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TAX SCOUT

A quarterly update on recent developments in Taxation Law

OCTOBER 2019 – DECEMBER 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 October 1, 2019 to December 31, 2019. We have also covered the judicial precedents covering some of the important decisions rendered by the Indian judiciary during this period.

In addition to the legislative precedents, we have also discussed the changes introduced by Taxation Laws (Amendment) Act, 2019 in the Income-tax Act, 1961. In order to counter the recent economy slump, the Government of India announced significant reduction in the corporate tax cuts for certain taxpayers subject to satisfaction of the prescribed conditions. In addition to it, the Government announced several other changes in the Income-tax law, including *inter alia* reduction in rates for minimum alternate tax, introduction of buy back tax on listed shares, etc. We have tried to discuss in greater detail the amendments made by the Government.

In addition to the above, 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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NON-COMPETE FEE RECEIVED BY A NON-RESIDENT TAXPAYER NOT TAXABLE IN ABSENCE OF A PE

In the case of ***Mr. Prabhakar Raghavendra Rao***[1], the ITAT held that non-compete and non-solicitation fees received by the non-resident taxpayer would not be taxable as 'business income', in absence of a 'business connection' or a PE in India.

FACTS

Mr. Prabhakar Raghavendra Rao ("**Assessee**"), a resident of Qatar, was a director and shareholder in Sievert India Pvt. Ltd. ("**SIPL**"), an Indian company. The Assessee had sold shares in SIPL to a Singapore based company and had also entered into a separate non-compete and non-solicitation agreement with the buyer company. Originally, the Assessee in its return had offered the non-compete and non-solicitation to tax as business income. However, during the course of the assessment proceedings, the Assessee submitted that he did not have a PE in India and accordingly, the non-compete and non-solicitation fees could not be taxed as business income in India, under the India-Qatar DTAA. The AO rejected the submission of the Assessee and held that by the virtue of the Assessee holding shares in SIPL, he established a business connection in India and accordingly, the non-compete and non-solicitation fees was subject to tax in India. The CIT(A) set aside the order of the AO and held that such non-compete and non-solicitation fees could not be taxed as business income in India since the Assessee did not have a business connection or a PE in India. Aggrieved by the order of the CIT(A), the IRA approached the ITAT.

> **"Non-compete fee would not be subject to tax in the hands of a non-resident taxpayer in absence of a PE or a business connection."**

ISSUE

Whether non-compete and non-solicitation fee received by a non-resident was taxable in India?

ARGUMENTS

The IRA argued that the non-compete and non-solicitation fees were interlinked with the sale of shares of SIPL, therefore, such consideration should be treated as a part of the sale consideration. Accordingly, the IRA argued that such income should be taxed in India, since such income was income accruing or arising in India. The IRA, placed reliance on the SC decision in the case of ***Goetz India Ltd.***[2], wherein it was held that the AO did not have the power to entertain an additional claim, unless such a claim was made in the revised return filed within the due date for revised return. Accordingly, it was argued that the claim of the Assessee seeking benefit under the India-Qatar DTAA could not be entertained as the same was not made by way of a proper return.

The Assessee on the other hand, placed reliance on the decision of the coordinate bench of the ITAT in the case of ***Trans Global Plc***[3], wherein on similar facts the ITAT had held that the non-compete fee was be taxable in hands of a non-resident, in absence of a PE.

DECISION

The ITAT observed that non-compete and non-solicitation fee received by the Assessee for restraint of trade, squarely gets taxed as 'business income' under section 28(va) of the IT Act. It also noted that the

[1] ITO v. Mr. Prabhakar Raghavendra Rao, ITA No.3985/Mum/2018 (Mumbai ITAT).
[2] Goetze India Ltd. v. CIT, 284 ITR 323 (SC).
[3] Trans Global PLC v. Director of Income Tax, International Taxation 158 ITD 230 (Kolkata ITAT).

Assessee being a resident of Qatar, was entitled to claim benefit of the India-Qatar DTAA. Accordingly, the ITAT held that in terms of Article 7 of the India-Qatar DTAA, the fee could not be taxed in India in the absence of a PE in India.

The ITAT rejected the argument of the AO that the Assessee holding shares in SIPL was tantamount to him having a business connection/PE in India. Consequently, the ITAT held that the AO did not bring anything on record to establish that the Assessee had a PE in India and, therefore, the non-compete and the non-solicitation fee was not taxable in India.

The ITAT also observed that the decision in the case of ***Goetz India Ltd.***[4], wherein it was held that the AO does not have the power to entertain an additional claim, unless such a claim was made in the revised return, was applicable only to the AOs and not to the appellate authorities. Accordingly, the ITAT held that the appellate authorities (such as the CIT (A)) could continue to entertain additional claims of the taxpayer, even in the absence of a revised return.

SIGNIFICANT TAKEAWAYS

This ruling reiterates the well-established position that business income will not be subject to tax in India in the absence of a business connection or a PE in India and clarifies that merely being a shareholder/promoter in an Indian company would not result in the non-resident having a business connection in India.

This judgment upholds the principle that only the legitimate tax amount must be assessed/collected and the IRA should not take advantage of a taxpayers' ignorance to collect more tax than what was legitimately due from the taxpayer.

It may be relevant to note that this position has also been upheld by the Delhi HC in the case of ***Jai Parabolic Springs Ltd***[5]. In the said case the taxpayer had claimed a certain amount of deduction for the first time before the CIT(A), which was allowed by the CIT(A) and subsequently by the ITAT. The Delhi HC while deciding on the issue of whether the CIT(A) / ITAT had the jurisdiction to entertain such additional claims, held that there was no prohibition on the powers of the ITAT to entertain an additional claim which, according to the ITAT, helped reaching a fair decision in the context of the case.

Similarly, the Bombay HC in the case of ***Pruthvi Brokers & Shareholders Pvt. Ltd***[6], while dealing with a similar factual matrix, also held that the appellate authorities have the discretion to permit additional claims to be raised and it cannot be said that they have no jurisdiction to consider the same.

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[4] Goetze India Ltd. v. CIT, 284 ITR 323 (SC).
[5] CIT v. Jai Parabolic Springs Ltd, 306 ITR 42 (Delhi HC).
[6] CIT v. Pruthvi Brokers and Shareholders Pvt. Ltd, 349 ITR 336 (Bombay HC).

DELHI HC HOLDS ONCE ARM'S LENGTH PRINCIPLE IS SATISFIED, NO FURTHER ATTRIBUTION CAN BE MADE TO PE

In the case of ***Honda Motors Co. Ltd.***[7], the Delhi HC has reiterated that once the Indian entity has been compensated at arm's length principle ("**ALP**"), there can be no further profit attributable to the foreign entity, even if it has a PE in India.

FACTS

Honda Motors Co. Ltd ("**Assessee**") was a company incorporated under laws of Japan and engaged in the business of manufacturing of cars, spare parts and accessories. The Assessee had a wholly owned subsidiary company in the name of Honda Cars India ltd. ("**HCIL**") which entered into several transactions relating to sale of raw materials, finished goods, capital goods and received royalty income, FTS etc. Several transactions were carried out between the two companies ever since its inception. A survey was carried out at premises of HCIL under section 133A of the Act. During the survey statements of expatriate employees in HCIL were recorded on basis of which AO formed a belief that income which was chargeable to tax had escaped assessment.

> **Delhi HC holds that no attribution for PE of foreign parent, once the Indian subsidiary has been compensated at arm's length.**

The Assessee had not filed its return of income in India. Therefore, the AO initiated reassessment proceedings (beyond four years) under sections 147 and 148 of the IT Act on the belief that HCIL had constituted a PE of the Assessee in India and thus, profits were required to be attributed to the PE in India in terms of the functions performed, risks assumed and assets deployed by the PE.

The SC by order dated March 14, 2018 had disposed off the re-assessment notices issued under section 148 of the IT Act for the AY 2005-06 and 2006-07. The SC had held that the AO was not entitled to issue a reopening notice only on the basis that the foreign company had a PE in India if, the transactions in respect of which there had been alleged escapement of income had already been disclosed by HCIL and found by the TPO to be at ALP.

An appeal was filed against the order of the AO/DRP before the ITAT for AY 2007 – 08. The ITAT held that appeals against the orders of re-assessment became infructuous as reassessment notices had already been quashed by the SC for those relevant years.

The IRA filed an appeal against the order passed by the ITAT under section 147 read with section 143 (3)/144C (13) of the IT Act for AY 2007-08 before the HC of Delhi.

ISSUE

Whether the re-assessment proceedings could be sustained when HCIL had already been compensated at arm's length?

ARGUMENTS

The Assessee had contended that the international transactions relating to purchase of raw-materials by HCIL from the Assessee had been subjected to transfer pricing assessment in the hands of HCIL and it was concluded by the AO that the value of the said international transactions were found to be on arm's length basis. It was also submitted that in terms of Article 9 of DTAA once the international transactions of the PE had been found to be compensated at ALP, the IRA was prohibited from allocating any further income of the Assessee to be taxed in India.

[7] CIT v. Honda Motors Co. Ltd, ITA 945/2019(Delhi HC).

The Assessee relied on the orders of the SC for earlier years and on the decision of the SC in ***M/S E-Funds IT Solution Inc.,***[8] to contend that once HCIL was compensated at ALP, no further profits could be attributed to the Assessee even if it had a PE in India.

DECISION

The Delhi HC rejected the appeal filed by the revenue and concurred with the Assessee. The Court relied on its decision in the case of ***E-Funds IT Solutions Inc.***[9] wherein it was held that once ALP has been satisfied, no further profits could be attributed to a person even if it had a PE in India.

Based on the same, the Court held that since the notice for re-assessment was based only on the allegation that the Assessee had a PE in India, the notice could not be sustained once HCIL had been compensated at arm's length.

SIGNIFICANT TAKEAWAYS

Courts have been consistently taking a position that once an associated enterprise, which constitutes a PE for the foreign parent, has been remunerated on an arm's length basis taking into account all the risk-taking functions of the enterprise, then nothing further maybe left to be attributed to the PE. It may be noted that this proposition was originally laid down by the SC in ***Director of Income-tax (International Taxation) v. Morgan Stanley & Co.***[10], which was, once again, reaffirmed by it in ***Assistant Director of Income-tax-1, New Delhi v. E-Funds IT Solution Inc***[11].

Furthermore, in the instant case, the SC had allowed the writ petition[12] filed by the Assessee seeking to quash the reopening proceedings under section 148 of the IT Act. Therefore, the consequent additions made on merits stands infructuous automatically.

[8] Assistant Director of the Income Tax-I, New Delhi v. M/S E-Funds IT Solution Inc., (2017) 86 taxmann.com 240 (SC).
[9] Assistant Director of the Income Tax-I, New Delhi v. M/S E-Funds IT Solution Inc., (2017) 86 taxmann.com 240 (SC).
[10] M/S DIT (International Taxation), Mumbai v. M/S Morgan Stanley & Co. Inc., (2007) 292 ITR 416 (SC).
[11] Assistant Director of the Income Tax-I, New Delhi v. M/S E-Funds IT Solution Inc., (2017) 86 taxmann.com 240 (SC).
[12] Honda Motor Co. Ltd.v. Assistant Director of Income-tax, Noida, (2018) 92 taxmann.com 353 (SC).

DELHI HC UPHOLDS PRESENCE OF A PE OF ROLLS ROYCE PLC IN INDIA

In the case of ***Rolls Royce Plc***[13] the Delhi HC upheld the ITAT order holding that the liaison office of RRIL, an indirect subsidiary of the assessee, constituted a PE for the assessee in India.

FACTS

Rolls Royce Plc ("**Assessee**"), a UK based company, had a wholly owned subsidiary, Rolls Royce International Ltd. ("**RR Int. Ltd**"), which in turn had another wholly owned subsidiary in UK, Rolls Royce India Ltd. ("**RRIL**"). RRIL had liaison offices in India which was engaged in liaison activities on behalf of the Assessee and the Rolls-Royce group. The Assessee was supplying aero-engines and spare parts to Indian customers and rendering services. An agreement was entered into between RR Int. Ltd and RRIL as per which RRIL rendered liaison services to the Assessee for which it was compensated on cost plus 6% as service fees. The AO conducted a survey under section 133A and concluded, on the basis of information and documents collected by him, that the liaison office in India was a PE of the Assessee, which was subsequently conformed by the CIT(A).

> **"In the absence of any new facts, Delhi HC upholds the existence of a PE of the non-resident in India."**

On appeal, the ITAT confirmed that the liaison office was a PE of the Assessee following the order of the ITAT as well as that of the HC during the earlier years. The ITAT had held that although it slightly felt persuaded by the arguments of the Assessee that constitution of PE had to be examined qua the activities carried out by the Assessee in India on year on year basis, it could not take a divergent view on account of judicial precedence.

Given the same, the Assessee filed an appeal before the Delhi HC.

ISSUES

1. Whether the Assessee had a PE in India in the form of liaison office of RRIL?
2. Whether the ad-hoc attribution of 35% of total profits made from sales made to Indian customers was justified?

ARGUMENTS

At the time of admission of the appeal, the Assessee argued that since the concept of res judicata did not apply in taxation matters, each AY had to be treated separately, as decided by the SC in the case of ***M.M. Ipoh***[14]. Therefore, an earlier decision of the ITAT concerning previous AYs, holding that the liaison office constituted PE for the Assessee, could not have been the sole criteria to decide that the Assessee had a PE during the relevant period. There had to be a fresh examination as articulated by the SC in the case of ***Formula One World Championship Ltd.***[15].

It was also argued by the Assessee that the earlier decisions passed in its case were not applicable to the instant case since the amendment introduced through Finance Act, 2018, which presumably is an attempt to enhance the scope of the term 'business connection' which clarified that only a person who played a principal role in the conclusion of the contracts by a non-resident could be construed as a 'business connection'. In other words, a person who played a principal role in conclusion of contracts would not be considered as constituting a 'business connection' for the non-resident in India prior to AY 2019-20. It was submitted that the only allegation of the IRA was that the liaison office of RRIL played a significant role (and not the principal role) in the conclusion of contracts for the Assessee in India and therefore, constituted

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[13] Rolls Royce PLC v. Director of Income Tax, ITA 969/2019 (Delhi HC).
[14] M.M. Ipoh v. CIT, (1968) 67 ITR 106 (SC).
[15] Formula World Championship Ltd. v. CIT, (International Taxation)-3 Delhi (2017) 394 ITR 80 (SC).

'business connection' in India. Therefore, such activities should not be construed as constituting a 'business connection' for the Assessee in India.

The Assessee had also contended that RRIL and the Assessee had been taxed separately on account of the same set of activities and thus, resulted in double taxation. It was also submitted the IRA had used the same evidences i.e. materials collected during the survey to make additions in the hands of the RRIL as well as the Assessee, for the relevant period. To establish the same, the Assessee relied on the order passed by the CIT(A) in the case of RRIL. It was submitted by the Assessee that the addition made in the hands of RRIL extinguishes the attribution in the hands of the Assessee.

The Assessee had also argued that since the same evidence was being relied upon by the AO as well as the lower authorities to hold that both RRIL as well as the Assessee had established a BC / PE in India during the entire period and since the alleged PE of RRIL had already been compensated on arm's length basis, no further income can be attributed to the PE of the Assessee. In support of this contention, copy of CIT(A)'s order and the order from the competent authorities confirming the resolution of dispute under the mutual acceptance procedure were submitted.

It was also argued by the Assessee that the lower authorities had erred in attributing 35% of its global trading profits to the Indian PE attributable to the sales and marketing activities in spite of acknowledging that only a miniscule amount of activities were carried out in India and the Indian PE did not have the expertise or resources to carry out the entire range of sales and marketing activities in respect the very technical complex products being sold by the Assessee.

DECISION

The HC held that while it was agreeable to the position laid down in M.M. Ipoh, it was unable to see any pertinent difference between the facts pertaining to the relevant AY and the previous AYs, which were pending before the SC. Further, the HC noted that the very same arguments of the Assessee had been dismissed by the ITAT as a matter of judicial precedence.

The HC held that the amendment to section 9(1) was not relevant to the present case as the explanation was not relied upon for the purposes of determination of the PE. Further, irrespective of whether the amendment was prospective or not, the same could not nullify a determination of PE made on the basis of the evidence collected and decided as per the pre-existing law prior to the amendment.

In regards to the ground of double taxation, the HC held that the Assessee ought to have raised this ground when the previous AYs came up for hearing before it. Since no such claim was made during the hearing pertaining to previous AYs, it held that they could not be raised before the HC.

SIGNIFICANT TAKEAWAYS

The HC had followed the orders pertaining to the previous AYs, which are currently pending before the SC, without appreciating the distinctions pointed out by the Assessee. It also misunderstood the reliance placed on the recent changes to the definition of business connection since the Assessee had never claimed that the reliance is being placed on the recent definition to establish a tax presence. In fact, the Assessee had relied on the said definition to argue that since, even as per the recent expanded decision of business connection, the Assessee could not be held to have established a business connection and hence, there is no way it could have established one as per the earlier restrictive definition. The HC had failed to appreciate the reliance placed by the Assessee on SC's landmark decision in the case of ***Formula One World Championship***[16] wherein the SC had held that fixed place PE of an entity is determined based on the activities carried out by the foreign company during the relevant year. On account of the orders pertaining to the previous AYs, the HC refused to entertain any of the arguments against PE on merits.

Another very important aspect which was not looked into by the HC was the fact that income of the

[16] Formula One World Championship Ltd. v. CIT (International Tax) – 3 Delhi, (2017) 394 ITR 80 (SC).

Assessee arising in India had already been taxed in the hands of RRIL for the same AY. However, the same is being subject to tax again in the hands of the Assessee by the IRA. It had brushed aside the established principle of taxation that the same income cannot be subject to tax twice on the ground that it is a question of fact which cannot be raised before the HC hereby effectively overriding the SC decision in the cases of ***Morgan Stanley & Co***.[17] and, ***E-Funds IT Solutions Inc.,***[18] which had later been confirmed by multiple HCs in ***SET Satellite (Singapore) Pte. Ltd.,***[19] ***BBC Worldwide Ltd.,***[20] ***B4U International Holdings Ltd.***[21] and ***Honda Motor Co. Ltd.***[22]

The HC has also erred in not considering other arguments made by the Assessee in connection with disproportionate attribution of profits to the alleged PE, including the bizzare method adopted by the AO to determine the profits out the said disproportionate attribution.

