hence, the activities under PSA only tantamounted to services rendered by him as an employee. Therefore, such supplies were to be treated neither as a supply of goods nor service as per Schedule III of the CGST Act and the TNGST Act.

DECISION

The TNAAR referred to the relevant clauses of the PSA and noted that it was an agreement between the investors/ shareholders of SHIA and the Applicant; rather than between the Applicant and SHIA. The TNAAR held that the shareholders of a company could not be the company itself and the shareholders in the instant case could not or did not act on behalf of the SHIA. Therefore, the aforesaid transaction could not be treated as services by Applicant to SHIA. The TNAAR also noted that the Applicant's claim to the specified amount under the PSA was contingent upon the occurring of a strategic sale or IPO. The profits arising out of such sale or IPO was a 'moveable property' which was not in the possession of the Applicant. The Applicant had a beneficial interest in future profits. Therefore, the TNAAR concluded that the PSA was to be treated as an 'actionable claim'; which was neither a supply of goods nor services under the CGST Act and TNGST

[46] Re Venkatasamy Jagganathan, (2019) 107 taxmann.com 276 (AAR – Tamil Nadu).

Act. Accordingly, TNAAR held that the PSA executed between the Applicant and the shareholders of SHIA was not exigible to GST.

SIGNIFICANT TAKEAWAYS

The levy of tax on profit sharing agreements was a contentious issue even under the erstwhile regime. The legislations under the GST regime also do not provide clarity on the tax treatment of profit sharing agreements. In such a scenario, the present ruling by TNAAR clears the air and is a welcome ruling on this issue. Though the AAR rulings are binding only on the relevant parties, the same can have persuasive value in cases involving similar issues. However, it must be noted that the findings of the TNAAR are entirely based on the agreement in dispute; which provided for profit sharing was based on an uncertain event. There is still no clarity on profit sharing agreements which do not fall under the category of 'actionable claims' and the same remains an open issue which needs to be either settled by a court of law/AAR or clarified by the CBIC.

CASE LAW UPDATES

- INDIRECT TAX

- OTHER JUDICIAL PRONOUNCEMENTS

ITC ONCE VALIDLY TAKEN IS INDEFEASIBLE AND A VESTED RIGHT ACCRUES IN FAVOUR OF THE REGISTERED PERSON

In ***Shabnam Petrofils Pvt. Ltd. v. Union of India,***[47] the Division Bench of the Gujarat HC struck down Notification No. 20/2018- Central Tax (Rate) dated July 26, 2018 ("**Notification**") and Circular No. 56/30/2018-GST dated August 24, 2018 ("**Circular**"), to the extent that the same provided that the input tax credit ("**ITC**") lying unutilised, after payment of tax for and up to the month of July 2018, on the inward supplies received up to till July 31, 2018 would lapse.

FACTS

M/s Shabnam Petrofils Pvt. Ltd. ("**Petitioner No. 1**") was engaged in manufacturing of polyester texturized yarn, polyester woven fabrics and polyester knitted fabrics from polyester partially oriented yarn/polyester texturized yarn. The Federation of Gujarat Weavers Welfare Association registered under the Maharashtra Public Trust Act, 1950 and Societies Registration Act, 1950 ("**Petitioner No. 2**") represented its members who were mostly man-made fibre fabric weavers. The Notification was an amendment to Notification No. 5/2017-Central Tax (Rate) dated June 28, 2017 ("**Notification No. 5/2017**"); and provided that ITC in relation to certain textile and textile articles notified under Notification No. 5/2017 would be allowed with effect from August 1, 2018. It also provided that accumulated unutilized ITC on inward supplies of such articles received up to July 31, 2018' would lapse after the payment of tax for and up to the month of July 2018. The Circular was issued to clarify certain ambiguities pertaining to the said amendment. Petitioner No. 1 and Petitioner No. 2 ("**Petitioners**") filed separate writ petitions challenging the validity of the Notification and Circular, before the Gujarat HC. The Gujarat HC clubbed both the petitions on account of the common question of law involved in them.

> **"ITC is a vested right of the taxpayer and shall not lapse except under an express provision in the Act."**

ISSUE

Whether the Notification and Circular were liable to be quashed as being contrary to Section 54(3) of the CGST Act and violative of Article 14 and 19(1)(g) of the Constitution of India.

ARGUMENTS

The Petitioners contended that the Notification was issued without application of mind as it caused huge monetary losses on account of payments towards ITC. The Petitioners also contended that the Notification had exceeded the powers delegated under Section 54(3)(ii) of the CGST Act, which was limited to notifying supplies that were not entitled to refund of ITC accumulated on account of the inverted rate structure. The Petitioners also contended that the ITC was as good as tax paid and once validly taken was an indefeasible right in favour of the registered person. The Petitioners also argued that in absence of an express retrospective applicability; a notification could only have a prospective effect.

On the other hand, the respondent contended that by reduction of rate of GST on man-made fabrics yarns, the accumulation of ITC was reduced. Further, the request to remove restriction on refund of accumulated ITC was agreed and the same was introduced with a prospective effect and a conscious decision was taken to lapse the accumulated ITC. The

[47] Shabnam Petrofils Pvt. Ltd. v. Union of India, Special Civil Application No. 16213 of 2018 (Gujarat HC).

respondent argued that the power to lapse the ITC flows inherently from the power to deny refund of accumulated ITC on account of inverted duty structure. The respondent also highlighted that the benefit of refund of accumulated ITC, on account of inverted duty structure was not available before the Notification coming into force. Allowing of the utilization of such credit would have led to the allowing of blocked credits, and in a way, negated the earlier position of blockage of refund of ITC.

DECISION

The Gujarat HC held that the CGST Act itself provides for the lapsing of the ITC at Sections 17(4) and 18(4) respectively and no such express provision was available in Section 54(3) of the CGST Act. Therefore, the Respondent had no inherent power under Section 54(3)(ii) of the CGST Act to lapse the utilised accumulated ITC. The HC also held that the Petitioners had vested right to the unutilised ITC accumulated on account of the inverted rate structure.

The Gujarat HC also highlighted that it was a well-settled principle that a delegated legislation had to be in consonance and conformity with the parent statute and the Notification in the present case exceeded the powers delegated under Section 54(3)(ii) of the CGST Act. Accordingly, the HC struck down Notification No. 05/2017 amended vide the Notification as ex facie invalid and without any authority of law, to the extent it provided for the lapse of the accumulated ITC lying unutilised after payment of tax for and up to the month of July 2018.

SIGNIFICANT TAKEAWAYS

This is a welcome decision as it recognises the vested right of a taxpayer in relation to unutilised ITC and accepts that ITC once taken is indefeasible. The Gujarat HC in *M/S Siddhartha Enterprises v. Nodal Officer,*[48] has further reiterated that ITC is a vested right of the taxpayer which cannot be curtailed by a procedural provision. The Gujarat HC in this case had gone to the extent of stating that even in a situation of procedural collapse, vested right to take ITC cannot be alienated from the taxpayer. The decisions can be relied up on to challenge decisions or provisions which deny ITC or transitional credit to a taxpayer after such credit was validly availed; so as to taking away the vested right of the taxpayer.

Further, the ruling also reinforces the legislative intent that only Sections 17(4) and 18(4) of the CGST Act expressly provide for lapsing of the ITC, and no other provision in the CGST Act delegates such inherent power.

[48] M/S Siddhartha Enterprises v. Nodal Officer, R/Special Civil Application No. 5758 of 2019 (Gujarat HC).

HC ALLOWS TRANSITION OF CREDIT OF EDUCATION CESS, SECONDARY AND HIGHER EDUCATION CESS AND KRISHI KALYAN CESS TO THE GST REGIME

In ***Sutherland Global Services Pvt. Ltd.,***[49] the Division Bench of the Madras HC held that accumulated credit pertaining to Education Cess[50] ("**EC**"), Secondary and Higher Education Cess[51] ("**SHEC**") and Krishi Kalyan Cess[52] ("**KKC**") could be transitioned into the GST regime.

FACTS

Sutherland Global Services Pvt. Ltd. ("**Petitioner**") was engaged in the business of providing Information Technology enabled services. During the pre-GST era, the Petitioner was entitled to avail the CENVAT credit of EC, SHEC and KKC levied on excisable goods / taxable services as set-off against its corresponding EC, SHEC and KKC liability on output services provided by it.

Pursuant to the implementation of GST, Section 140(1) of the CGST Act permits a person registered under GST to carry forward any accumulated CENVAT credit of eligible duties into the electronic ledger maintained in terms of GST legislations. Therefore, the Petitioner sought to carry forward accumulated credit of approximately INR 18.80 crores (including EC of INR 55 lakhs and SHEC of INR 30 lakhs) to its electronic credit ledger in terms of Section 140(1) of the CGST Act. However, the AO rejected the Petitioner's request by order dated February 9, 2018; on the ground that accumulated credit pertaining to EC, SHEC and KKC could not be transitioned to the GST regime, and directed the Petitioner to reverse any such credits availed by it. The Petitioner assailed the said order of the AO in the present writ petition.

ISSUE

Whether the Petitioner was entitled to carry forward the accumulated credit pertaining to EC, SHEC and KKC in terms of the GST legislations?

