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Tax Scout | April – June, 2020

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Dear Readers,

We are back with our regular, quarterly update on direct and indirect taxes, covering some of the important decisions and legislative changes that took place in the first quarter of financial year 2020-21 i.e. April 1, 2020 to June 30, 2020. Though the COVID-19 pandemic continues to spread across the country, the Central Government and several State Governments have now lifted restrictions to some extent and businesses have started to operate at sub-optimal capacities. In order to enable businesses to overcome this unprecedented crisis, several concessions and relaxations have been granted to them. However, with the end of this crisis nowhere in sight, everybody is cautiously treading the path.

In our cover story, we have discussed the importance and implications of the Insolvency and Bankruptcy Code, 2016 ("**IBC**") and how it sits with the other prevailing laws, specifically with the Income Tax Act, 1961. While the primacy of IBC is well established and well appreciated, the inherent denial of the Indian tax authorities to give up their powers and remain subservient to the process outlined in the IBC has resulted in several litigations. However, certain decisions taken by the NCLT have complicated the position, such as allowing assessment proceedings to continue while the concerned companies are still under the purview of the insolvency process. While the Supreme Court has been called upon to adjudicate on certain nuances, one may have to wait for comprehensive rulings on each of such complicated aspects so that this matter comes to rest.

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

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

Regards,
CYRIL SHROFF

Managing Partner
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IBC: Conquering The Moratorium - An Income Tax Perspective

Background

With the objective of consolidating multiple (then) applicable laws relating to insolvency resolution and liquidation of corporate entities, the Insolvency and Bankruptcy Code, 2016 ("**IBC**"), was enacted as an overhauling legislation. The IBC was enacted as a one-stop, coherent and consistent framework with a view to simplify debt recovery. With the IBC, the superiority of secured lenders and creditors over other creditors was also established, thereby allowing banks, financial institutions and other secured lenders to recover their dues in a timely manner and without unnecessary and protracted litigations. Thus, the IBC came as a sigh of relief for onshore as well as offshore creditors, who had long hoped for a seamless and unambiguous Indian insolvency regime, at par with international standards.

Over the past half-decade, the development of the IBC framework by policymakers has witnessed an increasing pool of creditors relying on the IBC for relief, as a result of a growing number of insolvency resolution proceedings instituted under the IBC. In the course of this growth, the taxman has also begun claiming a seat at the table of creditors, thereby leading to multiple instances where the cross-section between the IBC and the IT Act has been tested. In this story, we have dealt with the contours of the interplay between the IT Act and the IBC. The first two sections provide a background to the IRA's assessment process and the manner in which this process is impacted by a Corporate Insolvency Resolution Process ("**CIRP**") against the tax assessee. The third section deals specifically with the impact of the IBC 'moratorium' "as well as eventual liquidation of the assessee" on the taxman's claims. Lastly, we have shared our thoughts on the impact of COVID-19 related relaxations, provided under the IBC, on the IRA's claims.

Position of the IRA in priority waterfall

Under the erstwhile corporate insolvency regime of the Companies Act, 1956, tax and other governmental dues were to be paid in priority to all other debts.[1] In stark contrast to this secure position that the IRA had held under the Companies Act, 1956, IBC categorises tax dues as operational debts,[2] which are fifth in priority under the IBC waterfall.[3] The decision to push Government debt, including tax claims, down the queue was made to promote the availability of credit to Indian companies and to develop a market for unsecured debt, such as bonds, in a manner consistent with global practices.[4] Although, low on preference and not a part of the committee of creditors, the IRA, as an operational creditor, can pursue any claims from assessments completed before the initiation of the CIRP. The resolution plan approved under the CIRP shall be binding on the IRA.[5]

Despite the IRA's status in the waterfall being established, many areas of conflict between the IRA on the one hand, and the corporate debtor undergoing the CIRP ("**CD**") and its other creditors on the other, remain unresolved.

1 Section 530, Companies Act, 1956.
2 Pr. Director General of Income Tax (Admn. and TPS) v. Synergies-Dooray Automotive Ltd., (2019) 149 CLA 462 (NCLAT); Leo Edibles and Fats Limited v. TRO, (2018) 407 ITR 369 (Telangana & Andhra Pradesh High Court).
3 Section 53 of the IBC.
4 The report of the Bankruptcy Law Reforms Committee, Volume I: Rationale and Design (November 4, 2015).
5 Section 31, IBC.