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[17] DIT v. Morgan Stanley & Co, (2007) 292 ITR 416 (SC).
[18] ADIT v. E-Funds IT Solutions Inc., (2017) 399 ITR 34 (SC).
[19] SET Satellite (Singapore) Pte. Ltd. v. DDIT, (2008) 307 ITR 205 (Bombay HC).
[20] DIT v. BBC Worldwide Ltd., (2011) 203 Taxman 554 (Bombay HC).
[21] DIT v. B4U International Holdings Ltd., (2015) 374 ITR 453 (Bombay HC).
[22] CIT v. Honda Motor Co. Ltd., ITA No. 945/2019 (Delhi HC).

CAPITAL GAINS ARISING TO A SPANISH COMPANY FROM SALE OF SHARES OF REAL ESTATE COMPANIES NOT TAXABLE IN INDIA HOLDS ITAT

In ***Merrill Lynch Capital Market Espana SA SV,***[23] the ITAT has held that, under the India-Spain DTAA, the capital gains to a company resident in Spain from sale of shares of an Indian real estate company which does not hold immovable property as an investment and 50% of whose assets do not constitute immovable property, cannot be taxed in India.

FACTS

The Merrill Lynch Capital Market Espana SA SV ("**Assesse**") was a company incorporated in Spain and registered as a foreign institutional investor ("**FII**") in India. The AO while scrutinising the return of income filed by the Assessee for AY 2014-15, noticed that the Assessee had earned capital gains from sale of shares of real estate company listed on BSE realty index involved in business of real estate development. The AO argued that such gains should be taxed in India under Article 14(4) of the DTAA which provides that gains from alienation of shares of a company, the property of which consists of, directly or indirectly, principally of immoveable property, can be taxed in the source jurisdiction. Aggrieved by the order of the AO, the Assessee approached the CIT(A), who held that the capital gains by sale of shares of a real estate company were covered under Article 14(6) of the India-Spain DTAA and were not taxable in India. Aggrieved by the order of the CIT(A), the AO appealed to the ITAT.

> **Capital gains arising to a Spanish company from sale of shares of real estate companies not taxable in India if more than 50% of value not derived from immovable property.**

ISSUE

What did "principally consists of immovable property" entail as per Article 14(4) of the DTAA?

ARGUMENTS

Article 14(4) of the DTAA allowed the source state to tax the gains from the alienation of shares of the capital stock of a company the property of which consists, directly or indirectly, principally of immovable property situated in that state. The AO argued that by virtue of Article 14(4), any gain by sale of shares in Indian companies, which found place on BSE realty index, and dealt in real estate sector including development of properties, was taxable in India. The AO was of the opinion that the fact whether the properties were held as stock in trade or as investment was irrelevant for the purpose of application of Article 14(4).

The CIT(A) agreed with the plea of the Assessee that there was no indirect transfer of ownership of the immovable properties by transfer of shares of these real estate companies. The CIT(A) also relied on the decision of the co-ordinate bench where it was held that the value of the shares of the real estate companies was not dependent on only the extent of the immovable properties owned by them but also on several other factors. It also considered the fact that Assessee's shareholding in these companies was not substantial and with such a small percentage, it had no effective right to occupy the immovable properties of those companies.

DECISION

For the purpose of taxability of capital gains realised by capital gains, the ITAT explained that Article 14(1) to 14(5) of the DTAA were the specific carve outs which were taxable in the source state and for the

[23] JCIT v. Merrill Lynch Capital Market Espana SA SV, ITA No. 6108/Mum/2018, decided on October 11, 2019 (Mumbai ITAT).

invocation of exception of Article 14(4), "*the gains must arise in the hands of the Spanish company (i.e. the Assessee) on (a) alienation of shares in the other contracting state (i.e. India); (b) the property of such a company, shares in which are sold by the assesse, must consist of "principally" of immovable properties; (c) such a holding of, principally, the immovable properties may be direct or indirect*". As Article 14(4) is an exception, the onus of proving the satisfaction of the abovementioned conditions, was on the AO. The ITAT held that the AO failed to prove that the concerned Indian target companies involved in real estate business were principally holding the immovable properties. The AO just relied on the fact that these companies were listed on the BSE realty index and lost sight of the fact that these companies were not in the business of holding real estate as investments but were engaged in real estate development. Therefore, there income routes from the real estate development activities and not through holding immovable properties. The ITAT also explained that Article 14(4) was there to check the bypassing of Article 14(1) which stated that gains through alienation of the immovable property should be taxed in the source state.

In order to understand what the word "principally" in Article 14(4) entails, the ITAT relied on the UN Model Convention Commentary and the OECD Model Convention Commentary which provides that in order to tax such alienation of shares, the immovable properties of the company should constitute 50% or more of the aggregate value of assets. ITAT recognised the fact that these model convention commentaries did not bind India, but relied on the Andhra Pradesh HC's decision in ***CIT v. Vishakhapatnam Port Trust***[24] and held that until and unless a contrary intention was expressed, when a provision in tax treaty was similar to the provision in model tax convention, it was assumed that the persons using the tax treaty must know the interpretation and usage of such provisions by multilateral bodies. While relying on Article 31 of the Vienna Convention on the Law of Treaties which states that every provision should be interpreted in the light of its object and purpose, the ITAT held that though wordings of UN and OECD Model conventions are different, it was not arguable that the object and purpose of Article 14(4) can be any different than them. It was not the scheme of Article 14 to tax the companies which were not holding immovable properties as investment but were involved in real estate development activities. In addition, another factor to be considered was if the Assessee held any substantial and controlling interest in these real estate companies, answer to which was negative, and therefore, the Assesse had no right to occupy the property of these companies.

SIGNIFICANT TAKEAWAYS

The ITAT provides clarity to the foreign investors based out of Spain that the capital gains by sale of shares of real estate companies will be taxable only if the real estate companies are in the business of holding the immovable properties. While recognising the fact that the international conventions are not binding on India, it provides that for the provisions which are similar to the provisions in the international conventions, the interpretation in commentaries can be used for interpreting the provisions of the DTAA. By relying on the commentaries on international conventions, it has clarified that for the application of Article 14(4), the company should be holding more than fifty percent of its assets as immovable property. It also clarified that the purpose of Article 14(4) will be fulfilled only if the non-resident transferring the share of the company principally holding the immovable properties, has substantial holding in such Indian company, so that it can be held that the non-resident has right to occupy the immovable property held by the resident company. The judgments sets out important outline with respect to satisfaction of the conditions mentioned in various articles for taxation of income in the source state.

[24] CIT v. Vishakhapatnam Port Trust, (1983) 144 ITR 146 (Andhra Pradesh HC).

APPLICATION OF FAVOURABLE DTAA PROVISIONS PREVENTS THE EXAMINATION OF PROVISIONS OF THE IT ACT

In the case of ***KPMG***[25], Bombay HC held that when DTAA was applicable, the question of applicability of provisions of the IT Act did not arise, and accordingly, when the DTAA enabled the taxability of a transaction involving providing professional services in the residence state, no withholding tax could be deducted in India being the source state.

FACTS

KPMG ("**Assessee**") was engaged in the business of rendering tax related services, audit related advisory services and other consultancy services. During the AY 2008-09, the Assessee availed professional services of various non-resident concerns and paid them professional fees without deducting any TDS. The Assessee claimed deduction of the amount paid to such non-residents from its income from business. The AO disallowed such deduction on the basis of section 40(a)(ia) of the IT Act which provided that the amount on which TDS was not deducted, could not be deducted from Assessee's income from business.

On appeal, the CIT(A) deleted the disallowance and held that the payment of amount from the Assessee to these non-residents was governed by the respective DTAAs that their countries of residences had signed with India, except for the concern in China. On further appeal, the Mumbai bench of ITAT held that neither the services were in nature of technical services under the applicable DTAA nor such non-resident entities had a PE in India to be taxable under the IT Act. Moreover, such services were covered under the DTAAs, even for the Chinese resident. The ITAT further held that the obligation of deducting TDS was not present for the relevant AY, it was only added in 2010 with retrospective effect. On the applicability of these provisions from a retrospective effect, the ITAT held that when an obligation was completely absent, the same could not be made applicable retrospectively. Aggrieved by the order of the ITAT, the IRA appealed to the Bombay HC.

> **Where service provider receives income as per the DTAA, obligation to deduct tax at source would not arise.**

ISSUES

The following questions were raised by the IRA:

(a) Whether disallowance under section 40(a)(ia) of the IT Act could not be made without realizing that the tax was required to be deducted on these payments under section 195 of the IT Act; and

(b) Whether the TDS was supposed to be deducted even before the amendment added such an obligation the amendment was retrospective and clarificatory in nature?

ARGUMENTS

The AO argued that the deduction sought by the Assessee for the payments made to the non-resident entities outside India for services provided by the concerns could not be allowed since no TDS was not deducted from such payments. However, the Assessee argued that the payments made to service providers were governed by the respective DTAAs and as per the provisions of the relevant DTAAs, such income was not chargeable to tax in India and accordingly, no tax was liable to deducted at the time of payment.

[25] CIT v. KPMG, ITA No. 690/Mum/2017 (Bombay HC).

DECISION

The Bombay HC chose not to examine the issues that were raised by the IRA relating to applicability of sections 40(a)(ia) and 195 of the IT Act and rendered them academic because it was of the view that the ITAT has ruled DTAA was applicable and the AO has not challenged the same before the court. Accordingly, it was concluded that the taxability in this case would be governed by the DTAA.

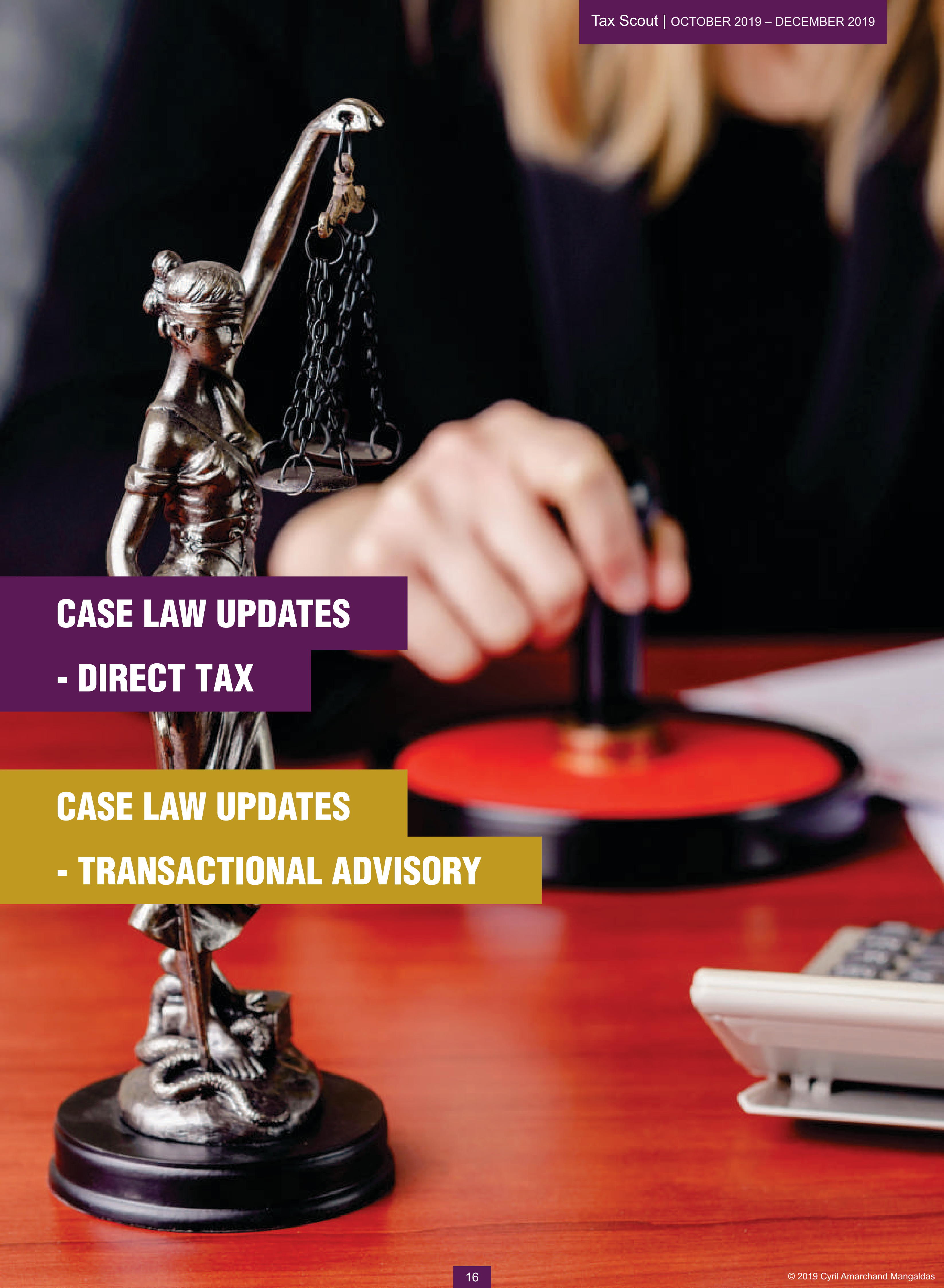
SIGNIFICANT TAKEAWAYS

In the year 2007, the SC in ***Ishikawajma-Harima Heavy Industries Ltd.***[26] held that in order to hold a non-resident taxable for income deemed to accrue or arise in India who provided technical services, the services must be rendered in India. In order to put this case to rest, the Finance Act, 2010 added an explanation to clarify that the income would be construed as income deemed to accrue or arise in India whether or not the services were rendered in India. This amendment was in the nature of clarification, and hence, could be made applicable retrospectively.

However, the Mumbai bench of ITAT in the present case was correct in holding that no one could be made to comply with an obligation which was not present at the relevant time making it impossible for an assessee to comply with it. Similarly, in ***NGC Networks India Pvt. Ltd.***[27] and ***Revathi Equipment Ltd.,***[28] the courts held that even if a provision is retrospective in nature, it cannot make an assessee liable for undertaking an impossible act. Thus, the judgment should aid in settling various actions/disputes where the IRA could be trying to invoke the amendment to section 9(1)(vii) and proposing to make a disallowance under section 40(a)(ia) based on retrospective amendment. Furthermore, the judgment would be helpful in providing comfort and respite to Indian concerns availing intra-group services especially in the financial services, investment advisory services, manufacturing companies where the Indian counterparts may be relying on the expertise of its offshore group companies.

While the HC has not assessed the case on merits vis-à-vis taxability under the applicable DTAA, the importance of the make-available clause needs to be assed based on the nature of the service provided. Where the DTAA itself contains a make available clause or has an enabling most favoured nation clause, unless the services make available *inter alia* technical know-how, knowledge, skill such that service recipient is enabled to apply such know-how etc., independently without recourse to the service provider; such services would not be taxable in India.

[26] Ishikawajma-Harima Heavy Industries Ltd. v. Director of Income Tax, Mumbai, (2007) 3 SCC 481 (SC).
[27] CIT v. NGC Networks India Pvt. Ltd., (2018) 304 CTR (Bom) 306 (Bombay HC).
[28] CIT v. Revathi Equipment Ltd., (2008) 298 ITR 67 (Madras HC).



CASE LAW UPDATES - DIRECT TAX

CASE LAW UPDATES - TRANSACTIONAL ADVISORY

MARKET VALUE OF ASSETS MAY BE USED TO COMPUTE THE FMV OF SHARES UNDER SECTION 56(2)(viib)

In the case of ***M/s India Convention and Culture Centre Pvt. Ltd.,***[29] the ITAT while deleting the additions made under section 56(2)(viib) of the IT Act, held that the FMV of shares under section 56(2)(viib) need not be necessarily determined basis the value of the assets recorded in the financial statements, when the taxpayer has substantiated that the market value of such assets were more than the value of the asset shown in the balance sheet.

FACTS

M/s India Convention and Culture Centre Pvt. Ltd (“**Assessee**”) had issued equity shares, with a face value of INR 10, at a premium of INR 5. The AO, based on the documentary evidence received from the Assessee to justify the premium in light of section 56(2)(viib), computed the FMV of the shares to be INR 6.65. Accordingly, since the consideration received by the Assessee for the issuance of shares exceeded the FMV of the shares, the AO made relevant additions under section 56(2)(viib) of the IT Act. In appeal before the CIT (A), it was held that the AO had erred in computing the value of ‘liabilities’, while computing the FMV of the shares under Rule 11UA of the IT Rules. The CIT (A) recomputed the FMV of the shares to be INR 10.05 and reduced the appropriate amount of additions made by the AO. Being aggrieved of the order of the CIT (A), the Assessee approached the ITAT.

> **Valuation of shares should be done on the basis of various factors and not merely on the basis of financial statements.**

ISSUE

Whether, in the facts and circumstances of the case, the Assessee was liable to pay any tax under section 56(2)(viib) of the IT Act?

ARGUMENTS

The Assessee stated that as per section 56(2)(viib), the FMV of the shares should be the value of share determined as per the net asset value method or the discounted cash flow method, prescribed in Rule 11UA of the IT Rules or as substantiated by the taxpayer based on the value of the assets on the date of issue, whichever is higher. Thus, it was argued that the FMV of the shares need not be necessarily determined on the basis of the book value of such assets as per the financial statements, when the taxpayer had substantiated that the market value of the asset was more than the book value of the asset in the balance sheet.

Further, the Assessee also pointed out that it had owned a piece of land and during the relevant AY, it was granted permission to construct an institution of art, culture and convention center, on the same. Accordingly, because of the change in land use, the circle rate for the said land had increased. Thus, it was argued that the FMV of the shares should be computed taking into consideration such increased value of land and not on the basis of the book value of the asset, while computing the FMV, as permitted under section 56(2)(viib).

On the other hand the IRA placed reliance on the orders of the AO and the CIT(A) arguing that the consideration received by the Assessee was in excess of the FMV computed in accordance with Rule 11UA of the IT Rules and hence, the Assessee was liable to pay tax on the difference.

[29] M/s India Convention and Culture Centre Pvt. Ltd. v ITO, ITA No.7262/Del/2017 (Delhi ITAT).

DECISION

The ITAT discussed the definition of FMV under section 56(2)(viib) of the IT Act and observed that the

FMV of the shares will either be the amount determined as per the prescribed method under Rule 11UA of the IT Rules or as substantiated by the taxpayer based on the value of the assets on the date of issue, whichever is higher. As the Assessee had already acknowledged the fact that the value of asset has increased, the ITAT held that it would not be open for the AO to reject the FMV of the shares where the same was computed taking into consideration factors other than the financial statements. The ITAT also held that it would be open for the Assessee to compute the FMV of the shares using the FMV of the assets, provided the Assessee can show that such value exceeds the book value of the asset.