ARGUMENTS

The Petitioner argued that, 'credits' in terms of the CEA read with Section 140 of the CGST Act, included credit of EC, SHEC and KKC. Therefore, such credits were eligible to be credited, transitioned and utilized. The Petitioner also argued that accumulated credit pertaining to EC, SHEC and KKC was eligible to be carried forward under Section 140(8) of CGST Act, which provided that a person with centralized registration under the erstwhile laws was permitted to take the amount of CENVAT credit carried forward in a return furnished as per the erstwhile laws; into the electronic ledger maintained in terms of the CGST Act. The Petitioner submitted that meaning of the phrase 'eligible duties and taxes' in the explanation to Section 140, was not relevant for the purposes of Section 140(1) and 140(8) of the CGST Act.

> **Accumulated credit cannot be said to have been wiped out without a specific order providing for it lapse.**

The revenue submitted that the Petitioner was not entitled to the transition of its unutilized credit of EC, SHEC and KKC into the GST regime. The right to claim ITC was a statutory right which could be claimed only on fulfilment of certain statutory conditions and not as a vested right. The revenue argued that with the abolition of EC, SHEC and KKC, the levy and availment of credit in respect to such cesses was removed from the sweep of the CGST Act. The revenue contended that permission to carry forward

[49] Sutherland Global Services Pvt. Ltd. v. Assistant Commissioner CGST and Central Excise and Ors., TS 972 HC 2019 (Madras HC).
[50] Introduced vide Finance Act, 2004 and abolished vide Finance Act, 2015 with effect from June 1, 2017.
[51] Introduced vide Finance Act, 2007 and abolished vide Finance Act, 2015 with effect from June 1, 2017.
[52] Introduced vide Finance Act, 2016 and abolished in July, 2017.

the credit of such cesses manually in the CENVAT credit register, by itself, was not a determining factor of its proper utilization. The revenue relied on various judicial precedents, including the judgment of the Delhi HC in *Cellular Operators Association of India v. Union of India,*[53] wherein it was held that credit of EC and SHEC was permitted only against EC and SHEC, and could not be cross-utilized against the excise duty or service tax.

DECISION

The Madras HC noted that the unutilized credit of EC, SHEC and KKC continued in the CENVAT registers of taxpayers even after such cesses were abolished and in absence of an enabling provision, their accumulated credits could not be utilized. The HC highlighted that on various occasions, while the authorities could have stipulated the lapse of such credits; no such notification/circular/instruction was issued. The HC also observed that in strategizing and conducting its business, the Petitioner would have certainly taken into account that credit was available for set-off against output tax liability. Therefore, until such credit had lapsed, the assessing authority could not have rejected the claim as it amounted to insertion of a rule / regulation which was impermissible. The HC also distinguished the judgment of *Cellular Operators Association (supra)* on the ground that the issue in that case pertained to cross utilization of EC and SHEC against set-off of excise duty and service tax, in context of the extant provisions and observed that the decision nowhere indicated that the EC and SHEC had lapsed. The HC stated that the credit in question reflected in the returns filed by the Petitioner under the pre-GST laws could be denied transition into GST only in certain specified circumstances. Since none of these circumstances arose in the case of the Petitioner, transfer of the credit could not be denied. Therefore, the HC held that the Petitioner was eligible to carry forward the credit pertaining to EC, SHEC and KKC into the GST regime.

SIGNIFICANT TAKEAWAYS

This is a landmark judgment by the Madras HC as it permits taxpayers to carry forward the accumulated credit on account of EC, SHEC and KKC. The judgment iterates that credit once availed is indefeasible. It provides a major relief for taxpayers. The government would have to provide for a legal machinery to grant relief to taxpayers who have not availed such credit or who were made to reverse such credit.

Notably, the Maharashtra AAAR in the case of *Kansai Nerolac Paints Ltd.*[54] had relied on the *Cellular Operators Association of India (supra)* judgment and ruled that credit of KKC that appeared in the service tax return of input service distributor and carried forward to his electronic credit ledger under the CGST Act, was not allowed as admissible ITC. The CBEC had also issued Frequently Asked Questions ("**FAQs**") which specified that unutilized credit of KKC could not be carried forward under CGST. Surprisingly, the present decision neither referred to the AAAR ruling nor the FAQs.

Therefore, there is a possibility that revenue may seek to challenge this decision. In addition, as the decision of Madras HC is binding only within the State of Tamil Nadu, the possibility of courts of other States taking divergent views cannot be ruled out.

Pursuant to CGST (Amendment) Act, 2018, Section 140(1) was amended retrospectively with effect from 1 July 2017, to allow only transitioning of CENVAT credit attributable to "eligible duties". The HC noted the amendment and observed that the corresponding amendment to the definition of "eligible duties" and "eligible duties and taxes", as given in explanation 1 and explanation 2, was not made effective. Therefore, the HC did not go into the retrospective application of section 140(1) and observed that, nevertheless, in absence of an amendment in Section 140(8), the cesses could be transitioned in terms of Section 140(8) without restriction of eligibility or otherwise.

53 Cellular Operators Association of India v. Union of India, (2018) 51 GSTR 338 (Delhi HC).
54 In re Kansai Nerolac Paints Ltd., (2018) 96 taxmann.com 153 (Maharashtra AAAR).

COMPOSITION OF THE GST APPELLATE TRIBUNAL WITH MAJORITY NON-JUDICIAL MEMBERS HELD TO BE UNCONSTITUTIONAL

In ***Revenue Bar Association v. Union of India***,[55] the Division Bench of the Madras HC has struck down the provisions pertaining to constitution of GST Appellate Tribunal ('**GSTAT**') and appointment of judicial and technical members, as being violative of Article 14 and 50 of Constitution of India.

FACTS

The Revenue Bar Association ("**Petitioners**") filed a writ petition under Article 226 of the Constitution of India, seeking declaration of section 109 and 110 of the CGST Act and TNGST Act, relating to the constitution of the GSTAT and composition of the members, as void, defective and unconstitutional; in violation of Articles 14, 21 and 50 of the Constitution of India. Section 109 of CGST Act provided that the Government shall on the recommendations of the GST Council, constitute an Appellate Tribunal i.e. GSTAT for hearing appeals against the orders passed by the Appellate Authority or Revisional Authority. Section 110 of CGST Act prescribed the qualifications, manner of appointment and conditions of service, etc. of the President and Members of the GSTAT.

> **"Tribunals which primarily decide disputes between State and citizens cannot be run by a bench constituted in majority of non-judicial members."**

ISSUES

(i) Whether the exclusion of advocates from being considered for appointment as a judicial member in GSTAT, is violative of Article 14 of the Constitution of India?

(ii) Whether the appointment of member of the Indian Legal Service ("**ILS**") as a judicial member of the appellate tribunal, contrary to the law laid down by the Hon'ble Supreme Court in *Union of India v. R. Gandhi*[56]?

(iii) Whether the composition of the National Bench, Regional Benches, State Bench and Area Benches of the GSTAT, wherein the administrative members outnumber the judicial member is violative of Articles 14 and 50 of the Constitution of India and the judgments of the Hon'ble Supreme Court of India?

ARGUMENTS

The Petitioners contended that section 110(1)(b) of the CGST Act which laid down qualification for the appointment of a Judicial member for GSTAT specifically excluded advocates. This was a departure from the practice that had been followed over the years. The Petitioners also contended that the Hon'ble SC in the *R.K. Jain v. Union of India*[57] held that recruitment of members of the Bar i.e. advocates to a Tribunal was needed. The Petitioners substantiated that an advocate with 10 years of experience in the subject was better equipped to understand, appreciate and adjudicate matters *vis-à-vis* a District Judge who did not possess the requisite experience. Therefore, section 110(1)(b) was capricious and irrational and violated Article 14 of the Constitution to such extent.

The Respondents on the other hand contended that there was no fundamental right which provided that advocates were to be considered for appointment as a judicial member of a tribunal. The Respondents also contended that even the Advocates Act, 1961 does not include such a provisions in favour of the

[55] Revenue Bar association v. Union of India, [2019] 109 taxmann.com 375 (Madras).
[56] Union of India v. R.Gandhi, 2010 (11) SCC 1.
[57] R.K. Jain v. Union of India, (1993) 4 SCC 119.

advocates. The government was vested with the powers to decide the eligibility for appointment as a judge. In the instant case the advocates have been specifically excluded by the government and therefore, in the absence of a specific provision the right to be considered for the appointment was not a statutory right.

With respect to challenge to the appointment of a member of ILS, the Petitioners referred to *R. Gandhi case (Supra)* and contended that persons who had held Group A posts under Central or State government with experience in the Indian Company Law Service (Legal Branch) and the ILS (Grade I) cannot be considered for appointment as judicial members. Their expertise would at best enable them to be considered for appointment as technical members. Therefore, the Petitioners contended that section 110(b)(iii) of the CGST Act is *per se* contrary to the law laid down by the Supreme Court in the said judgment and was liable to be struck down.

The respondents however contended that law even prior to GST had a provision for members of ILS to be appointed as judicial members in CESTAT. The respondents also contented that the cadre of ILS had advocates with 7 years or more of experience and also included some District Judges. The respondents emphasized that officers of the rank of Secretary in ILS also discharged quasi-judicial functions as members of several other tribunals and even worked as arbitrators. The Respondents submitted that the qualifications were minimum requirements, and that during the selection process, the competent authority would ensure officers of sufficient seniority and high level of competence are selected as members.