Registering a tax claim

A resolution professional ("**RP**") is appointed in respect of each CIRP, post which a public announcement regarding the CIRP is required to be made.[6] Following the announcement, all creditors, including the IRA, in case there are pending tax dues payable by the CD, are required to forward proof of their claims in the prescribed form to the RP on or before the ninetieth day of the insolvency commencement date.[7]

Section 288 of the IT Act deals with the appearance of authorised representatives before income-tax fora, on behalf of assessees. The Finance Act, 2020, amended the said provision to include 'any other person as may be prescribed' as authorised representative to appear on behalf of a company before the IRA or the ITAT. Although the CBDT has not issued a subsequent notification specifically identifying the RP as an authorised person to appear on behalf of the CD, the memorandum to the Finance Bill, 2020, suggests that this amendment to Section 288 of the IT Act was aimed at authorising the RP to appear before the IRA and various income-tax fora in relation to income-tax proceedings, thereby giving effect to the duty of RP to exercise rights for the benefit of the CD in judicial and quasi-judicial proceedings.[8] It would be consistent with this stated objective, if the CBDT were to notify the RP as an authorised representative of the CD.

All CDs must continue to file returns as customary during the CIRP. However, verification of the returns, which is typically undertaken by the directors of the company, would need to be undertaken by the RP.[9]

IRA and the moratorium: A saga of conflict

Another issue is that of income tax assessments against CDs during the moratorium period under the IBC, which has faced myriad complications. Section 14 of the IBC imposes a moratorium on the "*institution of suits or continuation of pending suits or proceedings against the CD, including execution of any judgment, decree or order in any court of law, tribunal, arbitration panel or other authority*" during the CIRP.

Before dealing with the impact of the moratorium on the income tax assessment process, it is important to appreciate the various stages of the assessment process itself. Once income tax returns ("**ROI**") are filed, typically, notices are issued to the assessees, seeking explanations or further inquiry or calling for additional information or documentation in support of the claims made in the ROI for the relevant FY. Upon receiving responses to the notices, and further explanations and hearings, assessment orders are passed. Where any order requiring payment of tax, interest, fine, etc., is passed under the IT Act, the AO must issue a "notice of demand" under section 156 of the IT Act, specifying the sum payable by the assessee. Theoretically, situations of conflict between the IBC moratorium and income tax assessments can arise during two phases – the pre-assessment phase (including assessment) and the post assessment phase.

a) **Pre-assessment ambiguities**

Ambiguity arises in the pre-assessment stage if moratoriums are in place pursuant to NCLT orders and income tax assessment orders have not yet been issued. In such cases, a vital question for consideration is, can the IRA pursue assessment, issue show-cause notices and/or make assessment orders even if it does not undertake the actual enforcement of assessment or without raising any tax demand?

(i) Precedents on the issue

The Madras High Court was first seized of this issue in the case of *Dishnet Wireless Limited*.[10] There, it had been argued by the IRA that the time limit stipulated under section 153 of the IT Act for completion of assessments for the relevant year was nearing expiry and, therefore, the assessments had to be made during the moratorium, in the interest of time. The IRA had also asserted that it had not proceeded to "take any coercive steps for recovery of demand" and that the assessment order that had been passed was to be treated only as "an intimation of the existing demand". The Court ruled, without paying regard to the timelines under the IT Act, that such assessment orders were to be kept in abeyance during the moratorium. It may be noted here that typically, an assessment order issued by an AO is accompanied by a notice of demand, as per which the demand must be fulfilled by the assessee within thirty days or the shorter timelines stipulated in the notice. However, in the instant case, the IRA contended (which was ultimately rejected by the Madras High Court) that it had only issued an assessment order and had not pursued any coercive steps for recovery of demand.

Similarly, in May 2019,[11] the Principal Bench of the NCLT held that show-cause notices and penalty orders issued against a CD in the wake of a moratorium were in contravention of Section 14 of the IBC and liable to be set aside till final orders from the NCLT.