Thus, in the instant case, the ITAT recognized that due to change in the land use, the circle rate for the land held by Assessee had increased substantially. The ITAT computed the FMV of the shares, using the increased market value of the land, as ~INR 658 per share, which was much more than the premium levied by the Assessee. Accordingly, the ITAT set aside the order of the lower authorities and deleted the additions made under section 56(2)(viib).

SIGNIFICANT TAKEAWAYS

This case highlights the right of a taxpayer to pursue a separate method of valuation (based on the value of assets), i.e. other than the net asset value method and the discounted cash flow method prescribed under Rule 11UA of the IT Act, for the purpose of computing FMV under section 56(2)(viib). This right of the taxpayer has also been recognized by the Delhi ITAT in the case of ***India Today Online Pvt. Ltd.***[30], where the ITAT had held that various factors have to be taken into consideration apart from financials at the time of valuation of shares. Therefore, valuation done by a taxpayer cannot be rejected simply on the ground that it did not stand the method provided in Rule 11UA of the IT Rules.

This alternate method of valuation can especially be relied upon by companies which have intangible assets like goodwill, patents, know-how, franchises, license etc. whose value is generally not considered in the valuation methods prescribed under Rule 11UA of the IT Rules. Additionally, such method of valuation may also be relied upon to reflect the increased economic value of an asset, owing to reasons like obtaining permission for changing the land use (like the instant case), or major renovation work on the asset, etc. while the book value of the assets remain unchanged.

[30] The India Today Online Pvt. Ltd., New Delhi v. Ito, Ward ITA No.6453 (Delhi ITAT).

HYDERABAD ITAT HOLDS PENALTY PAID OUTSIDE INDIA AND DEPRECIATION ON GOODWILL GENERATED FROM AMALGAMATION CAN BE CLAIMED AS EXPENSE

In the case of ***Mylan Laboratories Ltd.[31],*** the Hyderabad ITAT has held that depreciation can be claimed on goodwill generated by amalgamation by way of purchase method.

FACTS

Mylan Laboratories Ltd. ("**Assessee**"), and Niche Generics Ltd. ("**Niche**") had entered into a co-development agreement to jointly develop Perindopril tablets. Servier Labourites Ltd. ("**Servier**"), is the originator company/ patent holder for Perindopril in the EU region. In February 2005, Niche entered into a patent settlement agreement with Servier. The Assessee, considering its lack of resources to develop the drug independently and its lack of presence in the EU region, entered into a partnership with Niche and therefore, also signed a settlement agreement with Servier for an amount of GBP 11.8 Million. Under the terms of this agreement, the Assessee or its affiliates were required to not: manufacture/supply perindopril made using the process, for use anywhere in the territory or carry out any restricted act in relation to such 'perindopril'. The Assessee showed the settlement amount in its books of accounts as income on deferred basis, over a period of 44 months but the entire amount was offered to tax as business income, in the same AY 2005-06. The EU Commission under its ant-trust laws imposed a fine on Assessee, for violation of anti-trust laws by signing the settlement cum non-compete agreement. The fine was to the tune of GBP 11.8 Million, and the Assessee was required to disgorge this amount to the EU Commission. The Assessee claimed this fine as a business loss under section 28(i) of the IT Act and claimed it as a deduction under section 37(1) of the IT Act. The AO and the CIT(A) did not agree with the claims of the Assessee and held the fine to be a penalty. Hence, it was held that the same was covered under the Explanation to section 37(1) of the IT Act, and thus not eligible for a deduction.

> **"Expenses incurred in relation to payment of a fine outside India could be claimed as a tax deductible expense."**

The Assessee acquired Agila Specialities Ltd. ("**ASPL**") along with its wholly owned subsidiary Onco Therapies Ltd. ("**OTL**") on December 5, 2013 for a consideration of INR 59,786 Million, with certain payment towards outstanding credit, and the residual after payment towards assets and liabilities as payment towards intangible assets including goodwill. This acquisition was immediately followed by a merger of these two companies with the Assessee, which was approved by the Andhra Pradesh HC, with effect from December 6, 2013. The Assessee claimed depreciation on the goodwill obtained through the amalgamation but the same was not allowed by the AO, on the ground that the goodwill was not existent in the books of ASPL and was introduced only under the scheme of amalgamation, the proviso to section 32(1) of the Act is applicable and, therefore, the depreciation, allowable in the case of succession, amalgamation or merger, demerger should not exceed the depreciation allowable had the succession not taken place. The order of the AO was confirmed by the CIT(A).

Aggrieved by the orders of the CIT(A), the Assessee approached the ITAT.

ISSUES

1. Whether the fine imposed by the EU Commission being a mere take back/compensation of the settlement amount, was not penal but

[31] Mylan Laboratories Ltd., Hyderabad v. DCIT, (2020) 113 taxmann.com 6 (Hyderabad ITAT).

compensatory in nature, thus a deductible expense under section 37(1) of the IT Act?

2. Whether the amalgamated company could claim depreciation on the goodwill arising during the course of the amalgamation, when it was claimed that the amalgamating company did not have any such goodwill as part of its book of accounts?

ARGUMENTS

The Assessee argued that for the purpose of computation of profits for a particular year under section 28(I) of the IT Act, all business expenditure irrespective of them being specifically provided in the Act, may be allowed.

The IRA argued that as per Explanation 1 to section 37(1) of the Act, any expenditure incurred in relation to an offence was not amenable to be claimed as a deduction. The fine imposed by EU Commission being penal in nature was covered under this Explanation, and hence, could not have been allowed as a deduction.

The Assessee argued that the levy imposed by the EU Commission was not a fine but a disgorgement which basically means requiring a person to repay/ refund the settlement amount in order to prevent its unjust enrichment. It was contended that the lower authority instead of analysing whether the order was penal or compensatory in nature, relied upon the nomenclature and held it to be a penal order and disallowed the deduction. The Assessee argued that as the entire amount of GBP 11.8 Million had been refunded, and as it was towards patent infringement, the same was compensatory in nature and could not be disallowed, as it was purely for commercial reasons. It relied on cases, where the expenditure being compensatory in nature, had been allowed to be deductible under section 37(1).[32]

The Assessee also argued that the word 'law' referred to in Explanation 1 to section 37(1) only covers "law of the land" which means law in force in India and violation of provisions of the Treaty on the Functioning of the European Union will not qualify to be violation of law under the concerned Explanation. The IRA argued that the EU Commission levies such fines to deter other companies from entering into any anti-competitive practice and had levied the fine on the Assessee for violating the anti-competitive rules. Therefore, the fine was penal in nature and could not be allowed as a deduction. Accordingly, it could not be considered a business loss for computation of profits for section 28(i).

The Assessee by placing reliance on the SC's decision in the ***Smiff Securities Ltd.***[33]**,** argued that it can claim depreciation on the goodwill. The IRA on the other hand, argued that the goodwill was introduced in the books of accounts of the Assessee only during the course of the amalgamation and not prior to it. Therefore, the sixth proviso to section 32(1) was applicable, and depreciation more than what would have been allowed if no succession would have taken place, would not be allowed in the case of any succession, merger or amalgamation in the hands of the amalgamated company. It argued that the depreciation to the successor company could only have been on the WDV of assets in the books of the amalgamated company and not on the cost as recorded in the books of amalgamating company. Therefore, the Assessee could not have claimed depreciation on the goodwill which arose as a result of the amalgamation scheme. For this contention, it relied on the ITAT Bangalore's decision in the case of ***United Breweries Ltd.***[34]***,*** where depreciation on goodwill arising in the course of amalgamation was disallowed.

The Assessee argued that acquisition of ASPL and OSL was made vide a share purchase agreement signed with Strides Acro Lab Group ("**Strides**"). As per AS 14, and the purchase method provided therein, the amalgamation company is required to allocate consideration to all identifiable assets and liabilities, and any consideration over and above the fair value of such net assets is allocated as value towards the

[32] Prakash Cotton Mills Pvt. Ltd. v. CIT, (1993) 201 ITR 684 (SC); Swadeshi Cotton Mills Co. Ltd. v. CIT, (1998) 233 ITR 199 (SC); Standard Batteries Ltd v. CIT, (1995) 211 ITR 444 (SC); CIT v. Hyderabad Allwyn Metal Works Ltd., (1988) 172 ITR 1131(Andhra Pradesh HC); CIT v. Bharat Television Pvt. Ltd., (1996) 218 ITR 172 (Andhra Pradesh HC).

[33] CIT v. Smifs Securities Ltd., (2012) 348 ITR 302 (SC).

[34] United Breweries Ltd. v. Addl. CIT vide its order dated 30/09/2016 in ITA Nos. 722, 801 and 1065/Bang/2014 (Bangalore ITAT).

goodwill arising on amalgamation. It relied on SC's judgment in *Smiffs Securities* and other HC judgments wherein it was held that depreciation on goodwill was allowed.[35]

The Assessee further relied on coordinate bench's decision in case of ***AP Paper Mills Ltd.***[36]***,*** and Delhi HC's judgment in ***Areva T&D India Ltd.***[37], and contended that goodwill which is generated pursuant to amalgamation is a commercial right covered under clause (b) to Explanation 3 of section 32(1). While referring to the sixth proviso to section 32(1), the Assessee argued that the proviso is applicable for allocation of already existing assets between the predecessor and successor company, and is not applicable to new assets generated pursuant to amalgamation.

The IRA argued that when the Assessee owns another company through shareholding, subsequent merger will not lead to transfer of assets u/s 2(47) of the IT Act. Transfer of assets from a subsidiary to parent is not considered as transfer under section 2(47)(v), and claiming depreciation on goodwill was only a way of making profit out of oneself. It also argued that the total net asset value being negative, there can only be negative goodwill arising out of the amalgamation. It relied on ITAT, Vishakhapatnam bench's ruling in ***Kanaka Mahalakshmi Co-operative Bank Ltd.***[38]***,*** wherein it was held that if the company which has been acquired hasn't shown any goodwill and when the assesse has taken over accumulated losses, there cannot be any goodwill. It also relied on ***Toyo Engineering India Ltd.***[39]***,*** where it was held that depreciation on goodwill can be allowed only if the taxpayer has proved the purchase of goodwill.

"Depreciation can be claimed on goodwill generated by amalgamation by way of purchase method."

DECISION

The ITAT acknowledged reliance of the Assessee on the CBDT circular to explain the amendments made by the Finance Act 1998. It further cited the case of Allahabad HC in ***Abdul Hameed***[40], and Calcutta HC in ***Susanta Mukherjee***[41] to refer to the meaning of the term 'offence' which had relied on the definition of 'offence' under the General Clauses Act, 1897 to mean an act or omission punishable by law in force in India. The ITAT therefore decided that the law under Explanation 1 to section 37(1) refers to law in force in India and not in any foreign territory. It further relied on the Delhi HC case of ***Desiccant Rotors International Ltd.***[42]***,*** where it was held that violation of a patent in a foreign country cannot be considered as a violation of Indian laws, Therefore, the ITAT agreed with the Assessee that the Explanation 1 to section 37(1) disallows any payment made towards contravention of laws in force in India and not of any foreign country.

On the question of the payment being penal or compensatory in nature, the ITAT, by relying on the IRA's arguments, held that such payment cannot be considered to be compensatory in nature. On the argument of the Assessee that such payment to EU Commission was towards commercial expediency and was for the purpose of carrying on the business, and hence, should be computed as business loss for the purpose of section 28(I), the ITAT referred the issue back to the AO, with a direction to allow it as business loss if the income has been offered to tax in the earlier AY.

On the second issue the ITAT did not agree with the understanding of the AO that goodwill is self-generated and no depreciation can be claimed on self-generated goodwill. The ITAT also pointed out that Strides was not a related party, and there was no doubt about the amount paid to it. The ITAT observed that under AS14, accounting for amalgamation can be made in two ways a) in the nature of line by line consolidation and b) in the nature of purchase. It was noted that, in the latter type of amalgamation, any consideration paid in excess of net value of assets and liabilities of amalgamating company is regarded as

[35] Aluminium Corporation of India, 85 ITR 167 (1972) (SC); Karamchand Premchand Pvt. Ltd. v. CIT, 101 ITR 46 (Gujrat HC).
[36] A.P. Paper Mills Ltd. v. ACIT, (2010)128 TTJ 596 (Hyd.) (Hyderabad ITAT).
[37] Areva T and D India Ltd. and Ors. v. DCIT, (2012)345 ITR 421(Delhi HC).
[38] Kanaka Mahalakshmi Cooperative Bank Ltd. v. ACIT, (2018) 97 Taxmann.com 638 (Vishakhapatnam ITAT.).
[39] DCIT v. Toyo Engineering India Ltd., (2013) (33 Taxman.com 560) (Mumbai ITAT).
[40] Abdul Hameed v. Mohd. Ishaq, AIR 1975 All. 166 (Allahabad HC).
[41] UOI v. Susanta Kumar Mukherjee, 1977 IILLJ 460 Cal (Calcutta HC).
[42] CIT v. Desiccant Rotors International (P.) Limited, (2011) 245 CTR 572 (Delhi HC).

goodwill. The ITAT also distinguished the current case from the United Breweries case where the issue was of merger with a wholly owned subsidiary, whereas in the current fact situation it was amalgamation by way of purchase. Therefore, by relying on the SC's decision in the case of Smiff Securities, the ITAT allowed depreciation on goodwill.

SIGNIFICANT TAKEAWAYS

Though a lot of cases at different levels of judiciary have dealt with the issue of claiming depreciation on goodwill, it has still remained a debatable issue. In the current case, by relying on *Smiff Securities* and distinguishing from *United Breweries*, the ITAT has clarified that goodwill generated through purchase method of accounting in case of a merger, is amenable to the claim of depreciation.

For the corporate sector, especially in the M &A sphere, the claim of deprecation on goodwill recorded in the books of the amalgamated company assumes significance. The decision provides clarity for the purpose of claiming depreciation on goodwill created in such cases. It is pertinent to note that the Supreme Court in *Smiff Securities*, had not considered the impact of the sixth proviso to section 32(1) of the IT Act, and a review petition has been filed before the Supreme Court challenging the order of the Supreme Court on this ground. The subsequent decisions following *Smiff Securities* have also not analysed this perspective, hence in order to have a conclusive finding in respect of the claim of depreciation on goodwill, the outcome of the review proceedings is critical. Further, any position adopted by the stakeholders in the M & A sphere cannot be said to free from litigation risk especially considering the question raised before the Supreme Court was whether goodwill is a depreciable asset under section 32(1), however the question of the quantification/limitation on the amount of depreciation that can be claimed, owing to sixth proviso to section 32(1) of the IT Act.

Also, it has also clarified that for disallowing a deduction under Explanation 1 to section 37(1), the expenditure should be towards a violation of law which is in force in India. Accordingly, expenditure towards a violation of the law in a foreign territory could be claimed as a deductible expense under section 37(1) of the IT Act.

PROPERTY UNDER PERPETUAL LEASE ELIGIBLE FOR CAPITAL GAIN TAX EXEMPTION

In the case of **N Ramaswamy**,[43] the ITAT held that obtaining property on perpetual lease constitutes 'transfer' under the IT Act. Accordingly, the purchaser of the said property can claim exemption from his capital gains tax under section 54F of the IT Act.

FACTS

Mr. N Ramaswamy ("**Assessee**") had taken a property on perpetual lease from Mahindra Residential Developers Ltd. and claimed an exemption under section 54F of the IT Act. Section 54F, *inter alia*, exempts long term capital gains arising from the transfer of a long term capital asset (other than residential house) to an individual, if the entire consideration is invested in purchase of a residential house in India within 1 year before or 2 years after the date of transfer of such asset. The AO allowed the claim of exemption under section 54F. However, the PCIT invoked section 263 of the IT Act and reversed the order of the AO on the ground that the same was prejudicial to the interest of the revenue and denied the exemption under section 54F to the Assessee.

"Perpetual lease deed transferring enjoyment of immovable property constitutes purchase of property."

ISSUE

Whether the residential property taken on perpetual lease could be treated as 'purchase' of property for the purposes of claiming an exemption under section 54F of the Act?

ARGUMENTS

The Assessee contended that the perpetual lease holder not only had an enduring right to possess and enjoy the property as residential house for an unlimited period, but also had the right to transfer the lease / possession to another person in the open market. The Assessee argued that, by virtue of section 2(47)(vi) read with section 269UA(2)(iii)(f), the transfer of property by way of a perpetual lease deed amounted to purchase of property for purposes of section 54F of the IT Act.

The IRA argued that section 54F was a beneficial provision applicable only for purchases of property by way of an outright sale. The IRA contended that as the Assessee held the property under a lease agreement and not pursuant to an outright sale, he was not eligible for exemption under section 54F of the IT Act.

DECISION

The ITAT observed that section 2(47)(vi) of the IT Act provides that an agreement or arrangement which had the effect of transferring or enabling the enjoyment of immovable property, had to be considered as transfer in relation to capital asset. Further, section 269UA(2)(iii)(f) provides that any lease for a term of not less than twelve years including possession of such property , could be construed as transfer. The ITAT ruled that as the transfer under perpetual lease was for a period exceeding 12 years and it resulted in transferring of enjoyment of immovable property, the transfer would be regarded as purchase within section 54F of the IT Act.

SIGNIFICANT TAKEAWAYS

The ITAT ruling would provide relief to various taxpayers who have entered into similar arrangements. The issue of availability of exemption under section 54 on long term capital gains has been a subject matter of litigation before the judicial forums.

[43] Shri N Ramaswamy v. ITO, ITA No. 925 of 2019 (Chennai ITAT).

ITAT Mumbai in ***Mrs. Prema P Shah v. ITO***[44], and ***ACIT v. Smt Asha Ashok Boob***[45] had taken a view that where property was leased for a period of 150 years or 999 years, the lessee was to be treated as the absolute owner and held eligible for exemptions under section 54 and section 54F respectively. It is worthwhile to highlight that mere transfer of tenancy rights, without any absolute rights over the property, cannot be considered as 'transfer' for the purposes of the IT Act[46].

Therefore, the decision as to whether a perpetual lease does or does not constitute purchase for purposes of capital gain tax exemption would depend on the specific arrangements between the parties and the nature of rights which have been transferred. If full rights in relation to a property have been transferred under a perpetual lease, it is more likely to be treated as purchase of property for purposes of capital gain tax exemption.

This is a positive development since it allows certain different types of acquisitions to be entitled to benefits of sections 54 and 54F and thus, would enhance the options available to a taxpayer.