Separately, with respect to composition of GSTAT Petitioners also contended that section 111(4) of CGST Act provided that proceedings before GSTAT were judicial proceedings; and as such, the administrative members i.e. government servants should not be in majority in the GSTAT. With regard to the composition of the Benches wherein the technical members would be in majority as compared to the judicial members the Petitioners contended that the same was not only violative of Article 14 but was also contrary to the mandate of Article 50 of the Constitution of India which provided that State shall take steps to ensure separation of judiciary from the executive. Such a composition would seriously affect the independence of the judiciary. Additionally, since in most appeals before the GSTAT, the revenue would be involved, the composition of GSTAT would imply that the GSTAT might not be an independent body and be biased towards the Government in its orders.

The respondents also contended that the GSTAT was not a Court or a Judicial Tribunal and was only discharging judicial functions as per the powers granted by the statute. The respondents further argued that a minimum quorum of two members had already been prescribed under the CGST Act. The apprehension of the Petitioners due to preponderance of technical members over judicial member is wholly untenable; especially as the President of GSTAT was to be a judicial member who always had a say in the matters before it.

DECISION

The Madras HC held that section 110(1)(b) of CGST Act which excluded advocated from appointment to GSTAT could not be struck down as being in violation of Article 14 of the Constitution of India, as the right to be considered for appointment emanates from being eligible by virtue of any Act or Rules conferring such right. In absence of any such right, one cannot contend that a person's right was taken away. The HC observed that advocates are eligible to be appointed as judicial members in the ITATs which is the oldest Tribunal in the country. Further, lawyers are eligible for appointment as judicial member in the CESTAT. Accordingly, the HC recommended that the Parliament evaluate the said departure from the existing practice and reconsider the issue regarding eligibility of lawyers to be appointed as judicial members in the GSTAT.

With respect to challenge to the appointment of a member of ILS, the HC stated that the said issue was no longer res *integra* and was settled in the case of *R. Gandhi case (Supra)*. Therefore, the HC held section 110(b)(iii) of CGST Act to be contrary to the settled position of law.

The HC stated that all the Tribunals, irrespective of whether they were constituted under Article 323-A or 323-B of the Constitution of India or under any statute, were part of justice delivery system. For an effective justice delivery system, there is a need of an independent impartial Tribunal. As the GSTAT would replace the CESTAT and Sales Tax / VAT Tribunals; their constitution should be on the same lines as the earlier ones.

The Madras HC also observed that the law had been settled by the SC, insofar, as the creation of alternative institutions i.e. Tribunals that exercise judicial functions is concerned. The SC in previous occasions had held that the creation of alternate institutions to exercise the judicial functions should not be less effective than that of the HC. Therefore, the Parliament, only had the power to set up an alternate institutional mechanism, insofar as such institution offers an effective mechanism for delivery of justice which is no less effective than that of a HC. The HC also held that Article 50 of the Constitution of India which provides for separation of the judiciary from the executive, must be interpreted in such a way that the dominance of the departmental or technical members, cannot overwhelmingly outweigh that of the judicial members. Accordingly, the HC observed that the number of expert / technical members cannot exceed the number of judicial members on the bench since a properly trained judicial mind is necessary for the decision-making process and to decide on issues relating to interpretations of notifications and sections under the CGST Act. Therefore, the HC struck down section 109(3) and 109(9) of the CGST Act.

SIGNIFICANT TAKEAWAYS

Recently, the GST Council give its nod for the formation of GSTAT, which shall bring consistency to interpretation of the GST law and deciding matters. I However, it would be preemptive to conclude that the decision of the Madras HC would be final in this regard; since the government still has an opportunity to file an appeal before the Hon'ble SC. Given that, one may note that the predominance of technical members over judicial members in the composition of any tribunal is a settled position of law in favour of the judicial members and it can be expected that even in the present matter, the Hon'ble SC would not disembark away from the precedents set by it.

NO LEVY OF SALES TAX ON SUPPLY OF FOOD AND BEVERAGES BY MEMBERS' CLUBS TO ITS MEMBERS

In ***Calcutta Club Limited,***[58] the three-judge Bench of the SC held that the doctrine of mutuality would continue to be applicable to incorporated as well as unincorporated members' clubs even after the 46th Amendment to the Constitution ("**Amendment**") inserting Article 366(29-A) to the Constitution; which *inter-alia* stated that tax on the sale and purchase of goods included tax on supply of goods by any unincorporated association or body of persons to a member thereof.

FACTS

Calcutta Club Limited ("**Respondent**") was a registered club engaged in providing club related services including supply of food and beverages to its members as well as non-members. The Respondent was discharging sales tax on supplies to non-members. However, it did not discharge sales tax on supplies made without consideration to its permanent members. The Respondent received a notice demanding tax on sale of food and beverages by it to its permanent members. The said demand was set aside by the CESTAT. Thereafter, Revenue ("**Petitioner**") preferred a writ petition before the Calcutta HC. The Calcutta HC held that the supply of goods by the Respondent to its permanent members would not be exigible to sales tax. Aggrieved by the said decision, the Petitioner filed an appeal before the Division Bench of the SC, which subsequently referred the matter to the present three judge Bench of the SC.

> **"Supply of food and beverages by members' clubs to its members would not be exigible to sales tax."**

ISSUES

1. Whether the doctrine of mutuality would be applicable to incorporated/ unincorporated clubs, even after the Amendment?

2. Whether the decisions in *Young Men's Indian Association*[59], *Cosmopolitan Club*[60] *and Fateh Maidan*[61] which applied the doctrine of mutuality could be stated to be a correct law even after the Amendment?

3. Whether the supply of food and beverages by incorporated/unincorporated clubs to its members could be treated as 'deemed sales' exigible to sales tax?

ARGUMENTS

The Petitioner submitted that Article 366(29-A)(e) of the Constitution was inserted in order to do away with the doctrine of agency/trust or mutuality and the position of law established in *Young Men's Indian Association (Supra)*. The Petitioner argued that the expression "unincorporated association or body of persons" as it appeared in Article 366(29-A)(e) of the Constitution had to be read disjunctively. Thus, the said expression would include incorporated persons such as companies, cooperative societies, etc. The Petitioner relied on various English and Indian laws to argue that the doctrine of mutuality had no application when a member's club was in a corporate form. The Petitioner also contended that even where 'body of persons' under Article 366(29-A)(e) of the Constitution was assumed not to include incorporated associations; Article 366(29-A)(f) of the Constitution covered supplies made by the Respondent to its permanent members within its ambit.

On the other hand, the Respondent referred to Section 2(5) of the West Bengal Sales Tax Act, 1994 ("**Act**") and contended that the very first pre-requisite for being taxable under the Act i.e. the profit motive was missing in the case of supply of food, drinks and beverages. Therefore, the charging section under the

[58] State of West Bengal v. Calcutta Club Limited, 2019 SCC OnLine SC 1291.
[59] CTO v. Young Men's Indian Association, (1970) 1 SCC 462.
[60] Cosmopolitan Club v. State of Tamil Nadu, (2017) 5 SCC 635.
[61] Fateh Maidan Club v. CTO, (2017) 5 SCC 638.

Act was not attracted to the case of the Respondent. The Respondent also referred to the Statement of Objects and Reasons for the Amendment, and contended that it was only unincorporated clubs and body of person that were referred to in Article 366(29-A)(e) of the Constitution. A company cannot be fitted into the said expression. The Respondent contended that the it was an agent of its permanent members and argued that no consideration was paid for the supply of food, drinks or beverages etc. to such members. There was only reimbursement of the amount by the members. Therefore, no sales tax could be levied on the such supplies. The Respondent argued that there could not be a sale of goods by a person to itself as the doctrine of mutuality had not been done away with by Article 366(29-A)(e) of the Constitution. The Respondent also contended that Article 366 (29-A)(f) of the Constitution was specifically inserted only to levy sales tax on the sale of food and beverages by restaurants which by their nature included a service element. The Respondent argued that Article 366 (29-A)(f) of the Constitution was not inserted with an intention to levy sales tax on supplies which were beyond the scope of Article 366 (29-A)(e) of the Constitution. The Respondent thus contented that once a supply was well beyond the scope of Article 366 (29-A)(e) of the Constitution, it was also deemed to be beyond Article 366 (29-A)(f) of the Constitution.

DECISION

The SC referred to the 61st Law Commission Report which deliberated on the subject matter of Article 366(29-A) of the Constitution and the 'Statement of Objects and Reasons' which led to the Amendment. The SC also looked in the decision in the case of *Young Men's Indian Association (Supra)* and noted that the Court in the said decision made no distinction between a club in a corporate form and one in the form of a registered society or incorporated as a trust. It had held that there could not be a transfer of property from one person to another as long as the club held any property for or on behalf of the members. The SC also examined the difference between companies and clubs registered under corporate laws and noted that there are no shareholders, no dividends, no distributions of profits in case of clubs incorporated under the companies law as compared to regular companies. Therefore, it held that such clubs could not be treated as separate in law from their members. It further held that since the members performed activities of the club for themselves; the mere fact that they incorporated a legal entity to do it for them would not make a difference. Accordingly, the SC held that there could not be a sale transaction between the Respondent and its member; as one person cannot sell goods to self. The SC also held that the Statement of Objects and Reasons that led to the Amendment had misinterpreted *Young Men's Indian Association (Supra)*. The SC further noted that the said expression in Article 366(29-A)(e) of the Constitution made it clear that it was only clubs which are not in corporate form that were sought to be brought within the tax net. It further held that the phrase 'body of person' in the said expression did not include any 'person' as defined under other Acts which would have included corporate persons. Accordingly, the SC held that the ratio of *Young Men's Indian Association (Supra)* had not been done away with by the limited fiction introduced by Article 366(29-A)(e) of the Constitution. The SC also held that sub-clause (f) of Article 366(29-A) of the Constitution with a different subject matter i.e. only to bring supply of food and drinks in hotels and restaurants within the tax net. The same was not applicable to the Respondents. On the issue of applicability of service tax, the SC held that incorporated clubs or association prior to July 1, 2012 were not included in the service tax net; and due to the use of the terminology i.e. 'unincorporated association or body of person', even after the 2012 amendment, the position pre-2012 regarding the incorporated persons was still in operation.