(ii) Divergence in jurisprudence – Diamond Power Infrastructure and Mohan Lal Jain

However, recently in a marked departure from the usual approach, the Ahmedabad bench of the NCLT permitted

6 Sections 13(2) and 15, IBC.
7 Section 18(b), IBC; Regulations 7 and 12(2), Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016.
8 Section 25(2)(b), IBC.
9 Proviso (c) under section 140©, IT Act.
10 Dishnet Wireless Limited v. DCIT, Order dated December 18, 2018 in W.P. No. 24097 of 2018 (Madras High Court).
11 Oriental Bank of Commerce v. Allied Strips Ltd., Order dated May 24, 2019 in (IB)-46(PB)/2018 (NCLT).

the IRA to carry out assessment proceedings against a CD during moratorium.[12] In this case, the IRA had made an interlocutory application, seeking the NCLT's permission to undertake assessment proceedings against the CD during the moratorium. The IRA had also issued notices under Section 153A of the IT Act (relating to assessment pursuant to search procedure authorised under section 132 of the IT Act) during the moratorium. The IRA pleaded that failing to complete the assessment, prior to the expiry of the time limit set out under section 153A of the IT Act, would cause grave injustice to the IRA and the Government exchequer. The IRA further submitted that during a search procedure (conducted along with the Central Bureau of Investigation and the Directorate of Enforcement), it had unearthed certain discrepancies in the books of the CD, which it believed, would lead to crystallisation of a substantial tax demand under the IT Act.

The NCLT, upon "considering the necessity of the assessment of tax", allowed the IRA to proceed with the assessments for the relevant years. Further, the NCLT cautioned that the IRA must not "proceed / file case against the CD" without prior NCLT permission. With due respect to the observations of the NCLT, it may be noted that the NCLT did not elaborate on the source of its powers to grant permission to make assessments or to permit the IRA to "file cases" against CDs during moratorium. The IBC does not contemplate conferring such powers on the NCLT. Moreover, enabling assessment proceedings to be completed despite the bar of the moratorium under section 14 of the IBC is contrary to the basic scheme of the IBC and should not be permitted.

On the other hand, it appears that the concerns of the IRA over the urgency in completing assessments within the timeframes stipulated under the IT Act may be genuine but not squarely within the scheme of the IBC. IRA's concerns over the urgency seem to be based on the absence of any provision to exclude the moratorium period from the statutory limitation period for assessment. Nowhere under the IBC is it provided that the moratorium will extend statutory limitation periods under the Limitation Act, 1963, or under other statutes such as the IT Act, except under Section 60(6) of the IBC. This provision stipulates that in computing the period of limitation specified for any suit or application by or against a CD, the moratorium period shall be excluded. However, Section 60 of the IBC falls under the chapter titled "Adjudicating Authority for corporate persons", which delineates powers of the NCLT. The contents of Section 60, as well as the marginal note above the provision, deal with powers of the NCLT in relation to the CIRP. Therefore, section 60(6) of the IBC should be construed to apply only to suits and applications filed before the NCLT and the said provision would not aid the IRA. Further the provision specifically uses the term "suit or application", which would not cover proceedings such as assessment by the IRA, However, while one would need to be mindful that the IRA could seek to exclude mortarium period while calculating the applicable limitation period for the relevant proceedings, in some cases, as can be seen with the judicial precedents discussed above, the IRA has sought to complete the assessment and recovery proceedings without having regard for the supremacy/overruling effect accorded to the provisions of the IBC over the IT Act. As such action runs contrary to the scheme of IBC, these actions remain to be scrutinised on the touchstone of judicial review.

Notwithstanding the the IRA's concerns over the time periods, it remains that the IBC does not authorise the NCLT to grant permission to carry on certain proceedings during the moratorium. It may be worrisome that in the absence of such powers, the Ahmedabad bench of the NCLT has proceeded to permit income tax assessments during the moratorium, despite the earlier precedents holding that both assessments (including show-cause notices) as well as further appeals would be in contravention of Section 14 of the IBC. The Ahmedabad NCLT "considered the necessity of the assessment", however, the order does not delineate categorically the factors that could fulfil this necessity requirement – for instance, quantum of the potential tax demand, expiry of time limit under Section 153A of the IT Act, etc. Similar factors had been rejected by the Madras High Court in *Dishnet Wireless* as grounds to break the moratorium.