[44] Mrs. Prema P Shah v. ITO, (2006) 100 ITD (Mumbai ITAT).
[45] ACIT v. Smt Asha Ashok Boob, (2015) 59 taxmann.com 173 (Pune ITAT).
[46] Yogesh Sunderlal Shah v. ACIT, (2012) 25 taxman.com 300 (Mumbai ITAT).

INTER CORPORATE GIFTING OF SHARES IS VALID, AND IS NOT TAXABLE

In the case of ***Direct Media Distribution Ventures Pvt. Ltd.,***[47] Mumbai ITAT held that a transfer of shares between companies without consideration is valid as long as it is authorized by the Articles of Association and Memorandum of Association. This is because nowhere does the law require 'love and affection' to be present for such transfers.

FACTS

Direct Media Distribution Ventures Pvt. Ltd. ("**Assessee**") was engaged in the business of media distribution including distribution of television channels via cable network or satellite system. The Assessee transferred its shares in Dish TV India Ltd. to its related party i.e. Direct Media Solution Pvt. Ltd. without any consideration, during the course of an internal restructuring. The Assessee claimed that the same should be considered as a gift, and in the absence of any consideration, no capital gains accrued to the Assessee on the transaction. The AO passed an order in the favour of the Assessee. However, the CIT revised the order of the AO by invoking section 263 of the IT Act and holding that the order of the AO was erroneous and prejudicial to the interests of the IRA and the AO did not conduct a proper enquiry. Thereafter, the Assessee appealed against the order of the CIT before the Mumbai bench of the ITAT.

ISSUE

Whether the CIT was justified in invoking jurisdiction under section 263 of the IT Act in the present case?

"As long as Articles and Memorandum of Association enable it, the transfer of shares as inter-corporate gift is valid gift in law, and is not taxable."

ARGUMENTS

In order to prove that section 263 of IT Act could be invoked, it had to be proved that the order was erroneous as much as it was prejudicial to the interests of the IRA. Further, section 47 of the IT Act listed certain transfers which were not liable to be taxed and clause (iii) of this section enlisted a transfer of a capital asset under a gift or a will or an irrevocable trust.

The IRA argued in two limbs to prove that the revisionary jurisdiction should be invoked:

(a) The AO did not undertake proper enquiries.

(b) The IRA argued that the term 'gift' mentioned in section 47(iii) of the IT Act did not encompass transfer of shares by one entity to another as entities were incapable of feeling love and affection which is required to make a gift. Further, it was also argued that the Assessee was only transferring shares without consideration to avoid paying capital gains tax and such an intention was sufficient to not treat the transfer of shares as gift as provided under Section 47(iii) of the IT Act. Therefore, owing to all these reasons, it was claimed that the order of the AO was erroneous.

The Assessee had submitted the correspondence between the Assessee and AO before the CIT which showed that proper inquiry was undertaken. Besides, the Assessee placed reliance on various judicial decisions and argued that existence of love & affection for making a gift is not a requirement under any law and therefore, there is no bar on entities gifting shares to another entity. Additionally, it was also

[47] Direct Media Distribution Ventures Pvt. Ltd. v. CIT, ITA No. 2211/Mum/2019 (Mumbai ITAT).

argued that the company's Memorandum of Association also allowed making gifts to property of any kind. Further, the Assessee argued that as a consequence of nil consideration, as per various judicial decisions, the FMV cannot be taken as consideration for such transfer and accordingly, capital gains cannot be computed. Therefore, it was claimed there was nothing erroneous with the order of the AO.

DECISION

The Mumbai bench of ITAT held that the correspondence between the Assessee and AO clearly demonstrated that proper enquiry regarding the issue of loss on sale of non-current investments was undertaken. Further, it was also held that a transfer of shares between companies without consideration is valid as long as it was authorized by the Articles and Memorandum of Association. This is because nowhere does the law require 'love and affection' to be present for such transfers. Therefore, commenting on section 47(iii) of the IT Act, the ITAT held that considering there is a proviso which explicitly discusses gifting of ESOPs by a company, it provides further clarity regarding its applicability on transfer of shares by companies as gifts.

Further, it also observed that capital gains which could not be computed under section 48 of the IT Act, could not be charged under section 45 of the IT Act. Accordingly, such transfers did not result in capital gains in absence of consideration, and as held in numerous other decisions, the FMV of the shares cannot be taken for the computation of capital gains, as real and not hypothetical consideration was required for such computation.

SIGNIFICANT TAKEAWAYS

In order to understand whether transfer of shares is permitted to be given as gifts, section 44 of the Companies Act, 2013 needs to be read and the same is reproduced below:

"44. Nature of shares or debentures – The shares or debentures or other interest of any member in a company shall be movable property transferable in the manner provided by the articles of the company."

This implies that gifting of shares, as with any other movable property, will be permitted if the Memorandum and Articles of Association of the company permits. In the case of ***A. Lakshmanaswami Mudaliar and Ors.***[48]***,*** the SC held that the authority of a company to undertake a particular act depends on the Articles and Memorandum of Association, and the relationship between the act and the objects of the company must not be too indirect.

Further, there have been various judicial decisions on this issue and this decision in line with decisions such as ***KDA Enterprises***[49] and ***D.P. World***[50]. This is an important decision since this reiterates the legal principle and much accepted corporate position that gift by a corporate entity is permissible and it is not necessary to justify that such an action has arisen out of love and affection.

[48] A. Lakshmanaswami Mudaliar and Ors. v. Life Insurance Corporation of India and Anr., AIR 1963 SC 1185 (SC).
[49] DCIT v. KDA Enterprises, 2015 (39) ITR (Trib) 657 (Mumbai).
[50] D.P. World v. DCIT, (2013) 140 ITD 694 (Mumbai).

CASE LAW UPDATES - DIRECT TAX

CASE LAW UPDATES - MISCELLANEOUS

SC HOLDS APPLICATION OF PROVISIONS OF BLACK MONEY ACT NOT RETROSPECTIVE

In the case of ***Gautam Khaitan***[51], the SC sets aside the order of the HC which held that the impugned notification passed by the Central Government was unconstitutional as it made the penal provisions of Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015 ("**Black Money Act**"), applicable retrospectively.

FACTS

Gautam Khaitan ("**Assessee**") was one of the accused in INR 3,600 crore Augusta Westland VVIP chopper scam. The Assessee was alleged to have willfully evaded tax under Black Money Act. Accordingly, prosecution proceedings under section 51 of the said Act were initiated against the Assessee for AY 2016 - 17. Pursuant to this, the Assessee filed a writ petition before the HC seeking it to restrain the IRA from initiating assessment proceedings under the Black Money Act for AY 2016-17 since the Black Money Act came into force only on April 1, 2016 and the assessment proceedings pertain to a FY in which the said Act was not even in force. The Assessee also filed a writ petition under Articles 226 and 227 of the Constitution of India, challenging the constitutional validity of the order promulgated by the Central Government.

> **SC upholds the constitutional validity of Central Government's order bringing the Black Money Act into effect from July 1, 2015.**

The Central Government had promulgated the impugned Order[52] on July 1, 2015 under section 84 of the Black Money Act ("**Order**") which clarified that the Black Money Act shall come into force on July 1, 2015. The Order was passed on the pretext of the ambiguity around the date when Black Money Act comes into effect. Section 3(1) of the Black Money Act states that undisclosed income and assets of the PY would be relevant to the AY commencing from April 1, 2016. The term PY has been defined under section 2(9) of the Black Money Act to mean a period of 12 months immediately preceding the *AY*. Since the Black Money Act was passed by the Parliament and received Presidential Assent only on May 26, 2015, sub-section (3) to section 1 of Black Money Act was amended to state that the said Act will come into force on July 1, 2015.

The HC had, in its interim order, set aside the Centre's notification to make the Black Money Act operational with effect from July 1, 2015.

ISSUES

Whether the HC was right in observing that while exercising its powers under the provisions of sections 85 and 86 of the Black Money Act, the Central Government has made the said Act retrospectively applicable from July 1, 2015 and thereby passing the order restraining the IRA to proceed against the Assessee for AY 2016-17?

ARGUMENTS

The Assessee argued that section 1(3) of the Black Money Act explicitly provided that the said Act would come into force on April 1, 2016 and therefore, the CBDT could not issue notifications for the purposes of advancing the applicability of the said provisions to advance the said date from April 1, 2016 to April 1, 2015.

On the other hand, the IRA argued that section 86 of the Black Money Act empowers the CBDT to remove difficulties in order to give effect to the provisions of the said Act and hence, the notifications issued to prepone the applicability of the said Act are valid.

[51] Union of India v. Gautam Khaitan, (2019) 110 taxmann.com 272 (SC).
[52] Notification no. 56/2015, F. No. 133/33/2015 – TPL, dated July 1, 2015.

DECISION

The SC set aside the interim order passed by the HC and held that the Order passed by the Central Government could not be seen as a retrospective application of Black Money Act.

As per the SC, the scheme of Black Money Act is to provide stringent measures for curbing the menace of black money. Various offences have been defined and stringent punishments have also been provided. However, the scheme of Black Money Act, under section 59, also provided a one-time opportunity to make a declaration in respect of any undisclosed asset located outside India and acquired from income chargeable to tax under IT Act. Therefore, the penalty provisions under sections 50 and 51 of the Black Money Act would come into play only when an Assessee has failed to take benefit of section 59 of the said Act and has neither disclosed their foreign undisclosed assets nor paid the tax and penalty thereon.

After going through various provisions of the Black Money Act, the Court said that a conjoint reading of the various provisions revealed, that the AO could charge the taxes only from the AY commencing on or after April 1, 2016. However, the value of the said asset had to be as per its valuation in the PY. As such, even if there was no change of date in sub¬section (3) of section 1 of the Black Money Act, the value of the asset was to be determined as per its valuation in the PY. The date had been changed only for the purpose of enabling the Assessee(s) to take benefit of section 59 of the Black Money Act.

SIGNIFICANT TAKEAWAYS

It is worthwhile to highlight that section 85(3) of the said Act explicitly provides that the IRA is empowered to give retrospective effect to the rules forming part of the Act, from a date not earlier than the date of commencement of the Act itself and also that no retrospective effect shall be given to any rules which prejudicially affect the interest of the tax payers.

Although the said provision deals only with providing retrospective effect to the rules and not to the provisions of the Act itself, the legislative intent is clearly made available in the said provision i.e. the IRA cannot even make a rule retrospectively applicable, if the same is prejudicial to the interest of the tax payers.

However, sections 50 & 51 would come into play only when an Assessee has failed to take benefit of section 59. Further, section 3 of the Black Money Act itself states that the applicability is for AYs commencing on or after April 1, 2016, which automatically means FY 2015-16 is intended to be covered under the Act. Given the same, the Order passed by the Central Government may be seen as a mere clarification making the Black Money Act retrospectively applicable. Thus, the SC correctly held that the interim order passed by the HC is not sustainable in law.

NO SECTION 14A DISALLOWANCE PURSUANT TO DIVIDENDS ON SHARES HELD AS 'STOCK IN TRADE'

In the case of ***Punjab and Sind Bank***[53], the Delhi HC held that where a company was engaged in trading of shares and had earned some incidental dividend income, the expenditure incurred in acquisition of such shares cannot be disallowed under section 14A of the IT Act on the pretext that the dividend income is exempt.

FACTS

Punjab and Sind Bank **("Assessee")** a wholly owned undertaking of the Central Government, filed returns for AYs 2011-12 and 2012-13. The AO disallowed certain expenses incurred on the earning of dividend income towards the shares held as stock in trade, by invoking section 14A of the IT Act. The said section provides that if an income does not form part of the total income, then no deduction would be provided for the expenditure incurred to earn such income. The AO stated that the Assessee used its administrative, managerial, and infrastructural setup for earning all the income (including the exempt income) and that the expenditure in relation to the exempt income was inbuilt and debited under various heads as per the profit and loss account. On appeal against the AO's order, the CIT(A) deleted the disallowance which was also affirmed by the ITAT. This order of the ITAT was assailed by the IRA before the Delhi HC.

> **Shares held as stocks in trade stand on different pedestal from those acquired with an intention to retain control over the company.**

ISSUE

Whether the expenditure incurred on account of earning dividend income on shares held as stock in trade could to be disallowed under section 14A of the IT Act?

ARGUMENTS

The IRA relied on the CBDT Circular No. 5 / 2014 and the decision of ***Maxopp Invstment Ltd. v. CIT***[54] ("**Maxopp**"), to contend that the disallowance under section 14A applies to an expenditure in relation to the exempt income irrespective of whether such tax exempt income was earned from the stock-in-trade or from shares held as investments. The IRA relied on the Maxopp case to contend that the dominant purpose for which the investment into shares was made by the taxpayer was irrelevant while interpreting section 14A.

The Assessee on the other hand, contended that the shares held by it were part of its business and therefore, the expenses incurred for the purpose of such purchase were business expenses which could not be disallowed under section 14A of the IT Act. Further, the Assessee submitted that investment was held as stock in trade and it was a quirk of fate that the investee company declared a dividend. The Assessee relied on Maxopp case to contend that though the SC had rejected the theory of dominant intention, it should not lead to the proposition that irrespective of whether or not the shares are held as stock in trade, every investment made by the bank would trigger the applicability of section 14A of the IT Act.

DECISION

The Delhi HC upheld the decision of the ITAT deleting the disallowance under section 14A of the IT Act. The Delhi HC relied on the observations of the SC in *Maxopp* case that when the shares were held as stock

[53] Principal CIT v. M/S Punjab and Sind Bank, ITA 904 / 2019 (Delhi HC).
[54] Maxopp Invstment Ltd. v. CIT, (2018) 91 taxmann.com 154 (SC).

in trade, it became a business activity of the taxpayer and it was immaterial whether or not any dividend was earned on such shares. HC further observed that where a taxpayer entity held shares to have continuous control over an investee entity, it was certain that the taxpayer would earn the dividend income and therefore, the disallowance under section14A would get attracted only in such cases. However, when the shares were held as stock in trade, the main purpose was to liquidate those shares at profits and it was only by a quirk of fate that the Assessee earned the dividend income. The HC relied on these observations and dismissed the appeals of IRA.

SIGNIFICANT TAKEAWAYS

The issue of disallowance under section 14A of the IT Act had been subject to much litigation in the past. It was expected that the SC ruling in the *Maxopp* would settle this issue and provide certainty to the business entities. The confusion arose on account of the fact that while the SC rejected the dominant purpose theory in clear terms stating that the intention behind the investment was immaterial for applicability of section 14A of the IT Act. The SC also distinguished between shares held as stock in trade from the situation where the shares have been held as investments.

The Delhi ITAT in ***Nice Bombay Transport (P) Ltd. v. ACIT***[55] and in the present case, relied on the Maxopp judgment to hold that stocks in trade stand on a different pedestal from those acquired with an intention to retain control over the company for purposes of section 14A. Notably, Rule 8D of the IT Rules itself, which deals with the formula of computation of disallowance under section 14A, provides for calculation based on the value of investments and as such, should not be made applicable to shares held as stock in trade instead of investments.

The Delhi HC in the extant case did not discuss the Maxopp ruling in detail, but relied on the observations made in the case to hold that section 14A will not apply to dividend income earned on shares held as stock in trade.

[55] Nice Bombay Transport (P) Ltd. v. ACIT, (2019) 103 taxmann.com 338 (Delhi ITAT).

EXPENDITURE INCURRED ON ISSUANCE OF BONUS SHARES IS A DEDUCTIBLE REVENUE EXPENDITURE

In the case of ***Empower India Ltd.***[56]***,*** the ITAT held that the expenditure incurred on issuance of bonus shares does not lead to expansion of the capital base of the company and, therefore, it is a deductible revenue expenditure.

FACTS

M/s Empower India Ltd. ("**Assessee**") incurred expenses aggregating to INR 86 Million on account of increase in authorized share capital for issuing shares, including bonus shares, as fees to Registrar of Companies and stamp duty. The Assessee treated such expenditure as revenue expenditure and claimed deductions. The AO during the course of assessment proceedings had disallowed the said expenses which was appealed before CIT(A). The CIT(A), upheld the order of the AO, by holding that the expenses were capital in nature. An appeal was filed against this order before the ITAT.

ISSUE

Whether the expenditure incurred on the issuance of shares, including bonus shares, was a deductible revenue expenditure?

ARGUMENTS

The IRA contended that the expenses were incurred for the purposes of increasing the authorized share capital of the company, which resulted in expansion of capital base of the company. Therefore, above said expenditure was capital in nature which could not be allowed as a deductible revenue expenditure under section 37(1) of the IT Act. The IRA relied on the decisions in case of ***Punjab State Industrial Development Corporate Ltd. v. CIT***[57], and ***Brooke Bond India Ltd. v. CIT***[58] to contend that fee paid to the registrar for expansion of capital base of the company was directly related to expansion of capital base of the company and thus, was in the nature of capital expenditure.

The Assessee, on the other hand, claimed that expenses incurred in the nature of fees for increase in authorized share capital and stamp duty were due to issuance of bonus shares. Issuance of such bonus shares did not result in any inflow of capital or expansion of its capital base and thus, could not have been a capital expenditure. Accordingly, the Assessee submitted that the expenses were in the nature of deductible revenue expenditure.

DECISION

The ITAT observed that out of the total expenses incurred with respect to issuance of shares, INR 56 Million pertained to issuance of bonus shares. The ITAT held that these expenses on issuance of bonus share capital, was a mere capitalization of reserve by reallocation of companies funds and there was no inflow of fresh funds or increase in capital employed or expansion of capital base of the Assessee. The ITAT held that the Assessee did not acquire any benefit or advantage of enduring nature and thus expenses incurred on issuance of bonus shares were not capital expenditure but deductible revenue expenditure. The ITAT further held that the balance expenditure on issuance of shares other than bonus shares led to an increase in share capital and was not a deductible revenue expenditure.

> **"Expenses incurred in connection with issue of bonus shares should be regarded as tax deductible expenditure."**

[56] CIT v. M/s Empower India Ltd., ITA No. 5207 of 2017 (Mumbai ITAT).
[57] Punjab State Industrial Development Corporation. Ltd v. CIT, (1997) 93 Taxman 5 (SC).
[58] Brooke Bond India Ltd v. CIT, 91 Taxman 26 (SC).