SIGNIFICANT TAKEAWAYS

While the issue of levy of tax on supplies by clubs to its members was settled for the period prior to the Amendment; disputes arose for the period post the Amendment; which inserted a new clause to tax the sales/services by the clubs to its members. The pronouncement of the present decision by the larger Bench of the SC brings much awaited relief and clarity for clubs and their members. What must be noted that though the Larger Bench of the SC held that the doctrine of mutuality was applicable on the sales made by the incorporated as well as unincorporated clubs and services by incorporates clubs to their member, the issue of application of ‘doctrine of mutuality’ was not examined by the SC in relation to the provision of services by the unincorporated bodies (association or body of persons) to its members. As the provisions of the GST legislations are similar to that of erstwhile service tax; the ratio of the present judgment would also be relevant under the GST regime. However, since the doctrine of mutuality has been upheld by the SC, one may expect another round of litigation surrounding the applicability of GST on supplies by unincorporated clubs to its members; unless the CBIC clarifies the position of law in the context of GST.

TRANSITIONAL CREDIT REFLECTED IN ELECTRONIC CREDIT LEDGER IS NOT AVAILED OR UTILIZED

In ***Commercial Steel Engineering Corporation v. State of Bihar and others,***[62] the Division Bench of Patna HC held that a mere reflection of transitional credit in the electronic credit ledger cannot be construed as its availment or utilization to initiate proceedings under the CGST Act.[63]

FACTS

Commercial Steel Engineering Corporation ("**Petitioner**") received assessment orders which reflected that the Petitioner was entitled to ITC of INR 18,33,304/- for FY 2007-08 and INR 20,79,256/- for FY 2011-12, under the Bihar VAT Act, 2005 ("**BVAT Act**"). However, the Petitioner's accountant inadvertently failed to report the corresponding details of such ITC in the returns filed for the Petitioner for the subsequent period, up-to the year 2017. Thereafter, the Petitioner filed applications for refund of such unutilized ITC. The application for refund pertaining to the FY 2007-08 was rejected inter alia on the ground that it was time barred.

Pursuant to the implementation of GST, the Petitioner filed an application for the transitioning of such ITC to the electronic credit ledger under GST in terms of Section 140 of Bihar GST Act ("**BGST Act**"). Subsequently, the said application of the Petitioner was rejected by Assistant Commissioner of Sales Taxes ("**Respondent**"). The Respondent passed an order demanding payment of an amount to the tune of INR 56,18,089 (i.e. INR 42,73,869 of tax along with applicable interest and penalty) as dues from the Petitioner. Aggrieved by the said order, the Petitioner filed the present writ petition.

> **"Charge of wrong availment or utilization is a positive act."**

ISSUES

1. Whether the reflection of an amount as ITC in the electronic credit ledger was a confirmation of its availment or utilization?
2. Whether the Petitioner could have been subjected to proceedings under Section 73 of BGST Act, for entire amount reflected in the electronic credit ledger without quantification credit availed or utilized?

ARGUMENTS

The Petitioner contended that it had paid all taxes till date without the utilization of ITC. Therefore, there was no question of wrongful availment or utilization of such transitional credit. The Petitioner argued that a mere reflection of transitional credit in the electronic credit ledger neither amounted to availing or utilizing the credit, nor was it sufficient to invite a proceeding under Section 73 of the BGST Act. Such claim did not bestow any statutory jurisdiction on the Respondent to create a tax liability and initiate proceedings under Section 73 of the BGST Act. Therefore, even where it were not entitled to such transitional credit, at best, the Respondents could have rejected their application for the same.

On the other hand, the Respondents argued that the reflection of an amount in the electronic credit ledger was a confirmation of its availment, even where such credit was not utilized. Accordingly, the Respondent contended that the Petitioner wrongfully availed ITC and was liable for being proceeded against under Section 73 of the BGST Act. The Respondents relied on the SC decision in *Union of India v. Ind. Swift Laboratories Ltd.,*[64] wherein it was held that where

[62] Commercial Steel Engineering Corporation v. The State of Bihar and Ors., 2019 VIL 348 PAT (Patna HC).
[63] Section 73 of the BGST Act provides for initiation of recovery proceedings in case of non-payment / short payment of tax or erroneous refund or wrong availment of input tax credit or utilization of input tax credit for any reason other than fraud or wilful misstatement or suppression of facts.
[64] Union of India v. Ind. Swift Laboratories Ltd., 2011 (4) SCC 635 (SC).

CENVAT credit was taken and utilized wrongly, interest was payable from the date of wrong availment of CENVAT credit and not from the date of wrong utilization of CENVAT credit, to contend that the Petitioner was liable to pay interest and penalty for the period of wrongful availment of ITC.

DECISION

The HC observed that availment or utilization of ITC was a positive act. It held that, unless such an act was carried out for reducing any tax liability and reflected as such in the returns filed for any financial year, there could be no availment or utilization of ITC. It held that the assessing authority would have had jurisdiction to recover tax (along with interest and penalty) where it had been able to demonstrate that any tax was recoverable from the Petitioner. As the Petitioner had not availed the ITC for reducing its tax liability, a reflection of such ITC in the electronic credit ledger could not be treated as their availment or utilization. Thus, the order of Assistant Commissioner of Sales Tax was held illegal and set aside. HC distinguished the decision in the case of Ind. *Swift Laboratories Ltd.*[65] on the ground that in the concerned case the credit was utilized by the dealer unlike in the present case.

SIGNIFICANT TAKEAWAYS

The issue of whether mere reflection of the credit in the electronic ledger amounts to its availment is not res *integra*[66]. Various HCs in a number of judgments[67] under the pre-GST regime held that no interest was payable when credit was wrongfully taken on record but not utilized. However, the SC in *Union of India v. Ind-Swift Laboratories Ltd.*[68] held that CENVAT credit was recoverable along with interest on happening of any of the three circumstances; such credit was wrongly taken or wrongly utilized or erroneously refunded. This decision of the SC was followed in *CCE v. GL & V India Pvt Ltd.*[69] and *CCE v. Vandana Vidyut Ltd.*[70]. The ruling of the HC in the present case seems conflicting to the ruling of the SC. Therefore, the possibility of further litigation on this issue cannot be ruled out.

[65] Ibid.
[66] Under Pre-GST regime, Rule 14 of CENVAT Credit Rules, 2004 provided for recovery of CENVAT credit taken or utilized wrongly along with interest.
[67] CCE Ghaziabad v. Ashoka Metal Décor (P) Ltd., 2010 (256) ELT 524 (Allahabad); CCE v. Dynaflex Pvt. Ltd. 2011 (266) ELT 41 (Gujarat).
[68] Supra note 3.
[69] CCE v. GL & V India Pvt Ltd., 2015 (321) ELT 611 (Bombay).
[70] CCE v. Vandana Vidyut Ltd., 2016 (331) ELT 231 (Chattisgarh).

GST NOT EXIGIBLE ON PAYMENTS MADE TO COURT RECEIVER IF UNDERLYING TRANSACTION DOES NOT CONSTITUTE A SUPPLY IN TERMS OF THE GST LEGISLATIONS

In ***Bai Mamubai Trust and others v. Sucitra,***[71] the Bombay HC held that GST was not payable on the royalty payments paid by the defendants to the Court Receiver as a condition for remaining in possession of the Premises, on the ground that the underlying payments were not a consideration for the supply of services in terms of the GST legislations.

FACTS

Bai Mamubai Trust ("**Plaintiff**"), registered under GST legislations, was engaged in the business of running a restaurant in a premise comprising of three shops ("**Premises**"). The Plaintiff filed a suit on the cause of action of trespassing / unauthorized occupation of the Premises by the defendant. In a notice of motion for interim relief filed by the Plaintiff, an order was passed wherein a Court Receiver was appointed as a receiver of the Premises till the suit was finally decided, as the HC was of a *prima facie* finding that the defendant had no semblance of right to the Premises. The Court Receiver was directed to take formal possession of the Premises and the defendant was permitted to remain in possession of the Premises on payment of monthly royalty of INR 45,000/- along with applicable GST. The Court Receiver submitted a report seeking directions of the HC on certain issues pertaining to applicability and collection of GST on the amounts received by it. Considering the importance of issues involved, an *Amicus Curiae* was appointed by the HC.

ISSUES

1. Whether GST was applicable on services or assistance rendered by the Court Receiver.
2. Whether royalty payment by the defendant to the Court Receiver with respect to the Premises was consideration for a supply exigible to GST.
3. Whether the defendant or the Court Receiver was liable to discharge GST, where GST was held to be applicable on payments received by the Court Receiver.

ARGUMENTS

The *Amicus Curiae* submitted that GST could not be levied on amounts paid by the litigants to the office of Court Receiver, as the services provided by the Court Receiver fell under Entry 2 of Schedule III of CGST Act, which covers *'services by a court or tribunal established under any law for the time being in force'*, which were neither supply of goods nor services under the GST legislations.