The very purpose of introducing the concept of a moratorium in the IBC was to protect and keep together the CD's assets and strengthen its financial position. Allowing the tax department to pursue its claims during an otherwise watertight moratorium defeats this very purpose. Further, with no explanations as to the source of the tribunals' power to grant the IRA permission to complete assessments, the decision is particularly difficult to palate.

In another similar order passed in March 2020, the National Company Law Appellate Tribunal ("**NCLAT**") refused to interfere with the NCLT's finding that making assessment is different from enforcement thereof and that the former can proceed during moratorium. These orders seem to emerge from a pro-IRA position,[13] despite earlier High Court and NCLT decisions prohibiting income tax assessments during moratorium.[14] It may also be noted that even outside the realm of taxation, there is lack of consensus on how different quasi-judicial

12 Deputy Commissioner of Income Tax v. Diamond Power Infrastructure Ltd., Order dated May 27, 2020 in C.P. (I.B) No.137/2018 (NCLT).
13 Power Grid Corporation of India Ltd. v. Jyoti Structures Ltd., (2018) 142 CLA 285 (Delhi High Court).
14 Mohan Lal Jain v. ITO, Company Appeal (AT) (Insolvency) No. 414 of 2020 (March 12, 2020) (NCLAT).

authorities, such as Commissioners of the Employee Provident Fund Organisation,[15] and Directorate of Enforcement,[16] are permitted to operate during the moratorium.

(iii) *Need to rectify the inconsistency*

The inconsistency over the operation of moratorium on income tax proceedings calls for action by the IRA to ensure that all AOs adopt a uniform approach and avoid making assessments during a moratorium, in consonance with the earlier High Court and NCLT decisions, which is also in keeping with the spirit of the moratorium. Though it is appreciated that the interest of the IRA needs to be protected, the CD cannot be expected to get through the CIRP with the IRA's sword dangling over its head! More importantly, when the concerned taxpayer is on the verge of (or has already become a victim of) bankruptcy, the IRA cannot expect to recover any money from such a taxpayer and therefore, logically speaking, allowing the IRA to complete the assessment may not yield any benefit to the IRA.

In any event, the words of the Supreme Court, in *M/s Embassy Property Developments Pvt Ltd.,*[17], serve as a guiding force on this point. In this case, the Supreme Court held that although the NCLT and NCLAT possess jurisdiction over issues "arising out of or in relation to the insolvency resolution",[18] they would not have jurisdiction to decide upon disputes such as those arising under the other legislations such as the IT Act, "*mainly when the differences revolve around the decisions of statutory or quasi-judicial authorities, which can be corrected only by way of judicial review by the appropriate legal forum*." In another case, the NCLAT refrained from issuing instructions to the IRA.[19] Thus, if the jurisdiction of the NCLT and the NCLAT in regard to questions of other quasi-judicial authorities, such as the IRA, is not set in stone, reliance can still be placed on the Madras High Court decision in *Dishnet Wireless*, to rescue the CD from tax assessments during moratorium. It is pertinent to note that the judgments of the High Court, other than the jurisdictional High Court, may not be binding precedents, however, judicial discipline and consistency warrants that the Courts should consider the position adopted by a co-ordinate bench of another High Court, before proceeding to arrive at a contrary decision.

b) Post-assessment proceedings

With regard to the proceedings/ actions undertaken by the IRA post assessment, such as tax recovery and collection as well as appellate proceedings, both the legislative intent as well as jurisprudence are clear – the IBC will prevail over all other statutes,[20] including the IT Act.[21] Accordingly, the enforcement of an assessment order or an appeal against an assessment before the higher authorities, tribunals or courts, will be subject to the moratorium, i.e., it will have to be stayed till the resolution of the CIRP or until the NCLT approves a resolution plan or passes an order for liquidation

15 Regional Provident Fund Commissioner v. T.V. Balasubramanian, Company Appeal (AT) (Insolvency) No. 1521 of 2019 (June 8, 2020) (NCLAT).
16 Deputy Director, Directorate of Enforcement v. Axis Bank, 259 (2019) DLT 500 (SLP pending) (Delhi High Court).
17 M/s Embassy Property Developments Pvt Ltd., v. The State of Karnataka, 2019 (17) SCALE 37 (Supreme Court).
18 Section 60(5)(c), IBC.
19 Dada Dhuniwale Khandwa v. CIT, Company Appeal (AT) (Insolvency) No. 821 of 2019 (August 14, 2019) (NCLAT).
20 M/s. Innoventive Industries Ltd. v. ICICI Bank, (2018) 1 SCC 407 (Supreme Court), Principal CIT v. Monnet Ispat and Energy Ltd., 2018 SCC Online SC 984 (Supreme Court).
21 Section 178(6), IT Act (as amended by the Insolvency and Bankruptcy Code, 2016, w.e.f. November 1, 2016).