SIGNIFICANT TAKEAWAYS

The treatment of expenditure incurred on issuance of shares, including bonus shares, has been an issue under litigation with courts taking different views. The SC in ***Punjab State Industrial Development Corpn. Ltd v. CIT***[59] and ***Brooke Bond India Ltd v. CIT***[60] had held that issuance of shares result in expansion of the capital base, and thus the concerned expenditure on issuance of such shares is a capital expenditure. The Gujarat[61] and Andhra Pradesh[62] HCs had earlier held that the expenses incurred toward issuance of bonus shares were to be regarded as capital expenditure. The Bombay[63] and the Calcutta[64] HC drew a distinction between an issue of fresh shares and the issue of bonus shares, and held that the expenditure on the latter did not result in an expansion of the capital base and thus, was not a capital expenditure.

The SC in ***CIT v. General Insurance Corporation***[65], considered these conflicting views and held that issuance of bonus shares is a mere reallocation of company's funds which did not result in expansion of capital base of the company. As such, expenditure on issuance of bonus shares was held to be a deductible revenue expenditure. The present decision of the ITAT is in consonance with the SC decision, that for the purpose of disallowance of an expenditure as capital expenditure, it should result in the expansion of capital base of the company, by fresh inflow of capital.

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59 Punjab State Industrial Development Corporation. Ltd v. CIT, (1997) 93 Taxman 5 (SC).
60 Brooke Bond India Ltd v. CIT, 91 Taxman 26 (SC).
61 Ahmedabad Manufacturing and Calico (P) Ltd. v. CIT, (1986) 162 ITR 800 (Gujarat HC).
62 Vazir Sultan Tobacco Co. Ltd. v. CIT, (1990) 184 ITR 70 (Andhra Pradesh HC).
63 Bombay Burmah Trading Corporation v. CIT, (1984) 145 ITR 793 (Bombay HC).
64 Wood Craft Products Ltd. v. CIT, (1993) 204 ITR 545 (Calcutta HC).
65 CIT v. General Insurance Corporation, (2006) 156 Taxman 96 (SC).

WAIVER OF LOANS TAKEN FOR ACQUIRING CAPITAL ASSETS ARE NOT TAXABLE

In the case of ***Colour Roof (India) Ltd.***[66] the Bombay HC, following the SC judgment in the case of ***Mahindra and Mahindra Ltd.***[67], held that the waiver of loan, taken for the purpose of acquiring capital assets, would not be taxable under the IT Act, provided no deduction has been claimed in respect of such loan.

FACTS

Colour Roof (India) Ltd. ("**Assessee**"), a company engaged in the business of manufacturing steel profiles and coils, had obtained a loan which was waived off by the lenders. The AO sought to tax the waiver of loan under section 41(1) of the IT Act, which seeks to tax a benefit that the taxpayer receives by way of waiver of a trading liability in respect of which the taxpayer has claimed any deduction in any PY.

However, in appeal before the CIT(A), the CIT(A) observed that the loan was not obtained on account of a trading transaction and the Assessee had not claimed any deduction in respect of the same. Thus, the CIT(A) held that the said waiver of loan was not taxable under section 41(1) of the IT Act and deleted the said addition. The ITAT also upheld the decision of the CIT(A). Aggrieved of the ITAT's order the IRA appealed to the HC.

> **"Waiver of loans taken for acquiring capital assets are not taxable."**

ISSUE

Whether in the facts and circumstances of the case, the waiver of loan was taxable in the hands of the Assessee under the IT Act?

ARGUMENTS

It was argued on behalf of the IRA that the loan was taken from agents / dealers and therefore, it necessarily had to be on the revenue account. Accordingly the waiver of the said loan should have been brought to tax under section 41(1) of the IT Act.

On the other hand, the Assessee pointed out that the loan was taken for the purposes of acquiring a capital asset and the Assessee had not claimed any deduction with respect to the same. Accordingly, the Assessee argued that the *sine-qua-non* of section 41(1), were not satisfied in the instant case, therefore section 41(1) could not be invoked.

DECISION

The Bombay HC observed that before the ITAT, the IRA had conceded that section 41(1) of the IT Act was not applicable in the instant case. It also observed that both the CIT(A) and the ITAT had confirmed that the loan was obtained for acquiring a capital asset and that the Assessee had not claimed any deduction with respect to the same. In light of the aforementioned observations, the HC placed reliance on the SC decision in the case of ***Mahindra and Mahindra Ltd*** and held that the *sin-qua-non* of section 41(1) of the IT Act was not satisfied in the instant case. For section 41(1) of the IT Act to be attracted there should be an allowance or deduction claimed by the taxpayer in respect of a loss, expenditure or trading liability, which is subsequently waived. Accordingly, the HC ruled that section 41(1) was not applicable and the waiver of loan could not be brought to tax under the IT Act.

The HC also dismissed the argument of the IRA that the waiver of loan can be brought to tax under section 28(iv) of the IT Act, which seeks to tax, value of perquisite or benefit (whether convertible into monies or not), arising from a business. The HC explained that

[66] PCIT v. Colour Roof (India) Ltd., ITA NO. 896 of 2017 (Bombay HC).
[67] CIT v. Mahindra and Mahindra Ltd., (2018) 404 ITR 1 (SC).

it was not open for the IRA to raise a new line of argument for the first time before the HC. Further, as held in the case of *Mahindra and Mahindra Ltd.,* the HC pointed out that section 28(iv) would only be applicable in case of perquisites arising from a business and since the loan was on capital account, the section 28(iv) was not applicable.

SIGNIFICANT TAKEAWAYS

This decision primarily follows the SC decision in the case of *Mahindra and Mahindra Ltd.,* where in the SC had upheld that view that section 28(iv) of the IT Act only applies where the benefit or the perquisite is in the form other than money and waiver of loan does not satisfy this requirement. Similarly, the SC upheld the principle that section 41(1) would only apply in case of cessation of trading liability. Though the taxability of waiver of loans under section 41(1) and section 28(iv) of the IT Act, has been settled in light of this SC judgement, the ambiguity regarding applicability of MAT under section 115JB of the IT Act to such waivers, still looms at large.

As per the applicable accounting standard the benefit arising from waiver of loan is required be included in the book profits, irrespective of the fact that whether such loan has been taken for acquiring a capital asset or otherwise. Thus, a per the literal interpretation of the section 115JB, along with applicable accounting standards, waiver of loans may attract MAT, even if the same is not subject to tax under the IT Act.

Having said the above, in ***JSW Steel Ltd.***[68], the Mumbai ITAT has held that waiver of loan taken for acquiring capital asset would not be taxed in the hands of the company, both, under the normal provisions of the IT Act as well as under MAT provisions. Further, based on the legislative intent behind introducing MAT, (i.e. to levy tax on companies which did not pay any income tax even though they made profits and declared significant dividends) it is arguable that it was never the intention of the legislature to subject a benefit received by a company to MAT when such benefit did not qualify as income under the IT Act. However, in absence of any binding judicial precedent or statutory guidance in relation to applicability of MAT in case of waiver of loans, one would have to wait for the higher judiciary to clarify this issue.

[68] JSW Steel Ltd. v. Asst. CIT, (2017) 82 ITR 210 (Mumbai ITAT).

PENNY STOCKS ARE NOT ELIGIBLE FOR CAPITAL GAINS EXEMPTION

In the case of ***Shri Narendra Shrikishan Agrawal***[69], the ITAT denied a long term capital-gains ("**LTCG**") tax exemption on the ground that capital gains arose from 'penny stock' investment which was used as a device to launder black money.

FACTS

Shri Narendra Shrikishan Agarwal ("**Assessee**"), a director in M/s Sagar Pardhan Pvt. Ltd., had filed his return of income for AY 2015-16 and had presented some income as capital gains arising from sale of shares of Lifeline Drugs and Pharma Ltd. ("**LDPL**"). The Assessee had purchased 25,000 shares of INR 10 each (converted into 2,50,000 shares of INR 1 each) of LDPL for INR 15,00,000, out of which 43,000 shares were sold during the concerned year resulting in capital gain of INR 10.4 million.

The AO denied the exemption claimed on LTCG on the ground that the capital gains were not genuine but, based on premeditated actions taken with a specific intention to book capital gains by a dubious method. The AO observed that the Assessee, LDPL and other suspected entities linked to LDPL were laundering black money and raking in tax free profits. The AO treated the said amount of INR 10.4 Million as unexplained cash credit. The action of the AO was confirmed by CIT(A). An appeal against this order was filed before the ITAT.

> **Profits earned from the sale of penny stocks would not be entitled for capital gains exemption.**

ISSUE

Whether the transactions resulting into capital gains were premeditated, and thus, the exemption on LTCG was liable to be denied?

ARGUMENTS

The Assessee contended that the AO, merely based on the presumptions, suspicion and surmises treated the capital gains from sale of listed shares as non-genuine. The Assessee submitted that the purchase and sale of shares took place on the stock exchange and all documents in support of the said transactions were filed before the AO and CIT(A). The Assessee contended that the AO had failed to demonstrate how the Assessee had any nexus with the alleged share brokers and purchasers. He further submitted that LDPL had share capital and reserves of INR 212.7 Million and a revenue of INR 408.5 Million during the FY 2013-14.

The IRA contended that LDPL had no revenue on business operations as on March 31, 2012 and March 31, 2013. However, LDPL had shown revenue from business operations of INR 400 Million as on March 31, 2014 without any corresponding expenditure (salaries, transportation, etc.) pertaining to the said revenue from business of textiles. The IRA stated that LDPL declared profit after tax for INR 0.1 Million for FY 2010-11, INR 0.3 Million for FY 2011-12, INR 1.4 Million for FY 2012-13, INR 6.5 Million for FY 2013-14 and argued that there was no credibility between the transactions of Assessee purchasing LDPL shares at low prices and booking capital gains thereon by selling those shares at exorbitant prices. The IRA contended that the shares were purchased by an entity, controlled and managed by another entity which was in turn managed by Anuj Agarwal. The IRA relied on the statements of Anuj Agarwal wherein he admitted that all the companies involved in the transaction were using the same registered office and did not maintain

[69] Shri Narendra Shrikishan Agrawal v. ACIT, ITA No. 257 of 2019 (Pune ITAT).

any books of accounts. The IRA also relied on a statement given by one of the employees of these companies to contend that they were engaged in providing capital gains / loss to various entities through jamakarchi companies and LDPL was one of the major scrips dealt by them for bogus LTCG purposes.

DECISION

The ITAT examined the transactions in detail and observed that the LTCG were a result of pre-organised transactions and pre-meditated steps with connivance of several parties. Accordingly, it was held that as the transaction was a device used to launder black money, the Assessee was not eligible for the LTCG exemption. Several instances basis which the ITAT reached such conclusion include, *inter alia*, (i) Assessee purchased the LDPL shares through preferential allotment for INR 60 (face value of INR 10) per share when value of such shares was INR 2.13 on the stock exchange; (ii) the prices of LDPL shares multiplied by around 350 times in a year despite no revenue from business operations; (iii) Assessee invested in LDPL which had poor financials and no major corporate announcements only because of the fact that paper entities such as LDPL, the purchaser, brokers, etc. were working together to launder black money and rake tax free profits; (iv) BSE suspended the trading in the securities of LDPL with effect from August 20, 2015 as an interim preventive and remedial measure to maintain orderly development in the stock market.

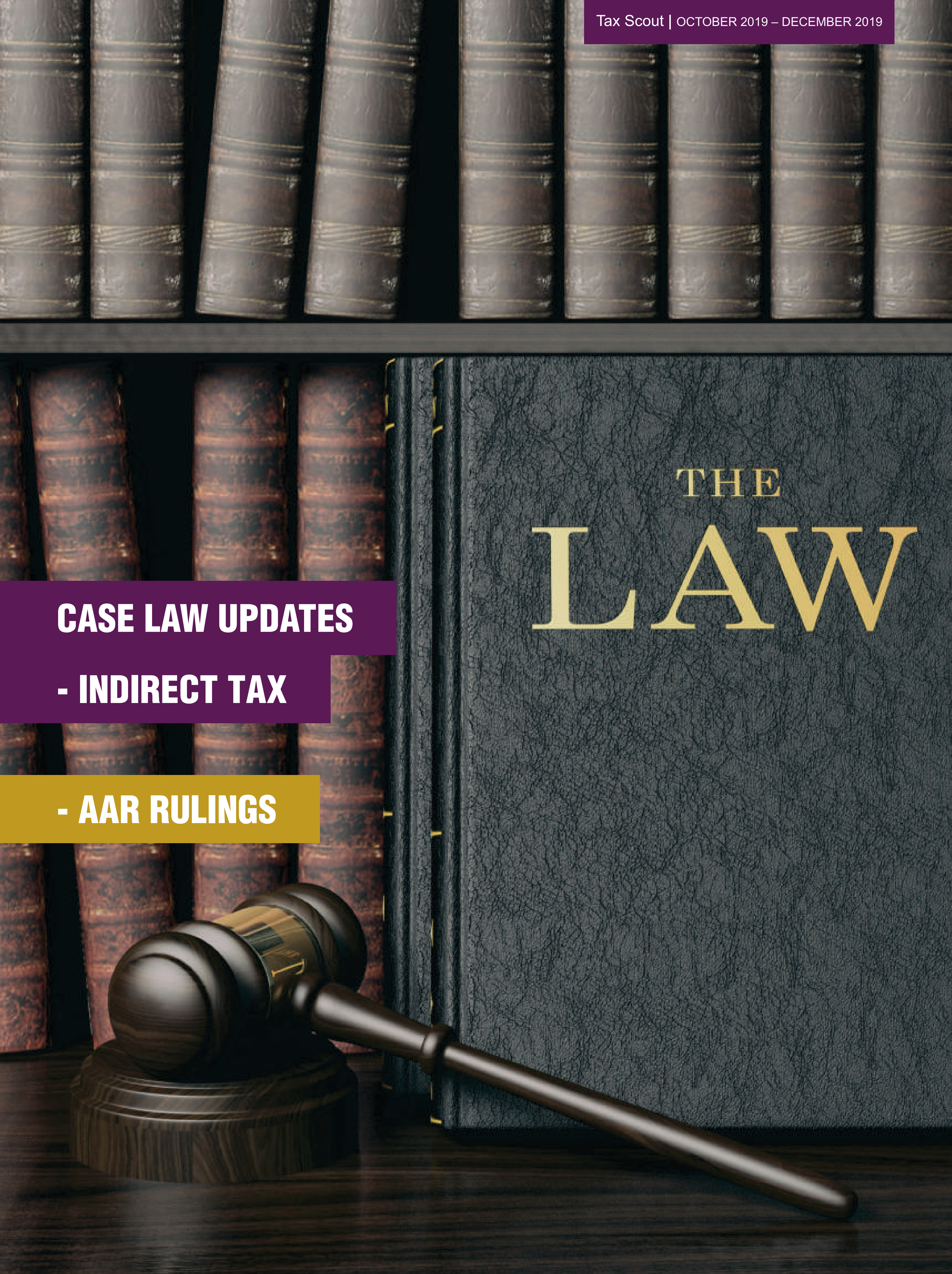
The ITAT noted that the Assessee failed to controvert the statements of Anuj Agarwal and the employee who had explained the modus operandi between the beneficiary, exit provider, stock broker and held that these entities were created for the purpose of booking bogus LTCG. The ITAT relied on the Bombay HC decision in ***Sanjay Bimal Chand Jain***[70] where the taxpayer had purchased shares of an unknown company worth INR 5 and the price of such shares jumped to INR 485 without any economic or finance basis, the HC denied LTCG tax exemption. Further, the ITAT relied on the Delhi Hc[71] decision wherein the HC had held that a price rise of over 491% in 5 months defied business logic and had denied the LTCG tax exemption.

SIGNIFICANT TAKEAWAYS

The issue of denial of LTCG on the sale of penny stocks has been subject to widespread litigation before the judicial forums. Recently, the Delhi HC[72], Chennai[73] and Pune[74] ITATs have also denied the LTCG tax exemption on sale of penny stocks on the ground that the taxpayers had failed to prove the genuineness of the transactions resulting in capital gains. However, it is pertinent to note that if there is sufficient evidence on record to establish the genuineness of a transaction, then mere investment in a penny stock would not lead to the denial of any exemption.[75]

It is a settled position of law that if the sole purpose of a transaction is to avoid tax liability, then such transactions may be disallowed even though they are perfectly legal. The legislature introduced GAAR (which became effective from April 1, 2017) to prevent tax avoidance through participation in arrangements that are not *bona fide* or lack commercial substance. Therefore, tax payers should ensure that they are in a position to establish commercial wisdom behind its arrangements to avoid a denial of tax benefits on grounds of violation of principles of GAAR.

70 Sanjay Bimalchand Jain v. PCIT, ITA No. 18 / 2017 (Bombay HC).
71 Suman Poddar v. ITO, ITA No. 841/2019 (Delhi HC).
72 Suman Poddar v. ITO, ITA No. 841/2019 (Delhi HC).
73 Harish Kumar HUF v. ITO, TS 306 ITAT 2019 (Chennai ITAT).
74 Rajkumar B. Agarwal v. DCIT, TS 5 ITAT 2019 (Pune ITAT).
75 Smt. Vandana Sankhala v. ACIT, TS 647 ITAT 2018 (Chennai ITAT); Mool Chand Jagwayan v. ITO, TS 326 ITAT 2019 (Kolkata ITAT).



CASE LAW UPDATES

- INDIRECT TAX

- AAR RULINGS

PREPAID PAYMENT INSTRUMENTS ARE NOT ACTIONABLE CLAIMS UNDER GST

In the case of ***M/s Kalyan Jewellers India Ltd.***[76]***,*** the Tamil Nadu AAR held that Prepaid Payment Instruments ("**PPI**") are covered under the definition of 'vouchers' under GST and cannot be classified as actionable claims. Therefore, GST would be chargeable on issuance of PPIs.

FACTS

M/s Kalyan Jewellers India Ltd. ("**Applicant**") was a manufacturer and trader of gold and other jewellery items. The Applicant introduced a facility of issuing the following types of PPIs to its customers:

1. Closed System PPIs: These PPIs were issued upon receiving the face value as per customers' requirement. The customer could redeem these PPIs at an outlet of the Applicant.
2. Semi Closed PPIs: The Applicant entered into an agreement with Third Party Issuer (Quick Silver Solutions Pvt. Ltd.), wherein it issued PPIs to the third party issuer at a discounted price and the Third Party Issuer would then issue those PPIs to the customers at the face value. The difference of the face value and discounted value ("**Differential Amount**") was the incentive for the third party issuer.

ISSUES

I. Whether the PPIs issued by the Applicant to the customers and the Third Party Issuer could be treated as supply of goods or services under GST?

ii. If yes, what was the time of supply, value of supply and rate of taxes applicable on such supply?

iii. Whether the PPIs issued by the Third Party Issuer could be treated as supply of goods or services under GST?

iv. Whether GST was payable on the Differential Amount?

v. Whether the Applicant was liable to pay GST on the Differential Amount?