Further, the counsel appearing on behalf of the Court Receiver also argued that the Court Receiver was adjunct and a permanent department of the HC. Therefore, the services provided by the Court Receiver were neither supply of goods nor services in terms of Schedule III of the CGST Act and the fee / remuneration of the Court Receiver under the rules of the Bombay HC was entirely exempt from GST.

The Counsel appearing on behalf of the State of Maharashtra contended that the Court Receiver was not included within the meaning of "court". Therefore, services rendered by the Court Receiver were not exempted from levy of GST, as services provided by any court or tribunal established under any law.

[71] Bai Mamubai Trust and others v. Suchitra, 2019 (109) taxmann.com 300 (Bombay HC).

With respect to royalty payment, the *Amicus Curiae* submitted that payments made under a court's order/ decree attracted GST where it amounted to consideration for a taxable supply which involved an enforceable reciprocal obligations. Payment in the nature of compensatory damages ordered in an action for damages arising out of property damage, illegal trespass, breach of copyright/ contract etc. to compensate loss suffered, was not a payment towards any supply and thus, no GST was payable. The *Amicus Curiae* also submitted that in absence of an enforceable agreement/ contract between the Plaintiff and the defendant, the royalty payments could not be construed as consideration for a supply exigible to GST.

On behalf of the Court Receiver it was argued that monies paid to or deposited with the Court Receiver by a litigant / third person during the course of a litigation pursuant to orders of the court, were exigible to GST if the underlying relationship between the parties fell within the ambit of the GST legislations. It was further argued that as the royalty payments by the defendant were a compensation for *prima facie* unauthorized occupation of the Premises and not towards payment of contractual consideration, the payments could not be construed as consideration for a supply under the GST legislations.

"In the absence of reciprocal enforceable obligations, it would not be correct to characterize the defendant's occupation of the Premises against payment of royalty as a 'supply'for 'consideration'."

The counsel appearing on behalf of the State of Maharashtra and the Union of India contented that the order of the court permitting the defendant to remain in possession of the Premises was essentially a contract and payment of royalty was a consideration for permitting the defendant to occupy the premises. Therefore, it was submitted that the transaction in question was akin to a transaction of renting of immovable property for consideration which was a taxable supply in terms of the GST legislations.

Separately, with respect to obligation of payment, the *Amicus Curiae* submitted that when the Court Receiver is in control of an estate or portion thereof of a taxable person owning a business in respect of which GST is payable, such tax, penalty, and interest thereon may be recovered from the Court Receiver under Section 92 of the CGST Act, only if the Court Receiver was running the business of the taxable person.

Further, the *Amicus Curiae* also submitted that where the Court Receiver would be liable to pay GST under section 92 of the CGST Act, the liability could be discharged by an agent of the Court Receiver within the meaning of Section 2 (105) of the CGST Act, then the Court Receiver would not be liable to pay GST.

The counsel appearing on behalf of the Court Receiver argued that where GST was held to be applicable on payments received by it, the liability could be discharged by either the Court Receiver or by a party acting as an agent of the Court Receiver. Further, the Court Receiver sought directions to include a clause in the agency contract to the effect that where payments made to Court Receiver attracted GST, agent must obtain GST registration and make such payment on behalf of the Court Receiver. Accordingly, the Court Receiver would not be required to obtain separate registration for each matter/ transaction.

The counsels appearing on behalf of the state of Maharashtra and Union of India contended that the Court Receiver acted as an agent of the Plaintiff and the estate under receivership is a 'business' and therefore, the Court Receiver was liable to make payment of applicable GST on monies received by it as royalty on behalf of the Plaintiff.

DECISION

Based on the submissions made by the counsels and the *Amicus Curiae*, the HC held that:

(i) Court Receiver was an establishment and a permanent department of the HC through which the orders of protection issued by the Court are given effect to. The services provided by the Court Receiver were covered under Entry 2 of

Schedule III of the CGST Act i.e. services provided by any court or tribunal established under any law and therefore, the services were exempt from levy of GST.

(ii) Generally, the Court Receiver receiving payments towards a taxable supply was liable to pay GST in terms of the GST legislations. The HC directed that where an agent is appointed to collect the payments on behalf of a Court Receiver, a standard clause could be included in the agency agreement to the effect that the agent would be required to obtain GST registration and make payments on behalf of the Court Receiver.

(iii) In the present case, GST could not be collected from Court Receiver as the payments towards royalty or the payment to the Court Receiver were not in relation to a supply in terms of the GST legislations. The act of illegal occupation which may be compensated in damages did not constitute a service in relation to renting of immovable property, as there was no positive act by the Plaintiff to permit the defendant to use the Premises.

SIGNIFICANT TAKEAWAYS

The ruling would aid in deciding the taxability of the monies received by a Court Receiver on behalf of the parties to the suit, as it gives illustrations of scenarios in which the monies received would be considered as a consideration for taxable supply in terms of the GST registration. Further, the ruling also clarifies that for compensatory damages to be considered as a consideration in relation to a supply under the GST legislations, it is important that there should be a reciprocity of obligations between the parties. The HC has not dwelled on the issue of whether the damages paid fall under clause 5(e) of Schedule II of CGST Act i.e., agreement to the obligation to refrain from the act, or to tolerate an act or a situation or to do an act. However, it is to be noted that pursuant to the amendment in scope of 'supply' under section 7 of the CGST Act, all activities which are specified in Schedule II would have to first qualify as a supply in terms of section 7(1) of CGST Act. Therefore, reference to clause 5(e) of Schedule II will not be relevant in cases where supply is absent. Hence, the principles laid down in this judgement would be of relevance in determining taxability of payments where no reciprocal relationship exists and no express contract is entered between the parties.

NAA ORDER PASSED IN VIOLATION OF PRINCIPLES OF NATURAL JUSTICE IS NOT A VALID ORDER

In ***Hardcastle Restaurants Pvt. Ltd.,***[72] the Division Bench of the Bombay HC held that signing of the order of NAA by a fourth member who was absent during the entire hearing of the complaint constituted a breach of principles of natural justice and such order was liable to be set aside.

FACTS

Hardcastle Restaurants Pvt. Ltd., a private limited company ("**Petitioner**") operates quick service restaurants under the brand name McDonald's in India and is registered in terms of GST legislations in 10 states. The services rendered by the Petitioner were exigible to GST at an effective rate of 18% with availability of ITC till November 14, 2017; which was reduced to 5% without ITC[73]. Thereafter, certain customers of the Petitioner filed complaints alleging that the Petitioner increased the price of its products post the GST rate reduction; which was an act of illegal profiteering. Pursuant to the same, the Director General of Anti-Profiteering ("**DGAP**") investigated the matter and submitted its report to NAA.

The NAA heard the Petitioner and DGAP on the complaints, and concluded that the Petitioner profiteered to the amount of INR 7.49 crores. The Petitioner was directed *vide* order of the NAA, to reduce prices of their products and deposit the said amount in the Consumer Welfare Fund along with 18% interest. NAA also directed the DGAP to continue investigation till the Petitioner reduced the prices commensurate to the reduction in tax and submit a report. It also issued a direction to initiate penalty proceedings against the Petitioner. During the hearing of the complaints, NAA consisted of three members only. However, after the closure of hearing, a fourth member joined the NAA. The order passed by NAA in the case of the Petitioner was signed by all four members.

Subsequently, the NAA issued a SCN to the Petitioner; initiating penalty proceedings. Thereafter, the Petitioner filed the present writ petition before the Bombay HC.

ISSUE

Whether the order of the NAA was liable to be set aside on the grounds of violation of principles of natural justice?

ARGUMENTS

The Petitioner contended that it was not afforded an opportunity to present its case before the fourth member; whereby the order of the fourth member was based on hearsay. This resulted in a breach of the principles of natural justice and thus, the impugned order was liable to be set aside. The Petitioner also contended that the NAA proceeded beyond its jurisdiction in passing the impugned order: as the complaints filed against the Petitioner were regarding specific products, NAA could not have extended such complaints to all the products of the Petitioner and passed the impugned order. The Petitioner contended that in the absence of any prescribed methodology / statutory guidelines for determination of profiteering; certain material facts such as loss of ITC during November 1, 2017 – November 14, 2017, incremental ITC loss due to branch transfer, increase in variable costs, etc. raised by the Petitioner were not considered by the NAA while concluding its findings in the impugned order. Therefore, the impugned order suffered from arbitrariness, perversity and contradictions.

> **"The rule that one who hears must pass the order remains as the basic proposition of judicial/quasi-judicial proceedings."**

[72] *Hardcastle Restaurants Pvt. Ltd. and Anr. v. Union of India and Ors., (2019)* 110 taxmann.com 410 (Bombay HC).
[73] Notification No. 46 / 2017 – Central Tax (Rate) dated November 14, 2017.

The respondents on the other hand contended that profiteering was manifest and NAA order was not arbitrary but passed in accordance with the GST legislations. The NAA and DGAP were empowered to *suo motu* look into the matter and their jurisdiction was not restricted to the products for which complaints were filed. On the contention of the Petitioner relating to the breach of principles of natural justice, the respondents countered that signing of NAA order by the fourth member was a mere irregularity in procedure. The order of the NAA could not be rendered invalid merely on the grounds of such irregularity. The Respondents also contended that the CGST Rules did not mandate an oral hearing and the entire records of the matter were placed before the fourth member to enable him to take a decision in the case.

DECISION

The Bombay HC analysed the provisions and prescribed procedure to be followed by NAA in handling profiteering complaints; and observed that the NAA was required to be guided by principles of natural justice while deciding matters pertaining to profiteering. The proceedings before NAA could not be held to be invalid on grounds of irregularity in the procedure; only where such invalidity did not affecting the merits of the case. Such irregularity did not include a breach of principles of natural justice. The HC placed reliance on several judicial pronouncements[74] and held that the Petitioner was entitled to be orally heard by all members who were the ultimate decision makers in its case. Omission of such hearing, caused prejudice to the Petitioner. Accordingly, the HC set aside the impugned order on the grounds of violation of principles of natural justice, and directed for the restoration of the proceedings before the NAA.

SIGNIFICANT TAKEAWAYS

The Bombay HC ruling comes as a huge relief to the McDonald's franchisee. However, it may be highlighted that the proceedings have been restored to the NAA and as such, the franchisee could still be held liable for profiteering by the NAA.

The HC ruling reinforces the basic principle that the tenets of natural justice are ingrained in all the judicial / quasi-judicial proceedings, including the proceedings before the NAA. Notably, certain concerns such as lack of guidelines / methodology for determining 'commensurate price reduction', impact of non-availability of ITC and other related factors on the variable costs of the business entity and their treatment while computing profiteering, etc. are raised by most petitioners before NAA. As the HC in the present ruling did not delve into the merits of the case, the ambiguities with respect to these aspects continue to persist.

Considering the fact that profiteering in terms of GST legislations is used in pejorative sense and may severely dent the reputation of a business; it is advisable that the business entities are cautious in their approach in order to ensure that they do not passively indulge in such profiteering.

[74] *G. Nageshwara Rao v. APRSTC, AIR 1959 SC 308; Mushtaq Ali and Ors. V. State, (1964)* All LJ 609 (Allahabad HC)

REGULATORY DIRECT TAX UPDATES

LOCK-IN PERIOD FOR NON-RESIDENTS INVESTING IN BONDS ISSUED BY INFRASTRUCTURE DEBT FUNDS, WAIVED OFF

Income Tax (7th Amendment) Rules, 2019 ("**7th Amendment Rules**") notified by the CBDT vide notification dated September 16, 2019, removes the lock-in period of 3 years for investments made by non-residents in the bonds issued by infrastructure debt funds.

Section 10(47) of the IT Act states that any income of an infrastructure debt fund is exempt from tax, provided that the infrastructure debt fund is set up in accordance with the prescribed guidelines and is notified by the Central Government.

Rule 2F of the IT Rules sets out the guidelines for setting up infrastructure debt fund for the purpose of claiming exemption under Section 10(47) of the IT Act. Sub-rule (3) of the said Rule 2F provides that the infrastructure debt fund shall issue rupee denominated bonds ("**RDBs**") or foreign currency bonds ("**FCBs**") in accordance with RBI directions and relevant applicable regulations. Further, sub-rule (5) states that in case the investor in aforesaid bonds is a non-resident, the initial or original investment maturity of bond at the time of first investment shall be in a period not less than five years. Proviso to sub-rule (5) provides a lock-in period of 3 years in respect of such investment made by a non-resident, although transfer to another non-resident investor was allowed during such lock-in.

The said lock-in period has now been done away with by the 7th Amendment Rules. The non-resident investors will now be able to freely transfer their infrastructure debt bonds. This waiver is expected to make investments in bonds issued by infrastructure debt funds more attractive for offshore investors.

CBDT ISSUES NOTIFICATION NOTIFYING INDIA'S POSITION UNDER THE MULTILATERAL CONVENTION TO IMPLEMENT TAX TREATY RELATED MEASURES TO PREVENT BASE EROSION AND PROFIT SHIFTING

On 25 June, 2019 India had deposited its instrument of ratification along with a list of 93 Covered Tax Agreements ("**CTAs**"), reservations and notification to Depositary, under the MLI. Pursuant to this, CBDT has issued a notification dated 9 August, 2019 notifying India's ratification of MLI and its position under it. The notification elaborately covers India's position on MLI including:

i. A list of bilateral treaties that India wishes to cover under the MLI or CTAs;

ii. Status and reservations on the provisions of MLI either entirely or partially;

iii. Notification of choice of optional provisions and relevant provisions of its CTAs, which may be amended/ replaced by provisions under the MLI.

The MLI was signed by India, along with 65 other countries, in June 2017. The MLI is an outcome of the OECD G20 Project to tackle the tax planning strategies to artificially shift profits to low or no-tax jurisdictions, resulting in little or no corporate tax being paid on such profits. India was a part of the Ad Hoc Group of more than 100 countries and jurisdiction from G20, OECD, BEPS associates and other countries, to work on an equal footing on finalization of text of MLI.

With MLI coming into force modifying the 93 CTAs listed by India, it would result in curbing the revenue loss from treaty abuse in profit shifting strategies by ensuring that profits are taxes where substantive economic activities generating the profits are carried out. The MLI will be applied alongside existing DTAAs, modifying their application in order to implement BEPS measures.

Out of the 93 CTAs which have been notified by India to be covered under MLI, 22 countries have already ratified the MLI and the DTAA with these countries shall be modified to bring MLI into effect. For remaining CTAs, the MLI shall come into effect from 3 months from the deposit of instrument of ratification by India's corresponding CTA partner.

The substantial ways in which the DTAAs of India will be modified, subject to positions taken under MLI by other signatory countries, is as follows:

i. Insertion of new preamble and Principle Purpose Test in the DTAAs to tackle treaty abuse.

ii. Implementation of minimum standard under BEPS Action 14 relating to Mutual Agreement Procedure

iii. Implementation of measures to prevent artificial avoidance of PE status through commissionaire arrangements and similar strategies or through specific activity exemptions and splitting up of contracts.

iv. Plugging in avenues leading to avoidance of tax on capital gains from alienation of shares/ interests deriving value principally from immovable properties.

v. Prevention of certain dividend transfer transactions that are intended to lower withholding taxes payable on dividends.

Given the above changes to the existing network of DTAAs, any cross border structuring, tax issues would need to be analysed on the touchstone of the changes under the MLI. The Cover Story of our April - June, 2019, issue of Tax Scout elaborately discusses India's position in MLI and how it impacts our DTAAs. The issue can be accessed here.

CBDT RAISES REVENUE EFFECT THRESHOLD FOR ISSUE OF CERTIFICATES U/S.197/195 TO INR 100 MILLION

As per Section 195(1) of the IT Act, any person responsible for making a payment of any sum chargeable to tax under the IT Act to a non-resident, shall deduct tax at source at the rate in force at the time of credit of such payment. Section 195(3) specifies that any person entitled to receive the sum referred to in sub-Section (1) may make an application to the AO for grant of certificate authorising him to receive such sum without deduction of tax. As per Section 197 of the IT Act the AO on being satisfied that the total income of the recipient justifies the deduction of income-tax at any lower rate or no deduction of income-tax, on an application being made grant him a certificate for lower deduction/nil deduction of tax ("**Certificate**").

With regards this, the CBDT issued an instruction dated October 13, 2006,[75] stating that Certificates are not to be issued indiscriminately and approval of the Joint CIT / ACIT needs to be taken by the AO in each case. On December 22, 2009,[76] CBDT also issued an instruction where it was specified that prior approval of the CIT should be taken (In Delhi, Mumbai, Chennai, Kolkata, Bangalore, Hyderabad, Ahmadabad and Pune where effect on revenue arising during a FY for a particular assessee exceeds INR 50,00,000 and INR 10,00,000 for other areas). Once the approval is given by the CIT, a copy has to be endorsed to the jurisdictional CIT as well.

Further, vide a notification dated October 25, 2018 the IT Rules were amended to prescribe electronic filing of applications under Section 197 of the IT Act. As per the prescribed procedure for electronic filing, the CIT was the one responsible to take a decision and the application was required to be marked to the AO to issue Certificate or reject the application. Some of the major issues faced by assessees in relation to the Certificates and the process of deduction under Section 195/197 of the IT Act were: limited validity of the Certificates leading to multiple applications for grant of Certificates if the transaction is structured in phases, delay in grant of Certificates, etc.

The CBDT has now vide an Office Memorandum dated September 2, 2019,[77] raised the threshold of revenue effect needing approval of CIT for issue of Certificates to non-resident assessee to INR 10 crore for all areas. This revised threshold will be applicable in respect of all applications pending or filed after September 2, 2019. The rationale behind increasing the threshold limit was to balance the need to exercise supervision and control on one hand, and expeditious grant of Certificate on the other. Since this increase in threshold limits and reiteration of time limits would expedite the issue of Certificates, the difficulties faced by the assessee would reduce. It must be noted that the revised threshold limits are only in respect of application for Certificate by a non-resident assessee under Section 195/ 197 of the IT Act. In all other cases, the threshold limits will continue based on the instruction dated December 22, 2009.[78]

[75] Instruction No. 8/2006 [F.No.275/37/2006-IT(B)].
[76] Instruction No. 7/2009 [F.No. 275/23/2007- IT-(B)].
[77] Office Memorandum [F. No. 275/16/2009- IT(B)].
[78] Instruction No. 7/2009 [F.No. 275/23/2007- IT-(B)].

ENHANCEMENT OF MONETARY LIMITS FOR FILING OF APPEALS BEFORE ITAT/HC/SC

CBDT vide notification dated August 8, 2019,[79] has decided to further enhance the monetary limits for filing of appeals before ITATs, HCs and the SC. The monetary limits for filing appeals before ITAT, HCs and the SC is now INR 5 million, 10 million and 20 million, respectively increased from INR 2 million, 5 million and 10 million respectively. This is in consonance with the objective of the Indian government to reduce and better manage tax litigation. In addition to the enhancement of monetary limits, CBDT has also clarified that in case an appeal is filed against consolidated order (single order in relation to more than one tax year or more than one tax year), the monetary limits shall be tested individually for every tax year and/or tax payer separately.