ARGUMENTS

The Applicant argued that PPIs were either actionable claims or equivalent to money and therefore, issuance of PPIs was not in the ambit of supply of goods or services under the GST legislations. The Applicant submitted that no goods were sold or provided to the customers in lieu of the cash received by them, at the time of issuance of PPIs. The amounts received for such Closed System PPIs were accounted under "Other Current Liabilities" and were treated like claims to debt of the customers. Therefore, Closed System PPIs were in the nature of actionable claim.

> **"PPIs are neither actionable claims nor money. PPIs fall under the definition of 'voucher' under GST."**

Further, with regard to Semi-closed PPIs, the Applicant submitted that such PPIs were issued in the form of "gift cards" by the Applicant itself and were redeemable at the designated stores specified by the Applicant. The only difference between the Closed System PPIs and Semi Closed PPIs was that the latter were provided through Third Party Issuer who activated the same before sale. Therefore, even in the latter case, the issuer of the PPIs was the Applicant itself. The Third Party Issuer was not issuing the PPIs and hence, in essence even such PPIs were closed system PPIs. The Third Parties Issuer merely acted as an agent for sale of such PPIs.

[76] In Re Kalyan Jewellers India Limited, Order No. 52/ARA/ 2019, dated November 25, 2019 (Tamil Nadu AAR).

The Applicant further submitted that the PPIs were covered under the Payment and Settlement Systems Act, 2007 and were recognized by civil courts as actionable claims under the Transfer of Property Act, 1882 as well. The Applicant also relied on the decision of the SC in the case of ***M/s Sodexo Svc India Private Limited***[77], wherein the SC had held that the vouchers could not be treated as goods for the purpose of levy of octroi. The Applicant argued that the PPIs in the present case were also neither goods nor services.

The Applicant submitted that in the instant case, the actual supply of goods or services were effected at the time of redemption of the PPIs, and the GST was leviable on such goods/services at the time of such supply at the applicable rates.

DECISION

The AAR looked into the nature of PPIs and noted that these were just an alternative method to pay for jewellery and were accepted as valid consideration. Therefore, such PPIs were squarely covered under the definition of "Payment Instrument" in the Payment and Settlement Act, 2007, which included any instrument through which payment would be effected by a person to a system participant, including an issuer.

The AAR however, disagreed with the contention of the Applicant and stated that the PPIs did not afford any claim to a debt nor did they give any beneficial interest in any movable property to the holder. If the holder did not present the PPI for redemption before the specified time limit, or if such a PPI was lost or misplaced, it would become invalid. Therefore, the PPIs could not be classified as an 'actionable claim' as defined under the Transfer of Property Act, 1882.

The AAR further noted that in the present case, the gift cards were purchased by the customers on payment of money. The holder of such gift card or PPIs could purchase jewellery at any store of the Applicant and pay with either cash or the gift card/PPIs. The AAR held that the instruments which satisfied the condition of being accepted as consideration/part consideration against purchase of goods and the identities of the potential suppliers were indicated in the instruments, were considered as 'voucher' as defined under section 2(118) of the CGST Act[78], and therefore, exigible to GST.

The AAR held that as the PPIs were not actionable claim and were also moveable, they were classifiable as goods under the GST legislations. It was also held that the PPIs were purchased for a consideration by the customers i.e. the face value of the PPIs, in furtherance of its business by the Applicant. Therefore, issuance of PPIs was to be treated as 'supply' under GST.

The AAR also referred to section 12(4) of the CGST Act for determination of time of supply in case of vouchers and held that as most of the PPIs would be redeemable against any jewellery bought, the time of supply would be the date of redemption.

As regards the rate of supply, the AAR made a distinction between paper PPIs and digital PPIs and stated that the printed vouchers were covered under Chapter 4911 of the Customs Tariff Act i.e. other printed matter. Therefore, GST was chargeable at 12% on paper PPIs. Whereas, digital PPIs were classifiable under Chapter 8523 of the Customs Tariff Act i.e. smart cards and GST thereon was leviable at 18%.

Lastly, with respect to the levy of GST on the differential Amount, the AAR noted that the Third Party Issuer was located in Bangalore and supplied its services to Kalyan Jewellers India Ltd. located in Kerala. The AAR therefore, held that it did not have the jurisdiction to answer this query for advance ruling.

SIGNIFICANT TAKEAWAYS

The aforesaid ruling of the AAR seems to be flawed in its interpretation. The decision has ignored various judicial interpretations which treat coupons and vouchers as actionable claims. The SC in the case of ***Sodexo (Supra)*** also held that vouchers are not to be treated as goods. Therefore, this ruling, instead of

[77] Sodexo Svc India Private Limited v. State of Maharashtra, Writ Petition Nos. 5653 of 2010 (SC).
[78] In terms of Section 2(118) of the CGST Act vouchers means an instrument where there was an obligation to accept the voucher/ gift card as a valid consideration or part consideration against a supply of goods or services.

clarifying the persistent issue in the GST regime, has made it even more complicated by taxing PPIs as goods. Another anomaly that exists in the ruling is that it has not taken consideration of the fact that charging GST on both the value of the PPI as well as the goods supplied against it i.e. jewellery would lead to an issue of double taxation. With rise in issuance of different type of vouchers by businesses across various industries in the recent past, the present AAR ruling opens a flood bank of litigation before various judicial forums.

ITC OF GST NOT AVAILABLE ON INPUTS WHICH ARE PREREQUISITE FOR OFFICE SPACE

In the case of ***Wework India Management Pvt. Ltd.***[79]***,*** the Karnataka AAR held that detachable wooden flooring is not 'immovable property' and hence, ITC could be availed on the same. Whereas, the sliding and stacking glass partitions used at a co-working space were a prerequisite to the office space and hence, became immovable property. Therefore, no ITC would be available on the inward supply of sliding and stacking glass partitions.

FACTS

Wework India Management Pvt. Ltd. ("**Applicant**") was engaged in supplying shared office space to the freelancers, start-ups, small businesses and large enterprises on rent. Towards this end, the Applicant had *inter-alia* procured detachable 14mm engineered wood with oak top wooden flooring ("**Wooden Flooring**") and detachable sliding and stacking glass partitions ("**Glass Partitions**") for fitting-out of the workspaces and paid GST on the same.

"Declaration of an asset in the books of account does not determine its nature as moveable or immovable property."

ISSUE

Whether the Applicant could avail ITC on Wooden Flooring and Glass Partitions?

ARGUMENTS

The Applicant submitted that the Wooden Flooring and Glass Partitions were installed in office spaces rented out by them, and therefore, were used in furtherance of their business. Hence, the Applicant was entitled to avail ITC on GST paid on the purchase of the aforesaid items under Section 16 of CGST Act.

The Applicant emphasized that section 17(5) of the CGST Act used the phrase 'for' construction and not 'in relation to'. The Applicant argued that the word 'for' was defined to mean as 'for the purpose of' or 'in the interest of' or 'to the benefit of', etc., which implied that the goods/ services were to be used directly for construction of immovable property in the instant case. However, Wooden Flooring and Glass Partitions were just addition to the already existing and fully constructed building and not inextricably linked to the construction itself and therefore, were not covered within the exclusion of section 17(5) of the CGST Act.

The Applicant contended that the Wooden Flooring and the Glass Partitions were neither rooted/ embedded in the earth nor attached for the permanent beneficial enjoyment but were fixed using the streap foam and nut and bolts to a foundation intended to provide stability, respectively. Such Wooden Flooring and Glass Partitions could be easily dismantled and re-used and were not intended to be set up permanently and could be moved basis the business requirements. Therefore, the aforesaid items were covered under the ambit of 'movable property' eligible for ITC under the CGST Act.

The Applicant further argued that since Wooden Floorings and Glass Partitions could be detached and reused, they were not permanent civil assets. These items were also not capitalized as 'immovable property' but were recorded as 'furniture and fixtures' in the books of accounts.

DECISION

The AAR accepted the contention of the Applicant that Wooden Flooring and Glass Partitions were used by

[79] Wework India Management Pvt. Ltd., (2019) 110 taxman.com 288 (Karnataka AAR).

the Applicant in furtherance of his business and that he was eligible to ITC of tax paid on inward supplies, subject to the conditions and restrictions prescribed under the GST laws.

However, with regards to the contention of the Applicant in relation to capitalisation of products in the Books of Accounts, the AAR held that mere capitalising of such products under the fixed assets head 'furniture and fixtures', in the books of accounts would not change their nature of being an immovable property. The AAR held that the Accounting Standards did not classify property as movable or immovable property, and an asset classified as fixture could still be a movable or an immovable property.

The AAR observed the office space was an immovable property and Glass Partitions attached to the building separated the places given on rent. The Glass Partitions were prerequisite for letting out the office space and therefore, were to be treated as permanently fastened to the building. The AAR therefore, held that Glass Partitions amounted to addition / alteration, i.e. construction of an immovable property, and hence, no ITC was available.

However, the AAR held that the Wooden Flooring was not a prerequisite for the office space. As the Wooden Flooring could be removed and replaced without any damage either to the building or the Wooden Flooring, there was no permanence involved in its fastening and hence, it did not amount to construction of immovable property. Hence, the Petitioner was allowed to avail ITC on Wooden Flooring.

SIGNIFICANT TAKEAWAYS

While the present ruling of the AAR is yet another ruling on the issue of ITC on furniture and fixtures, this ruling brings out certain interesting facts. In this ruling, the AAR has, instead of examining whether the furniture and fixtures were 'immovable property' or not, looked into whether such furniture and fixtures were prerequisite for office space. In our view, merely being a prerequisite for renting an office space does not classify a particular item as 'immovable property'. The AAR has clearly ignored the facts that the glass partitions were detachable and could easily be moved from one place to another without any damages. The present AAR ruling, thus, reinforces the principle that there cannot be an exhaustive list of goods / services on which ITC is available and such availability would depend on case to case basis.

REIMBURSEMENT OF DISCOUNT/REBATE FROM THE SUPPLIER IS EXIGIBLE TO TAX

In the case of ***M/s Santosh Distributors***[80], the Kerala AAR held that the additional/scheme discount given as per the directions of the principal company and later reimbursed by it was to be included in the value of supply made by the assessee to the customer.

FACTS

M/s Santosh Distributors ("**Applicant**") was an authorized distributor of M/s Castrol India Ltd., Mumbai ("**Principal Company**") for the supply of castrol brand industrial and automotive lubricants. The Principal Company had various rate scheme with customers. Further, all distributors were mandatorily required to use the billing software of the Principal Company for further supply. The billing done by the Applicant was based on various rate schemes pre-fixed by the Principal Company in the billing software. At the time of generation of the invoice by the Applicant, the software deducted the discounts as per the schemes and the net price was charged to the customers. The Applicant was bound to supply the products to the respective customers as per the value shown in the invoice. Such discount / rebate was subsequently reimbursed by the Principal Company on issuance of Commercial Credit Notes.

> **"Reimbursement of discount is a part of consideration in the hands of the distributor."**

ISSUES

i. Whether the discount provided by the Principal Company to their customers through the Applicant would attract GST?

ii. Whether the amount shown in the commercial credit note issued by the Principal Company to the Applicant would attract proportionate reversal of ITC?

iii. Whether the amount received as reimbursement of discount or rebate in terms of the written agreement between the Principal Company and their customers and agreement between the Principal Company and the Applicant, was exigible to GST?

ARGUMENTS

The Applicant submitted that the each of the products were identifiable basis the product codes and invoice pricing as per the software and was controlled by the Principal Company and the distributors. The Applicant had no control over it. The additional discount/ scheme discount was given by the Applicant to the particular customers as directed by the Principal Company and was intended to augment the sales volume. The Applicant had no control either on the quantum of scheme discount to be offered or on the category of customers to whom the scheme discounts was to be offered. The discounts were offered as per instructions of the Principal Company and were completely reimbursed by them.

DECISION

The AAR noted that value of taxable supply was governed by section 15 of the CGST Act and the deduction of discounts from the value of taxable supply was subject to the conditions prescribed in section 15(3) of the CGST Act. The AAR further observed that the commercial credit notes did not satisfy the conditions of section 15(3) of the CGST Act. As the original tax was not reduced, ITC was available as per the invoice raised by the Principal Company, subject to payment of the value of supply reduced by the value of commercial credit notes plus the amount

[80] In re M/s Santosh Distributors, 2019-TIOL-433-AAR-GST (Kerala AAR).

of the original tax charged. Hence, no reversal of ITC was required in respect of the commercial credit notes. The AAR also observed that the additional discounts given by the Applicant were given as per the directions of the Principal Company and were intended to augment the sales. The Applicant had no control over the discount schemes. The AAR held that discounts represented the consideration flowing from the Principal Company to the Applicant for the supply made to the customers. Hence, the discount was liable to be added to the value of supply made to the customer in terms of section 15 of the CGST Act.

SIGNIFICANT TAKEAWAYS

In the said ruling the AAR did not refer to Circular No. 105/24/2019-GST dated June 28, 2019 ("**Circular**") which was issued to clarify positions on post-sale discount schemes. However, the position taken by the AAR is in line with the Circular. However, it is relevant to note that the said Circular was withdrawn w.e.f. October 03, 2019 *vide* Circular No. 112/31/2019 dated October 03, 2019, without providing clarity on the impact of the withdrawal for the period the Circular was applicable. The clarity is still awaited on the impact of the prospective withdrawal of the Circular on the transaction on which GST had been paid based on the clarifications provided in the Circular.

IGST PAYABLE BY IMPORTER ON OCEAN FREIGHT INCLUDED IN THE VALUE OF IMPORTED GOODS

In the case of ***M/s Indian Potash Ltd.***[81], the Andhra Pradesh AAR held that transportation of goods by a vessel from a non-taxable territory to a taxable territory amounts to import of service. Hence, the importer was liable to pay IGST on the ocean freight as the transportation service qualifies as an inter-state supply. Further, the AAR also spelt out that IGST was payable under reverse charge mechanism ("**RCM**") regardless of the valuation adopted in relation to the imported goods [free on board ("**FOB**") or cost inclusive of freight ("**CIF**")].

FACTS

M/s Indian Potash Ltd ("**Applicant**") was engaged in import-handling, promotion and marketing of fertilisers in the entire country. The Applicant primarily imported fertilizers on CIF basis. However, on some instances, the goods were imported on FOB basis and the Applicant would engage a shipping company to provide transportation services. In terms of a Notification No. 10/2017 – Integrated Tax (Rate) dated June 28, 2017, the importer is required to pay IGST on RCM on the amount of deemed ocean freight equal to 10% of the value of goods imported.

> **"IGST is payable on ocean freight irrespective of valuation adopted for the import of goods i.e. FOB or CIF."**

ISSUES

i. Whether the transaction was import of service and inter-state supply?

ii. Whether the Applicant could be deemed as the recipient of the service?

iii. Whether the Applicant was liable to pay tax on the transaction under RCM?

iv. Whether the levy of IGST on ocean freight as a service, while levying customs duties by including freight charges in the value of imported goods, amounted to double taxation?

ARGUMENTS

The Applicant was of the view that levy of IGST on ocean freight resulted in double taxation since it had already included in the value of the goods imported into India, while computing the customs duties payable on the goods.

The AAR observed that in terms of section 7 of the IGST, transportation of goods in a vessel from a non-taxable territory to a taxable territory amounted to import of service and such ocean freight would be leviable to IGST as an inter-state supply of service. Further, the AAR also observed that the Applicant was the recipient of both goods and services as the consideration paid for the transaction was inclusive of freight as well. Accordingly, the AAR stated that the Applicant, being an importer, was liable to pay IGST under RCM. Furthermore, there was no exemption available under the GST legislations for payment of IGST on ocean freight in case where IGST was paid on the goods imported into India.

DECISION

The AAR held that transportation of goods in a vessel from a non-taxable territory to taxable territory amounted to import of service and such ocean freight was leviable to IGST, as an inter-state supply of service under RCM in terms of Notification No. 10/2017 - Integrated tax (Rate) dated July 28, 2017,

[81] In re M/s Indian Potash Ltd., TS-1068-AAR-2019-NT (Andhra Pradesh AAR).

basis the valuation prescribed vide Notification No. 8/2017-Integrated Tax (Rate) dated July 28, 2017, irrespective of valuation adopted for the import of goods i.e. FOB or CIF.

Further, in relation to the issues raised on double taxation and cascading effect leading to accumulation of credit, the AAR held that the same fell beyond the purview of section 97 of CGST Act. Accordingly, the AAR did not its decision in relation to the same.

SIGNIFICANT TAKEAWAYS

Levy of IGST on ocean freight has been a matter of extensive litigation. The Madhya Pradesh AAR[82] had rejected the challenge to the validity of levy of IGST on ocean freight under RCM and held that IGST is leviable on ocean freight paid on imported goods under RCM even when the ocean freight formed part of the CIF value of imports. Further, the matter is sub-judice before various HCs. Recently, the Karnataka AAR[83] also held that IGST was payable by the importer on ocean freight in case of a contract on CIF basis under RCM, subject to the final decision of the HC.

[82] In re M/s E-DP Marketing Pvt. Ltd., 01/2019/AAR/R-28/14 (Madhya Pradesh AAR).
[83] In re M/s M K Agro Tech Ltd., Advance Ruling No. KAR ADRG 97/2019 (Karnataka AAR).

CASE LAW UPDATES
- INDIRECT TAX
- OTHER JUDICIAL PRONOUNCEMENTS

AAR CANNOT RULE ON AN ISSUE WHICH HAS NOT BEEN REFERRED TO IT

In the case of ***Abbott Healthcare Pvt. Ltd.***[84]***,*** the Kerala HC held that there was no scope of clubbing of two independent supplies made by two different suppliers to alter the nature of each of these supplies. The AAR digressed from the main issue by treating the supplies as a composite supply.

FACTS

Abbott Healthcare Pvt. Ltd. ("**Petitioner**") was engaged in the business of sale of pharmaceutical products, diagnostic kits, etc. As per the terms of the Petitioner's business model, it entered into a Reagent Supply and Instrument Use Agreement ("**Agreement**") with various hospitals and laboratories ("**Recipient(s)**"). Thereunder, the Petitioner provided the Recipients with its instruments for use without any consideration for a specified period. Such use was permitted on the condition that the Recipients were required to procure specified quantities of reagents, calibrators, disposables, etc. ("**Products**") from Petitioner's distributors at pre-agreed prices on payment of applicable GST. The Petitioner's distributors had procured such Products from the Petitioner on a principal to principal basis. The Petitioner sought a ruling on the issue, "whether provision of instruments without any consideration constituted a "supply or movement of goods otherwise than by way of supply" under the GST legislations from the AAR.

The AAR ruled that placement of instruments at Recipient's premises without any consideration in the backdrop of an obligation for purchase of a minimum quantity of Products from the Petitioner's distributors constituted a composite supply. The supply of instruments was the principal supply. The ruling of the AAR was based on the *rationale* that the instruments supplied had no utility without the Products and therefore, the supply of instruments and Products were naturally bundled. The transaction of the Petitioner was structured as such with the intention to avoid payment of tax. The consideration for right to use was subsumed in the overall price realized from the Recipients. Accordingly, the supply was exigible to GST at an effective rate of 18% ("**Findings**"), i.e. the rate applicable to the principal supply of transfer of right to use the instruments. The Petitioner appealed against the said ruling before the AAAR, which upheld the view of AAR. Aggrieved by the same, the Petitioner approached the Kerala HC *via* a writ petition to challenge the Findings.

ISSUES

i. Whether the AAR and AAAR were right in adjudicating upon a query which was not raised before them?

ii. Whether the Findings were illegal and against the provisions of the GST legislations?

ARGUMENTS

The Petitioner contended that the AAR and AAAR had acted without jurisdiction by deciding on an issue that was not raised before them for a ruling. The Findings were perverse and not based on any material and purely based on conjectures.

The Petitioner submitted that the provision of the instruments was independent and distinct from supply of Products by the distributors. The two supplies were to be treated as independent and not as one composite supply. The Petitioner also contended alternatively that the provision of instruments could not be the treated as the principal supply as their value was around 20% of the value of Products supplied during the period of the contract.

[84] Abbott Healthcare Pvt. Ltd. v. UOI, TS-4-HC-2020(KER)-NT (Kerala HC).

On the other hand, the respondent submitted that the AAR had to examine the terms of the Agreement in order to ascertain the real supply involved. It appeared from the Agreement that the instruments could not function without the Products. Therefore, supplies of both, i.e. the instruments and Products, had to be clubbed and treated as part of one supply. Thus, supply of instruments and Products was treated as a composite supply, and the supply of instruments was the principal supply.

DECISION

The Kerala HC reviewed the query posed by Petitioner before the AAR and Findings. The HC observed that the AAR went beyond the scope of such query in determining whether the supplies of Petitioner constituted a composite supply. The real issue was whether the provision of the instruments per se constituted a taxable supply, which the AAR failed to decide. Hence, it remanded the matter back to the AAR for fresh consideration basis the views expressed by the HC in the present judgment.

In this regard, the HC, on the Findings observed that the concept of enhancement of utility of instrument through supply of Products was relevant for the limited purpose of valuation and it was not to be a factor in determining the concept of composite supply under GST legislations. It stated that two independent supplies could not be clubbed to notionally alter the very nature of such independent supplies. The HC held that the concept of composite supply would not be applicable to cases where supplies were made by more than one supplier. It also stated that in the business model of Petitioner the two supplies could not be treated as being naturally bundled and supplied in conjunction with each other in ordinary course of business. It was further noted that in order to determine the existence of a composite supply, only supplies effected at a given point of time on a "as is where is" basis must be taken into consideration.

SIGNIFICANT TAKEAWAYS

Interestingly in the aforementioned judgement, the HC discussed the principles and relevant factors to be considered while determining the existence of a composite supply/bundled services extensively. Thus, it would play a substantial role in guiding different AARs and commissioners in determining the nature of supply(ies) and applicable rates of GST in various transactions involving multiple supplies. It would also be a comprehensive reference in the context of composite supplies for various sectors while structuring their business models tax efficiently.

> **"Only supplies effected at a given point in time on as is where is basis must be taken into account while determining the existence of a composite supply."**

Moreover, the HC clearly reiterated that although an AAR may examine other factors such as agreements, supply chain, etc. for purpose of issuing rulings, it cannot disregard or depart from the query of the Applicant.

EXEMPTION FROM A PARTICULAR DUTY DOES NOT AUTOMATICALLY EXEMPT OTHER DUTIES OF SIMILAR NATURE

In the case of ***Unicorn Industries***[85], the SC held that when a particular kind of duty is exempted, other types of duties or cesses imposed by different legislations for different purposes cannot be said to have been exempted.

FACTS

Unicorn Industries ("**Appellant**") was engaged in the business of manufacturing mouth fresheners, which were exigible to excise duties such as basic excise duty, national calamity contingent duty ("**NCCD**")[86], education cess[87] and secondary and higher education cess[88] ("**Other Duties**"). The Government had introduced fiscal incentives for manufacturers in the north eastern region, whereby taxpayers were required to utilize their CENVAT credit balance for the payment of excise duty, and pay the rest of duties in cash, which was refundable or re-creditable. Such benefits were extended to Sikkim in 2003. The exemption from payment of excise duty (other than amount paid utilizing the CENVAT credit) in the State of Sikkim was introduced *vide* Notification No. 71/2003-CE dated September 09, 2003 ("**Exemption Notification**"). The Appellant had initially filed a writ petition before the Sikkim HC seeking declaration that the said exemption was applicable to Other Duties as well. However, the HC held that Other Duties were not included within the ambit of the Exemption Notification. Aggrieved by the same, the Appellant approached the SC to challenge the order of the HC.

"When a particular kind of duty is exempted, other types of duties or cesses imposed under different legislations for different purposes would not get automatically exempted."

ISSUE

Whether the Exemption Notification included Other Duties imposed by Finance Acts of 2001, 2004 and 2007?

ARGUMENTS

The Petitioner contended that Other Duties were in the nature of excise duty notwithstanding their nomenclature as the relevant Finance Acts referred to them as "duty of excise". The relevant Finance Act pertaining to the levy of Other Duties also provided that the CE Act and rules made thereunder relating to refunds and exemptions from duty would apply in respect of Other Duties. The Petitioner relied on ***SRD Nutrient***[89] which dealt with education cess and ***Bajaj Auto***[90] which dealt with NCCD wherein the division bench of the SC held that no Other Duties would be leviable where excise duty or customs duty was not payable or collected. Reliance was also placed upon circulars issued wherein it was stated that where no excise duty was collected on an activity, no education cess would be levied.

On the other hand, the respondent submitted that the Other Duties were imposed post the issuance of the Exemption Notification and therefore, they could not be covered by the Exemption Notification. Other Duties were also imposed by separate legislations which were not covered under the Exemption Notification.

[85] Unicorn Industries v. UOI, Civil Appeal No. 9237/2019 dated December 06, 2019 (SC).
[86] Section 136 of Finance Act, 2001.
[87] Section 91 and 93 of Finance Act, 2004.
[88] Section 126 and 128 of Finance Act, 2007.
[89] SRD Nutrients Pvt. Ltd. v. CCE, Guwahati, 2018 (1) SCC 105 (SC).
[90] Bajaj Auto Pvt. Ltd. v. UOI, 2019 SCCOnline SC 421 (SC).

DECISION

The SC referred to the larger bench decision in the case of ***Modi Rubber***[91] wherein the meaning of the expression “duty of excise” was ascertained. The SC in the Modi Rubber case had held that the exemption had to be considered in reference to provisions stated in the concerned notification and the said exemption would not cover any other kind of excise duty imposed under a separate act. In other words, the expression “duty of excise” was to be interpreted restrictedly on the basis of words stated in the concerned notification. As, the division bench of SC in SRD Nutrients and Bajaj Auto had failed to consider the decision of Modi Rubber, the said decisions were *per incuriam*.

The SC also laid down the presumption that an exemption notification can grant exemption on a duty which was leviable at the time of its notification and not on a duty to be imposed in future. Reference to provisions of the CE Act and rules was made as the source of power for issuing a notification for exemption. The scope of exemption has to be interpreted from the notification itself. The SC stated that the circular relied upon by the Petitioner was based on the interpretation of the tax officer and was not binding on the court. The SC observed that the proposition that if one kind of duty is exempted, other kinds of duties fall under the exemption, cannot be accepted as there was no difficulty in computation of NCCD and Other Duties. Accordingly, the SC noted that a statutory notification must cover explicitly the duty it intends to cover. Therefore, it held that the Exemption Notification did not exempt the levy of NCCD and Other Duties.

SIGNIFICANT TAKEAWAYS

The Hon’ble SC has put to rest the issue which was disturbed by certain cases regarding the availability of exemption on duties of similar nature which were not specifically stated in an exemption notification.

Recently, the Madras HC in ***Gemini Edibles and Fats India Pvt. Ltd.***[92], relied on the aforementioned judgment while determining whether social welfare surcharge (“**SWS**”) was leviable in case customs duty was paid through duty credit scrips. The HC held that the payment of customs duty using the duty credit scrips does not make the import exempt as tax was realized in a different form. It further stated that SWS was an independent levy and notification issued for usage of scrips was restricted only to basic customs duty and would not apply to SWS.

Moreover, CBIC *vide* Circular No. 02/2020- Customs dated January 10, 2020 reiterated that SWS was not exempted if customs duty was paid using duty credit scrips. As taxpayers were discharging SWS using duty credit scrips in past, such practice would be discontinued for any future transactions as the same was neither contemplated by any customs notification nor under the FTP.

[91] UOI v. Modi Rubber Ltd., 1986 (4) SCC 66 (SC).
[92] Gemini Edibles and Fats India Pvt Ltd, TS-3-HC-2020(MAD)-CUST (Madras HC).

PRESENCE OF A LAWYER IS NOT ALLOWED DURING THE QUESTIONING BY AN INVESTIGATING OFFICER

In the case of ***Sudhir Kumar Aggarwal*[93]**, the Delhi HC held that the investigating officers under the GST laws are not police officers, and therefore, the presence of a lawyer at the time of questioning and examination by the investigating officers under the GST laws cannot be allowed.

FACTS

Sudhir Kumar Aggarwal ("**Petitioner**") was a director of M/s Dominion Expo ventures Pvt. Ltd. ("**Company**"), engaged in import of FMCG and tobacco products.

The Directorate General of GST Intelligence ("**DGGI/Respondent**") was undertaking an investigation against Company in relation to fraudulent availment of ITC under the cover of fake invoices. In this regard, the Respondent had conducted a search on and detained his tenant as well as an employee of the Company for questioning. The Petitioner was informed that both the tenant and the employee were manhandled and mentally, physically and verbally harassed by the Respondent. During the questioning, the Respondent also questioned them about the Petitioner. Therefore, the Petitioner had an apprehension that the Respondent could cause physical, mental and/or verbal harassment to him as well, if summoned for questioning.

> **Presence of lawyers not permitted during the investigation by GST authorities.**

Therefore, the Petitioner filed a writ petition requesting the HC to allow the presence of his advocate during the investigation by the Respondents, in case summons was issued to him. The said prayer of the Petitioner was allowed by the Delhi HC in light of the order of the SC in ***Nandini Satpathy v. Dani (P.L.) and Anr*[94]**. However, the Respondent filed an application seeking a modification of the aforesaid order of the HC.

ISSUE

Whether the presence of a lawyer was allowed during the questioning or examination by the Respondent?

ARGUMENTS

The Petitioner submitted that based on the experience of his tenant and Company's employee, he feared for his life, health and safety and was under the apprehension that the Respondent could cause physical, mental and/or verbal harassment during the pendency of the investigation. Therefore, a presence of an advocate was necessary during the interrogation by the Respondent, as laid down by the SC in *Nandini Satpathy (Supra).*

The Petitioner further submitted that all the relevant information / documentation was already available with the Respondent and he was also ready and willing to join the investigation as and when called by the Respondent. However, he could not be arrested as long as he/she complied with the notice of appearance, in relation to the offences mentioned under section 132 of CGST Act[95].

On the other hand, the Respondent relied on the decision of SC in *Pool Pandi*,[96] wherein the SC examined the petition seeking presence of lawyer in an investigation carried out by customs authorities and distinguished the same from *Nandini Satpathy*

[93] Sudhir Kumar Aggarwal v. Directorate General of GST Intelligence, W.P.(CRL) 2686/2019- (Delhi HC).
[94] Nandini Satpathy v. Dani (P.L.) and Anr, (1978) 2 SCC 424 (SC).
[95] Section 132 of the CGST Act provides for punishment in certain case.
[96] Pool Pandi v. Superintendent, Central Excise and Ors., 1992 AIR 1795 (SC).

(Supra) case. In the said case, the SC had that the purpose of the enquiry under the Customs Act and the other similar statutes were to be completely frustrated if the whims of the persons in possession of useful information for the departments were allowed to prevail and adopt a non-cooperative attitude to the machineries of law.

The Respondent further argued that the Petitioner himself did not have clean antecedents as he concealed a material fact that he was out on a conditional interim bail in a case which was being investigated by the DRI. The Respondent further argued that allowing the presence of a lawyer during examination would frustrate the purpose of inquiry under section 70 of the CGST Act.

DECISION

The Delhi HC noted the findings of the SC in both *Pool Pandi (supra)* and *Sudhir Gulati*,[97] wherein the SC had categorically denied the presence of a lawyer during examination/interrogation by Customs Officers. The Delhi HC held that the summons in the instant case was issued by the officers under GST laws, who were not police officers under section 70 of the CGST Act. These officers were conferred with the power to summon any person whose attendance they considered necessary to produce a document or give evidence. Therefore, the presence of a lawyer during such an examination was not required.

The Delhi HC held that the provisions of the Constitution had to be construed in the spirit in which they were made and the benefit thereunder could not be extended to exploiters engaged in tax evasion at the cost of public exchequer.

The Delhi HC further held that so far as the apprehension of the petitioner that he could be mentally and physically assaulted or manhandled was concerned, it was a settled law that no investigating officer had a right to use any such method to extract any evidence/information, and in case it was done so, the officer would have to face the consequences.

Accordingly, the Delhi HC modified its earlier order and disposed off the application holding that the presence of lawyer was not allowed during the investigation of the Petitioner by the Respondent.

SIGNIFICANT TAKEAWAYS

The present decision of the Delhi HC is the first decision where the Court has examined the power of the authorities under the GST laws to interrogate any person. In the instant case, though the HC reiterated the findings the orders of the SC and stated that the GST investigating officers are not police officers, the HC failed to note that practically, an immense pressure is built on assessees and in the absence of a lawyer, the assessee may succumb to coercion, resulting in biased investigation leading to unfair and unjust outcome. Therefore, in our view, as the intention of the court was not to extend the benefit of lawyers to exploiters, the court should have restricted the applicability of this judgement to major offences.

[97] Sudhir Gulati v. Union of India, 1998 (100) E.L.T. 344 (Delhi HC).

REGULATORY DIRECT TAX UPDATES

CBDT NOTIFIES DIGITAL MODES OF PAYMENT FOR SECTION 269SU OF IT ACT.

In furtherance of promoting the Central Government's initiative of movement towards a cashless economy, the Finance Act, 2019 introduced section 269SU in the IT Act, which states that every person, carrying on business, shall, provide facility for accepting payment through prescribed electronic modes of payment, which would be in addition to the facility of other electronic mode of payment, if any, provided by such persons. The requirement to maintain electronic mode of payment for any such person carrying on business whose total sales, turnover or gross receipts in business exceeds INR 500 million. The amendment came into effect from 1 November, 2019

In order to ensure compliance to this requirement, the Central Government had also introduced a new and additional penalty provision under section 271DB of IT Act, which levies a penalty of INR 5000, for every day, on which the failure to maintain the prescribed mode of payment continues.

Given the same, the CBDT has *vide* notification[98] dated December 30, 2019, inserted rule 119AA under IT Rules which notifies the following electronic modes of payment, which are to be mandatorily provided by every such person covered under section 269SU of IT Act:

i. Debit Card powered by RuPay;

ii. Unified Payments Interface (UPI) (BHIM - UPI); and

iii. Unified Payments Interface Quick Response Code (UPI QR Code) (BHIP UPI QR Code)

The requirement to mandatorily maintain the aforesaid mode of payments has come into force from January 1, 2020.

CBDT ISSUES NOTIFICATION NOTIFYING NEW RULES PERTAINING TO TDS PAYMENT UNDER SECTION 194M AND 194N OF THE IT ACT

Income Tax (14th Amendment) Rules, 2019 notified by the CBDT vide notification dated November 18, 2019 amend rules 30, 31 & 31A and prescribe rules under section 194M and section 194N of the IT Act ("**Notification**").

Rule 30 of the IT Rules sets out the time and mode of payment for TDS and for tax paid under section 192 of the IT Act. The notification inserts sub rule 2(c) to rule 30, which provides for a period of thirty days from the end of the month in which the deduction is made for the payment of credit of the Central Government. Further, sub rule 6(C) notified *vide* this amendment provides for the mode of payment of the deducted tax to the Central Government. It prescribes that where the tax deducted is required to be submitted along with a challan-cum-statement, the amount of tax so deducted has to be deposited to the Central Government by remitting it electronically into the Reserve Bank of India or the State Bank of India or any authorised bank.

Rule 31 of the IT Rules provides the form of the certificate of TDS to be furnished under section 203 of the IT Act. The notification inserts sub rule 3(c), which provides that every person responsible for deduction of tax under section 194M must furnish the certificate of deduction of tax at source in Form No.16D to the payee within fifteen days from the due date for furnishing the challan-cum-statement in Form No.26QD under rule 31A after generating and downloading the same from the web portal specified by the Principal Director General of Income-tax (Systems) or the Director General of Income-tax (Systems) or the person authorised by him.

Rule 31A of the IT Rules sets out the statements of deduction of tax under sub-section (3) of section 200 of the IT Act. The notification inserts sub clause (ix) under sub rule 4, which requires furnishing of particulars of amount paid or credited on which tax was not deducted as per exemptions provided under clause (iii) and clause (iv) of proviso to section 194N. Proviso to section 194N provides exemptions to the requirement to withhold tax under section 194N. Clause (iii) of the said proviso exempts any business correspondent of a banking company or a co-operative society engaged in carrying on the business of banking in accordance with the guidelines issued by RBI, from the requirement to withhold tax. Similarly,

[98] Notification no. 105/ 2019/ F. No. 370142/ 35/ 2019 – TPL.

clause (iv) of the proviso exempts any white label automated teller machine operator of a banking company or cooperative society engaged in carrying on the business of banking in accordance with RBI authorization, from the requirement to withhold tax.

Further, sub rule (4C) notified vide this amendment provides that every person responsible for deduction of tax under section 194M must furnish to the Principal Director General of Income-tax (Systems) or Director General of Income-tax (System) or the person authorised by the Principal Director General of Income-tax (Systems) or the Director General of Income-tax (Systems) a challan-cum statement in Form No.26QD electronically in accordance with the procedures, formats and standard specified under sub-rule (5) within thirty days from the end of the month in which the deduction is made.