Moreover, the CBDT has clarified that the enhanced monetary limits to file appeals shall apply to pending SLPs/appeals/references and has directed that appeals within the revised monetary limits shall be withdrawn before October 31, 2019.[80]

The circular also provides that the enhanced monetary limits will not be applicable to cases of organised tax-evasion scam cases through Long-Term Capital Gain/ Short Term Capital Loss ("**LTCG/STCL**") on penny stocks. This implies that the tax officers can even pursue appeals within the monetary limits for filing of appeals in cases where there is tax evasion scams through LTCG/STCL on penny stocks.

CBDT CLARIFIES ON THE ELIGIBILITY OF SMALL START-UPS TO AVAIL SECTION 80-IAC TAX HOLIDAY

Section 80IAC of the IT Act is a beneficial provision under which an 'eligible start-up' can claim tax holiday for a period of any three consecutive AYs out of seven years beginning from the year in which the eligible start-up is incorporated. On February 19, 2019, the Department for Promotion of Industry and Internal Trade vide notification GSR 127 (E) ("**DPIIT Notification**") provided the conditions to be fulfilled for an entity to be considered as a start-up,[81] procedure for application, and certification for the purposes of Section 80-IAC of the IT Act. .

Under the DPIIT Notification one of the conditions to be satisfied to be a startup is that the turnover of the entity for any of the FYs since incorporation / registration should not have exceeded INR 1000 million. Under Section 80IAC of the Act, an eligible start-up is an entity whose turnover does not exceed INR 250 million. This discrepancy lead to doubts in relation to the threshold of the turnover to claim the tax holiday under Section 80IAC of the Act. CBDT has issued a clarification to do away with this uncertainty and has clarified that the threshold turnover for claiming relief under Section 80-IAC would be INR 250 million as required under Section 80IAC. CBDT also specified that in order to be eligible to get the benefit of Section 80IAC, the entity will have to satisfy the conditions provided under Section 80IAC and merely satisfying the conditions under the DPIIT Notification will not automatically make a start-up eligible for tax holiday. For this purpose, the CBDT relied on paragraph 3 of the DPIIT Notification, where it is mentioned that a start-up shall be eligible to apply for the certificate from the Inter-Ministerial Board of Certification for claiming deduction under Section 80-IAC of the IT Act, only if the start-up fulfils the conditions specified in sub-clause (i) and sub-clause (ii) of the Explanation of Section 80IAC[82] of the IT Act.

CBDT EXTENDS THE SCOPE OF APPLICATION OF DPIIT NOTIFICATION'S ON START-UPS TO CLAIM EXEMPTION FROM SECTION 56(2)(VIIB)

Section 56(2)(viib) of the IT Act taxes premium received towards issue of shares over and above the fair market value, by a company, not being a company

[79] Circular 7 of 2019 dated August 8, 2019.
[80] F. No. 279/Misc/M-93/2018-ITJ dated August 20, 2019.
[81] The conditions to be a "start-up" under the DPIIT Notification are:
(i) Upto a period of ten years from the date of incorporation/ registration, if it is incorporated as a private limited company (as defined in the Companies Act, 2013) or registered as a partnership firm (registered under Section 59 of the Partnership Act, 1932) or a limited liability partnership (under the Limited Liability Partnership Act, 2008) in India.
(ii) Turnover of the entity for any of the financial years since incorporation/ registration has not exceeded one hundred crore rupees.
(iii) Entity is working towards innovation, development or improvement of products or processes or services, or if it is a scalable business model with a high potential of employment generation or wealth creation
[82] Sub-clause (ii) of Explanation of Section 80-IAC of the Act: "eligible start-up" means a company or a limited liability partnership engaged in eligible business which fulfils the following conditions, namely:—
(a) it is incorporated on or after the 1st day of April, 2016 but before the 1st day of April, 2021;
(b) the total turnover of its business does not exceed twenty-five crore rupees 88[in the previous year relevant to the assessment year for which deduction under sub-Section (1) is claimed]; and
(c) it holds a certificate of eligible business from the Inter-Ministerial Board of Certification as notified in the Official Gazette by the Central Government;

in which the public are substantially interested, from any resident. The proviso to Section 56(2)(viib) enables the Central Government to notify a class or classes of persons, from whom consideration received on issuance of shares by a company, to which the said provision would not be applicable. However, the second proviso to Section 56(2)(viib) of the IT Act also states that in order to avail the exemption the conditions provided under the notification issued by the Central Government will be required to be complied with.

The DPIIT Notification has exempted the startups from the application of Section 56(2)(vii) if the start-up fulfills two conditions. *Firstly,* it has been recognised by DPIIT as a start-up as per DPIIT Notification or as per any earlier notification on the subject; secondly, aggregate amount of paid up share capital and share premium of the start-up after issue or proposed issue of share, if any, does not exceed, INR 250 million (excluding consideration received from (a) a non-resident; or (b) a venture capital company or a venture capital fund; or (c) a specified company[83]).

DPIIT Notification specifically provides that the exemption will be applicable irrespective of the dates on which shares are issued by the start-up from the date of its incorporation, except for the shares issued in respect of which an addition under Section 56(2)(viib) of the Act has been made in an assessment order made under the Act before the date of issue of the notification i.e. February 19, 2019. The scope of application of the DPIIT Notification was causing hardship to the start-ups for whom additions under Section 56(2)(viib) were already made prior to February 19, 2019. Therefore, in order to save such start-ups from the hardships, the CBDT has issued a clarification on August 9, 2019 extending the benefit of exemption from Section 56(2)(viib) to the start-ups for whom the additions under Section 56(2)(viib) were made prior to February 19, 2019 provided they declared in Form 2 that they have complied with all the conditions laid down in DPIIT Notification.

CENTRAL GOVERNMENT EXEMPTS FOREIGN INVESTORS EARNING INCOME FROM AN INVESTMENT FUND ESTABLISHED IN IFSC FROM FILING INCOME TAX RETURNS

Section 10(23FBB) of the IT Act excludes from the total income of a unit holder, the income accruing or arising to, or received by such unit holder of an investment fund, in the proportion of income which is in the nature of 'business income'. Section 194LBB of the IT Act provides that where such unitholder has any income other than the income referred to under Section 10(23FBB), the person responsible for making that payment will deduct tax before making such payment to the unitholder.

On July 26, 2019, the CBDT issued a circular exempting the foreign investors which include (i) non-residents not including companies, and (ii) foreign companies, who have any income chargeable under the IT Act during a previous-year from any investment in an investment fund set up in an International Financial Services Centre (IFSC) located in India, from the requirement of filing income tax returns under Section 139 of the IT Act. In order to avail this exemption such foreign investor will have to satisfy two conditions, firstly, any income-tax due on income of such foreign investor should have been deducted at source and remitted to the Central Government by the investment fund at the tax-rate in force as per provisions of Section 194LBB; and secondly, there the foreign investor should not have any income other income on which tax has been deducted under 194LBBduring the FY for which such foreign investor, is otherwise liable to file the income tax-return.

This circular will come into force from July 26, 2019 and the benefit of the exemption will be available from AY 2019-20 onwards. This exemption will not be available if a notice under Section 142(1) (*Inquiry before assessment*) or Section 148 (*Issue of notice where income has escaped assessment*) or Section 153A (*Assessment in case of search or requisition*) or Section 153C (*Assessment of income of any other person*) of the IT Act has been issued for filing a return of income for the AY specified therein.

[83] Explanation to paragraph 4 of the DPIIT Notification: "Specified Company" means a company whose shares are frequently traded within the meaning of Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 and whose net worth on the last date of financial year preceding the year in which shares are issued exceeds one hundred crore rupees or turnover for the financial year preceding the year in which shares are issued exceeds two hundred fifty crore rupees.

ROLLBACK OF THE INCREASED SURCHARGE ON FOREIGN PORTFOLIO INVESTMENTS ("FPIS")

The Finance Act, 2019 had enhanced surcharge on the rich and super-rich individuals, HUF, Associations of Persons ("**AOP**"), Body of Individuals ("**BOI**") and artificial juridical persons having taxable income between 20-50 million and above 50 million to 25% and 37%, respectively. This change in surcharge had an enormous effect on the FPIs. FPIs in India are usually structured either through trusts or through AOP. Since FPIs form a major part of foreign investors in India, it was anticipated that the Government would exempt FPIs from this enhanced surcharge. However, the Government's refusal to do so lead to the FPIs started withdrawing from the Indian market, leading to an outflow worth several crores by FPIs over July and August, 2019.

As a result certain Foreign Institutional Investors presented a charter of demands to the Hon'ble Finance Minister which included the demand for exemption of FPIs from the enhanced surcharge. Catering to the demand of the investors, the government decided to withdraw the hike in surcharge in Long-term Capital Gains/Short-term Capital Gains for FPIs and domestic investors as mentioned in Sec. 111A & Sec. 112A of the Income Tax Act. This announcement came as a huge relief for both FPIs as well as domestic investors. This announcement has now been implemented by way of Finance Act (no.2) 2019.