The notification further provides the new TDS certificate Form 16D and the new Challan cum statement of deduction of tax under section 194M, in Form 26QD. It also introduces new changes to already existing forms 26Q and 27Q.

CBDT AMENDS RULE 10CB RELATING TO INTEREST INCOME COMPUTATION FOR SECONDARY ADJUSTMENTS

On 30 September 2019, CBDT made amendments to Rule 10CB of the IT Rules. This rule provides for the manner of computation of the interest in relation to secondary adjustment, pursuant to an adjustment made by the IRA or *suo moto* by taxpayer in transfer pricing cases, where the AE has not repatriated the 'excess money' within the prescribed time i.e. 90 days.

In Rule 10CB(1) and 10CB(2), 'excess money' has been substituted with "excess money and part thereof". The amended rules provide for the manner of computation of the prescribed period for return of such excess money by the AEs. For the cases where APA is concluded, the computation of time period of 90 days for repatriation of money will depend on the due date of filing the income tax return, in the year, in which the adjustments in relation to transfer pricing took place. In the event the APA was concluded after the due date of filing had already passed, the prescribed time of 90 days will start from the end of the month in which APA was signed. If APA was signed before the due date of filing, then the repatriation should be made 90 days from the due date of filing.

In the event, adjustments in relation to transfer pricing are made on the basis of the resolution under MAP, the balance money will be required to be repatriated within 90 days from the date when a demand notice is issued by AO, to give effect to the resolution under MAP.

CBDT has also inserted Rule 10CB (3) clarifying the time from which interest which will be charged in the event the excess money is not repatriated with the prescribed time of 90 days. The table below provides the period from when the requirement of paying interest will start:

Sr. No.	In the way transfer pricing adjustment has been made	Period for commencement of 90 days
1	Voluntary adjustment in tax return	Due date of filing of return u/s 139(1) of the Act
	By an APA which was signed before the due date of filing income tax return	
	If the option under the safe harbour rules has been exercised by the taxpayer	
2	Determined by the order of IRA, which has been accepted by the taxpayer	Date of the order of IRA
3	By an APA which was signed after the due date of filing income tax return	End of the month in which APA was entered into by the taxpayer
4	Where the adjustment has been made as per the resolution under MAP	From the date when a demand notice is issued by AO, to give effect to the resolution under MAP

GOVERNMENT PASSES THE TAXATION LAWS (AMENDMENT) ACT, 2019 TO REDUCE THE CORPORATE TAX RATES

The Indian Parliament passed the Taxation Laws (Amendment) Act, 2019 ("**Amendment Act**"), which received the assent of the President on December 11, 2019, to make significant amendments in the IT Act with respect to the corporate tax rates. The Amendment Act incorporated the amendments proposed *vide* Taxation Laws (Amendment) Ordinance 2019 ("**Ordinance**") promulgated by the President of India on September 20, 2019, albeit with certain modifications. As mentioned in the Amendment Act, it shall be deemed to have come into force on September 20, 2019. The key amendments introduced in the IT Act by the Amendment Act have been discussed below:

1. Insertion of new section 115BAA

The government has introduced a new corporate tax rate of 22% (plus 10% surcharge and 4% cess) w.e.f. AY 2020-21 for domestic companies, subject to certain conditions. Companies have option to avail new rate before the due date of filing income tax return, keeping in mind that said option once availed cannot be withdrawn in subsequent years.

As per the new provisions, certain specified deductions[99] in the IT Act, which already provide substantial deductions from total income, cannot be availed by a company when it avails the new tax rates u/s 115BAA. Further, brought forward loss or unabsorbed depreciation of a company or brought forward loss or unabsorbed depreciation pertaining to amalgamation, demerger etc. u/s 72A of IT Act, attributable to these deductions, can also not be claimed.

It has been specifically provided in the Amendment Act that MAT credit will not be available for set off if this section is availed. Hence, companies availing concessional tax rate under this Section will not be able to utilise their MAT credit. However, they do have an option to go for the new tax regime after a few years, essentially meaning that they can choose to utilize their MAT credit to set off their income tax liability as per the old rates till the time moving on to the new regime is more beneficial. Even the CBDT vide its Circular[100] dated October 2, 2019, after passing the Ordinance, had clarified that since there is no timeline for exercising option under Section 115BAA, a company having MAT credit may exercise the option after utilizing the MAT credit against regular tax payable.

If we analyse a situation where a company has MAT credit in its books, currently liable to pay taxes under the normal tax provisions, the tax outgo under the new tax regime will be 25.17%. Whereas if it continues paying taxes under the previous tax regime at the rate of 34.94%, assuming it is in the highest tax bracket, after set off of MAT credit to the tune of 17.47%, it will be paying taxes at the rate of 17.47%. Hence, in case of companies with MAT credit in their books, utilizing their MAT credit is more favourable in the initial years wherein the MAT credit can set off the entire or a substantial portion of the liability. It is advisable that a detailed analysis under both options be carried out in the year in which MAT credit is available for a partial set off of income tax liability under normal provisions.

Further, in case of new domestic manufacturing companies incorporated after March 1, 2016, the benefit of availing tax rate of 22% under section 115BAA has not been foreclosed, i.e. a company may opt out of section 115BA to exercise option under section 115BAA.

It has also been provided that in case of violation of conditions prescribed for availing concessional tax rates in a PY, the provisions will become inapplicable for that year and subsequent years.

2. Insertion of new section 115BAB

The government has reduced the tax rates for new domestic manufacturing companies set up on or after October 1, 2019, which commence manufacturing before March 31, 2023. Such companies will have an option to pay taxes at a concessional rate of 15% (plus 10% surcharge and 4% cess) w.e.f. AY 2020-21.

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[99] Deductions specified under section 10AA or section 32(1)(iia) or section 32AD or section 33AB or section 33ABA or under specified clauses of section 35 or section 35AD or section 35CCC or section 35CCD or under Chapter VI-A under heading C except section 80JJAA cannot be availed.

[100] Circular No. 29/ 2019.

The new tax rates under this section also need to be availed before due date of filing income tax return and will apply even in subsequent years. Further, specified deductions[101] in the IT Act, cannot be availed when opting for section 115BAB. Brought forward losses or unabsorbed depreciation pertaining to amalgamation, demerger etc as specified u/s 72A of IT Act, attributable to aforesaid deductions also cannot be claimed. Also, MAT provisions will not apply.

It has further been provided that business of "manufacture" shall exclude businesses such as:

"development of computer software, mining, conversion of marble blocks or similar items into slabs, bottling of gas into cylinder, printing of books or production of cinematograph film or any other business as may be notified"

Various other conditions have also been prescribed such as:

i. business of the new entity should not be formed by splitting up or reconstruction of business already in existence.

ii. it does not use plant and machinery previously used for any purpose in India subject to certain conditions

iii. it does not use any building previously used as a hotel or convention centre in respect of which deduction under section 80-ID has been allowed

iv. in order to avail the benefit of this Section, the company should not be engaged in any business other than manufacture of any article or thing and research in relation to, or distribution of such article or thing.

While the failure to meet these conditions, will make the company ineligible for the benefit of this section in that year as also subsequent years, it has been provided that in case of violation of the conditions specified in serial no. ii, iii or iv above, a company may still exercise option under Section 115BAA.

Further, instead of the term "*company*" used in the Ordinance, it has been provided in the Amendment Act that the "*business*" of the new entity should not be formed by splitting up or reconstruction of an existing business.

Also, in case Section 115BAB has been opted, STCG from transfer of capital asset on which no deprecation is allowable and also income, which has neither derived from nor incidental to manufacturing / production, will be taxable at the rate of 22%.

It has also been provided that any profits determined by AO to be more than ordinary profits, owing to a "*close connection*" between assessee and any close person, shall be taxable at 30%. Section 92BA of IT Act has also been amended to provide that any business transacted between assessee and such close person shall be a specified domestic transaction and profits therefrom shall be determined having regard to Arm's Length Price ("**ALP**") as defined u/s 92F.

3. Reduction in MAT rate

The rate of MAT has been reduced from 18.5% to 15% w.e.f. AY 2020-21.

4. Changes in surcharge rates

Surcharge on the newly introduced tax provisions viz Section 115BAA and Section 115BAB of the IT Act has been fixed at a uniform rate of 10% irrespective of the taxable income of the company.

Surcharge rates of 25% and 37% recently introduced vide Finance (No 2) Act 2019, in case of income exceeding INR 2 crore and INR 5 crores respectively, have been relaxed in case of income from:

- capital gains u/s 111A or 112A of the IT Act, in which case now maximum surcharge applicable is 15%.
- capital gain from transfer of securities by a Foreign Institutional Investor u/s 115AD of the IT Act, in which case also maximum surcharge applicable is 15%.

[101] Same as deductions specified in Section 115BAA.

Effective tax rates for AY 2020-21

<table>
<tr><th>Total Income (INR)</th><th>Companies with “turnover” upto INR 400 crores in F.Y. 2017-18 taxable at 25%</th><th>Companies under normal tax rate of 30%</th><th>Section 115BA</th><th>Section 115BAA</th><th>Section 115BAB</th></tr>
<tr><td>Up to 1 crore</td><td>26% (no surcharge)</td><td>31.20% (no surcharge)</td><td>26% (no surcharge)</td><td rowspan="3">25.17% (10% surcharge)</td><td rowspan="3">17.16% (10% surcharge)</td></tr>
<tr><td>More than 1 crore but up to 10 crore</td><td>27.82% (7% surcharge)</td><td>33.384% (7% surcharge)</td><td>27.82% (7% surcharge)</td></tr>
<tr><td>More than 10 crore</td><td>29.12% (12% surcharge)</td><td>34.944% (12% surcharge)</td><td>29.12% (12% surcharge)</td></tr>
</table>

5. Relief from tax on buy-back of shares in case of listed companies for intervening period

Finance (No. 2) Act, 2019 made the existing tax of 20% payable by a company on buy-back of shares under section 115QA of the IT Act, applicable on listed companies as well. Hence, in case of companies where public announcement for buy-back had already been made before July 5, 2019, which is the date on which the budget was presented in the Parliament, but the required approvals were received post July 5, 2019, the buy-back became subject to tax. A proviso has been inserted in section 115QA of the IT Act to provide that additional tax u/s 115QA shall not apply to such companies where public announcement had already been made before July 5, 2019.

REGULATORY INDIRECT TAX UPDATES

OBLIGATION TO INFORM REGARDING ADJUDICATION BEFORE NCLT

Notification No. 25/2015-2020 dated October 18, 2019 read with Public Notice No. 39/2015-2020 dated October 18, 2019 made it mandatory for a firm/company facing adjudication proceeding before NCLT to intimate the regional authority of DGFT and NCLT of the following details in form of a summary of statement before the commencement of proceeding:

a. any outstanding export obligation/liabilities under any scheme of the FTP, indicating duty saved amount and interest till the date of commencement of NCLT proceedings;

b. penalty imposed under FTD&R Act;

c. any due such as fee.

All of such amounts would form part of dues against the said firm/company to the government. The firm/company would also be required to furnish a statement of consumption of inputs / procurement of capital goods attested by chartered engineer / accountant along with documentary detail of any partial fulfilment of export obligation claimed towards offsetting the duty saved amount.

E-invoicing under the GST Legislation

Notification No. 68/2019-Central Tax dated December 13, 2019 read with Notification No. 70/2019-Central Tax dated December 13, 2019 provides that registered persons having aggregate turnover exceeding INR one hundred crore in a FY shall issue an e-invoice w.e.f. April 01, 2020. Invoice issued in any other manner would not be treated as a valid invoice. The e-invoice can be generated on GST electronic portal by furnishing relevant information.

Requirement of Quick Response ("QR") Code

Notification No. 72/2019-Central Tax dated December 13, 2019 provides that registered persons having aggregate turnover exceeding INR five hundred crore in a financial year are required to issue invoices with QR code to an unregistered person. (B2C invoicing) w.e.f. April 01, 2020.

However, where such registered person makes a Dynamic QR code available to recipient through a digital display, the invoice containing cross-reference of payment using Dynamic QR code shall be deemed to have QR code.

CBIC issues clarification on levy of GST on airport levies

Circular No. 115/34/2019-GST, dated October 11, 2019 clarified that the passenger service fee and user development fee are charged by airport operators such as Airport Authority of India, MIAL, DIAL etc. through airlines for providing the services to passengers. Such services are exigible to GST in the hands of airport operator. Such charges are inclusive of GST and are collected by airlines as pure agents of the passengers as it is not consideration for any service provided by airline. Therefore, airline should separately indicate the amount of such fees and GST in the invoice issued.

CBIC issues clarification on levy of GST on service of display of name of donor in the premises of charitable organizations

Circular No. 116/35/2019-GST, dated October 11, 2019 clarified that placing a name plate or similar acknowledgment in premises of charitable organizations, religious institutions, hospital etc. as an expression of gratitude and public recognition of donor's act of philanthropy and not for publicity or advertising or promotion of donor's business is not in the nature of supply of service. Therefore, there is no GST liability on the act of displaying the name or acknowledgement.

CBIC issues clarification on determination of place of supply in case of software/design services

Circular No. 118/37/2019-GST, dated October 11, 2019 clarified the place of supply in certain cases of software/ design service. The electronic semi-conductor and design manufacturing industry in India provide software development and integrated circuit designing services to customers located overseas. In some cases, pursuant to the integration of the software on hardware, the prototype or sample is provided to the India service supplier for testing purposes. The circular clarified that such supply would be in the nature of a composite supply where the software development/ circuit designing would be the principal supply. Testing of software on sample or prototype would be ancillary supply. Therefore, the place of supply of principal supply i.e. software development would be the location of recipient.

CBIC issues clarification on taxability of supply of securities under lending scheme

Circular No. 119/38/2019-GST, dated October 11, 2019 clarified that the activity of lending of securities is not a transaction in securities as it does not involve disposal of securities. The explanation that services includes facilitating or arranging transaction in securities added w.e.f. February 01, 2019 was clarificatory in nature. Therefore, as the lending fee charged by the borrowers of securities had a character of consideration, this activity has been taxable since July 01, 2017. The circular also stated that for the period from July 01, 2017 to September 20, 2019, IGST is payable under forward charge by the lender. In case any lender has already discharged CGST/SGST/UTGST treating it as intra state supply, such lender shall not be required to pay IGST again.

Whereas from October 01, 2019, the borrower of securities would be liable to discharge IGST under RCM.

Requirement of Document Identification Number ("DIN") and standardized formats

Circular No. 122/41/2019-GST, dated November 5, 2019 provided that no search authorization, summons, arrest memo, inspection notices and letter issued in course of any enquiry shall be issued by any officer to a taxpayer or any other person, on or after November 08, 2019 without computer generated DIN being duly quoted prominently in the body of such communication. The said requirement was extended to all communication (including email) sent to taxpayers or any other person w.e.f December 24, 2019 vide Circular No. 128/47/2019- GST dated December 23, 2019. This is done to ensure transparency and accountability in indirect tax administration. The exceptional circumstances only when communication without DIN can be issued are:

a) Technical difficulties in generating DIN;

b) When communication regarding investigation / enquiry, verification, etc. is required to be issued at short notice or in urgent situation and the officer is outside the office in discharge of his official duties.

However, such communication needed to be obtain a post-facto approval. The circular also stated that any specified communication (Other than in exceptional circumstance) which lacked the DIN would be treated as invalid and deemed to have been never issued.

Moreover, harmonized and standardized formats for search authorization, summons, arrest memo, inspection notices, etc. have been introduced w.e.f January 01, 2020.

Clarification regarding job-work service

Circular No. 126/45/2019-GST, dated November 22, 2019 clarified that the services by way of job work (other than in relation to specified goods) provided to registered person would be exigible to GST at effective rate of 12% whereas to a non-registered person would be exigible to GST at effective rate of 18%.

Retrospective withdrawal of Circular in relation to treatment of Information Technology enabled Services ("ITeS")

Circular No. 127/46/2019-GST, dated December 4, 2019 has withdrawn Circular No. 107/26/2019-GST, dated July 18, 2019 form its date of issuance. The withdrawn circular had 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.

Amendment to CGST Rules

Notification No. 75/2019 – Central Tax dated December 26, 2019 incorporated the following changes to CGST Rules:

<u>Limit on availment of ITC:</u> 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 10% of the eligible credit available in respect of invoices or debit notes; the details of which have been furnished by the suppliers w.e.f. January 01, 2020.

Conditions for use of amount available in electronic credit ledger: The Commissioner or his deputed subordinate may disallow debit of amount (equal to ineligible ITC or fraudulently availed ITC) for discharging GST liability or for claiming refund in the following scenarios:

a. ITC has been availed on strength of tax invoice or debit note or any other valid document where:

    i. It has been issued by a registered person who is non-existing or not conducting any business from registered location; or

    ii. goods and/or services are not received; or

    iii. GST charged has not been paid to Government;

b. Where the registered person availing ITC is:

    i. non-existing or not conducting any business from registered location; or

    ii. not in possession of tax invoice or debit note or any other valid document.

The reasons have to be recorded in writing for such disallowance. Where the conditions for disallowing no longer exist, the Commissioner or his deputed subordinate may allow such debit. The restriction automatically waives after expiry of period of 1 year from the date of imposition of such restriction.

Enforcement of certain amendments of Finance Act (No. 2) Act, 2019

Notification No. 01/2020- Central Tax dated January 01, 2019 has implemented the following provisions *inter alia* w.e.f. January 01, 2020:

a. Power to increase threshold upto INR 40 lakhs for registration for suppliers engaged exclusively in supply of goods;

b. Additional requirement of undergoing authentication or furnishing proof of possession of Aadhaar number of individual (in case of other than individual proof of Aadhaar number of karta, managing director, whole time director, partner, member of managing committee, etc.) or proof through alternate notified by Government. In its absence, the registration allotted shall be deemed to be invalid and CGST Act would apply considering such person as unregistered person.

c. Power to prescribe a class of registered person who shall provide prescribed mode of electronic payment to recipient;

d. Power to extend time limit for furnishing annual return;

e. Penalty of 10% of the profiteered amount in case of profiteering which would be waived where payment is deposited within 30 days of passing of NAA order.

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
APA	Advance Pricing Agreement
AY	Assessment Year
Customs Act	Customs Act, 1962
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)
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
HC	Hon'ble High Court

ABBREVIATION	MEANING
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
MAP	Mutual Agreement Procedure
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
PY	Previous Year
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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