CBDT RELAXES THE TIME FOR FILING OF APPLICATION FOR COMPOUNDING OF OFFENCES UNDER GUIDELINES FOR COMPOUNDING OF OFFENCES AS ONE TIME MEASURE

The Guidelines for Compounding of Offences under Direct Tax Laws, 2019 dated June 14, 2019 ("**2019 Guidelines**") and the Guidelines for Compounding of Offences under Direct Tax Laws, 2014 dated December 23, 2014 contain the guidelines for filing of application of compounding of offences. Both the Guidelines have restricted the time for filing of compounding application to 12 (twelve) months from the end of the month in which prosecution complaint, if any is filed in the court of law in respect of the offence for which compounding is sought. The restriction on the time within which the application could be made was causing major hardship to the taxpayers. In order to lessen the hardship to the taxpayers in deserving cases and reduce the burden of pending cases, the CBDT issued a circular dated September 9, 2019 ("**Circular**") relaxing the condition of time restraint on filing of compounding application as one time measure.

In order to avail the benefit of this relaxation, the application will have to be filed before the Competent Authority i.e. the Pr. CCIT/CCIT/Pr. DGIT/DGIT concerned, on or before December 31, 2019. This relaxation will not be available in respect of an offence which is generally/normally not compoundable, as per 2019 Guidelines. The 2019 Guidelines specify condition that whenever any relaxation in terms of time for filing of the compounding application is given, the compounding charges would be 1.25 times of the normal compounding fees as applicable to the offence on the date of filing of the original compounding application. However, the Circular specifically provides that applications filed before the Competent Authority, on or before December 31, 2019 will be deemed to be in time under the 2019 Guidelines. The Circular t also clarifies that the condition of extra fees will not be applicable to such applications.

As per the Circular, the compounding application can be filed in all such cases where, (a) prosecution proceedings are pending before any court of law for more than 12 (twelve) months, or (b) any compounding application for an offence filed previously was withdrawn by the applicant solely for the reason that such application was filed beyond 12 (twelve) months, or (c) any compounding application for an offence had been rejected previously solely for technical reasons.

REGULATORY INDIRECT TAX UPDATES

CBIC ISSUES INSTRUCTION FOR RAISING MONETARY LIMITS FOR FILING APPEALS BY DEPARTMENT IN LEGACY CENTRAL EXCISE AND SERVICE TAX MATTERS

CBIC *vide* Instruction F No. 390/Misc/116/2017- JC dated August 22, 2019 instructed departmental officers that appeals in matters relating to Central Excise and Service Tax shall be filed before the CESTAT, HC and the SC provided the amount involved is above the following limits:

S.No.	Appellate Forum	Monetary Limit
a)	CESTAT	INR 50,00,000
b)	High Court	INR 1,00,00,000
c)	Supreme Court	INR 2,00,00,000

CBIC ISSUES CLARIFICATION ON REQUIREMENT OF REVERSAL UNDER RULE 6(3) OF CCR UNDER SPECIFIC SCENARIO

Circular No. 213/3/2019-Service Tax, dated July 05, 2019 clarified the following regarding reversal of CENVAT Credit under Rule 6(3) of CCR:

i. The services included under the Notification No. 26/2012 dated June 20, 2012 i.e. abatement notification do not *ipso facto* become exempt services. In order to qualify as exempted services there has to be restrictions on availment of CENVAT Credit pertaining to both inputs and input services. Thus, all the service providers engaged in providing services on which abatement was available were not required to reverse CENVAT Credit.

ii. In relation to the services portion in an activity wherein food or any other article of human consumption or any drinks are supplied as part of such activity, there was a restriction on as availment of CENVAT Credit under Rule 2C of CCR. Therefore, there was no requirement to reverse CENVAT Credit under Rule 6(3) of CCR.

TREATMENT OF INFORMATION TECHNOLOGY ENABLED SERVICES ("ITES") UNDER GST

Circular No. 107/26/2019-GST, dated July 18, 2019 clarified the scenarios in which supply of ITeS services such as call centers, BPOs, legal databases, remote maintenances from India would qualify as export of services. Where such suppliers act as intermediaries for their clients located outside India, such supplier would not qualify for export of services, as the place of supply would be the location of supplier i.e. India. However, it further clarified that a supplier of services would not be treated as an "intermediary" even where such a supplier qualifies as an agent or broker, where the said supplier supplies services on its own account on client's behalf.

The said Circular also clarifies where a supplier in India arranges or facilitates back-end support services such as logistical support, government clearances, transportation of goods etc., during pre-delivery, delivery and post-delivery stages of a supply; such supplier would qualify as intermediary and the place of supply would be India. In other words, such a scenario would not qualify as export of services.

CLARIFICATION IN RESPECT OF GOODS SENT/TAKEN OUT OF INDIA FOR EXHIBITION OR ON CONSIGNMENT BASIS FOR EXPORT PROMOTION

Circular No. 108/27/2019-GST, dated July 18, 2019 clarified the following in respect of goods sent/taken out of India for exhibition or on a consignment basis for export promotion ("**Activity**"):

i. The Activity would not constitute a supply unless specifically covered under Schedule 1 to the CGST Act.

ii. The records of the Activity shall have to be maintained as per the format provided in the said circular.

iii. The Activity should only be undertaken by issuance of delivery challan in terms of GST legislations. No bond or Letter of Undertaking ("**LUT**") would be required as such an activity is not a zero rated supply.

iv. Where the goods are neither sold abroad nor brought back within 6 months, the supply would be deemed to have taken place on the expiry of 6 months from the date of their removal. The supplier would be required to issue an invoice on the date of expiry of 6 months in terms of GST legislations. However, where such goods are sold abroad, partially or fully within 6 months, the date of sale with respect to goods sold would be the time of supply and the supplier would be required to issue an invoice at such time of supply in terms of GST legislations.

v. Even where the Activity is undertaken without a bond or LUT, the supplier would be eligible for refund for zero rated supply of goods after he has issued an invoice as stated above. However, no refund which pertains to refund of Integrated GST on export can be undertaken as per Rule 96 of the CGST Act.

GST RATE REVISIONS FOR ELECTRIC VEHICLES

The effective rate of GST on charger or charging station for electrically operated vehicles has been reduced to 5% from 18%. Moreover, the effective rate of GST on electrically operated vehicles, including two and three wheeled electric vehicles has been reduced to 5%.[84]

In addition, the services by way of giving on hire an electrically operated vehicle meant to carry more than twelve passengers to a local authority has been exempted.[85]

ANNUAL RETURN FOR FY 2017-18 AND 2018-19

Notification No. 47/2019 – Central Tax dated October 09, 2019 provides that registered persons having aggregate turnover less than or equal to two crore rupees in a FY and having not furnished the annual return before the due date shall have the option to furnish the annual return even after due date. However, the said return shall be deemed to have been furnished on the due date if it has not been furnished before the due date.

AMENDMENT TO CGST RULES

Notification No. 49/2019 – Central Tax dated October 09, 2019 inserted new rules pertaining to following:

Suspension of Registration: A registered person shall not issue any tax invoice and accordingly, cannot charge tax on supplies made by him during the period of suspension.

Limit on availment of ITC: A registered person (recipient) can avail ITC pertaining to invoices or debit notes the details of which have not been uploaded by its suppliers However, such ITC shall be limited in value upto 20% of the eligible credit available in respect of invoices or debit notes; the details of which have been furnished by the suppliers.

Intimation of tax details: The proper officer prior to issuance of SCN, in case any tax has not been paid or has been short paid or has been erroneously refunded, or where input tax credit has been wrongly availed or utilized for any reason by a person, shall communicate the details of the tax, interest and penalty as ascertained to such person in the form specified in this Notification.

PROHIBITION IN IMPORT/ EXPORT OF ELECTRONIC CIGARETTE

Notification No. 20/2015-2020 dated September 26, 2019 and Notification No. 22/ 2015-2020 dated September 30, 2019 provides that electronic cigarette including all forms of electronic nicotine delivery system, heat not burn products, e-hookah and the like devices are prohibited from import and export. However, this prohibition would not include any product licensed under the Drugs and Cosmetics Act, 1940.

CHANGE IN IMPORT POLICY OF CERTAIN IRON AND STEEL PRODUCTS

The import policy pertaining to iron and steel products specified in annexure to Notification No. 17/ 2015-2020 dated September 05, 2019 has been changed from 'free' to 'free subject to registration under Steel Import Monitoring System'. The importer w.e.f. November 1, 2019 may submit online advance information to obtain such registration. The bill of entry henceforth should carry the registration number and expiry date for clearance of consignment.

[84] Notification No. 12/2019- Central Tax (Rate) dated July 31, 2019.
[85] Notification No. 13/2019- Central Tax (Rate) dated July 31, 2019.

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
CbC	Country by Country Reporting
CBDT	Central Board of Direct Taxes
CBEC	Central Board of Excise 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
CT Act	Custom Tariff Act, 1975
CVD	Countervailing Duty
DCIT	Learned Deputy Commissioner of Income Tax
DIT	Learned Director of Income Tax
DGFT	Directorate General of Foreign Trade
DRP	Dispute Resolution Panel
DTAA	Double Taxation Avoidance Agreement
EPCG	Export Promotion Capital Goods
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

ABBREVIATION	MEANING
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
ITO	Income Tax Officer
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
MoU	Memorandum of Understanding
MRP	Maximum Retail Price
NAA	National Anti-profiteering Authority
NCLT	National Company Law Tribunal
OECD	Organization for Economic Co-operation and Development
PCIT	Learned Principal Commissioner of Income Tax
PE	Permanent Establishment
Pvt.	Private
R&D	Research and Development
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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