of the CD.[22] Further, in the case of *Leo Edibles*, despite an order of attachment of assets of the CD having been passed under the second schedule of the IT Act prior to the moratorium, the Andhra Pradesh High Court refused to find merit in the claim of the IRA that such attached assets would fall outside the purview of the moratorium.[23]

c) **Assessments post liquidation**

It is said that nothing is certain in this world, except death and taxes. But does the death (liquidation) of a company redeem it from paying taxes? In the past,[24] the CBDT had requested the Registrar of Companies to reinstate deregistered companies in relation to which assessment, penalty or prosecution proceedings or appeal proceedings were pending, prior to their deregistration, on a case-by-case basis. The Companies Act, 2013, also permits creditors such as the IRA to file such applications for restoration of deregistered companies before the NCLT, within a period of twenty years from the date of deregistration of the company.[25] However, assessment proceedings shall still have to be completed within the timelines prescribed in the IT Act.

The IRA has thus far taken such action against companies that were struck off either *suo motu* by the Registrar or voluntarily by application under Section 248 of the Companies Act, 2013. Since the legal framework provides for such reopening of struck off companies, it is also plausible that the IRA pursues liquidated companies for tax dues.

However, having said that, in case a company has been wound up pursuant to CIRP, the fact that the company could not meet its obligations and, therefore, its secured creditors had to take a haircut, may not make an attractive proposition for the IRA to proceed against such companies because it is unlikely to provide any significant tax recoveries.

d) **Directors liability post liquidation**

At the outset, it must be noted that a company is limited in its liability to the extent of its paid-up capital. In case all the shares issued by the company are fully paid up and the company is unable to meet its obligations, its lenders, creditors, IRA, etc., have no option but to assume that they will not be able to recover any of such dues and hence, have to write off such amounts. Under such circumstances, such lenders, creditors or IRA, etc., cannot claim anything more from any of the directors or shareholders of such entity, unless they are able to prove that there was abuse of power and faith and funds of the company were misappropriated by such directors or shareholders.

Under such circumstances, the IT Act also confers wide-ranging powers on the IRA to pursue directors of a private company, where tax dues from the company cannot be recovered due to liquidation of the company. Section 179 of the IT Act holds directors of private limited companies jointly and severally liable to the IRA in the event the dues (including penalty and interest) cannot be recovered directly from the company. The provision is applicable to those persons who were directors of the company during the relevant FY to which the tax claims relate.

Prior to 1975, Section 179 of the IT Act applied solely to private companies that had undergone liquidation, holding directors of such companies jointly and severally liable for payment of tax dues. With effect from October 1, 1975, the provision was made generally applicable to directors of all private companies from which tax dues cannot be recovered. Considering its wide ambit, the provision may very well be used by the IRA to recover tax dues from directors of companies post CIRP, in the event the dues could not be recovered through the IBC waterfall. A possible way out for a director to prevent lifting of the corporate veil and escape this vicarious liability is proving that the non-recovery of tax claim cannot be attributed to any gross neglect, misfeasance or breach of duty on his part in relation to the affairs of the company.[26] It thus becomes critical to demonstrate that reasonable duty of care has been adopted by the director, wherever he believes that the position or claim adopted under the ROI could be aggressive. Further, before undertaking a marque transaction or complex structuring, in addition to the auditor, an independent tax opinion may be obtained from reputed law firm to safeguard the director's liability. Further, taxpayers would do well to bear in mind that the notice of demand issued to directors in such cases should highlight whether the IRA has taken steps to recover the demand from the company and why they failed, and any order passed pursuant to such a notice should be a well-reasoned order.[27] It would be insufficient for the IRA to simply mention that despite repeated efforts, tax dues of the company remained unpaid, since the director must be given an opportunity to prove that the non-recovery of tax claim cannot be attributed to any gross neglect, misfeasance or breach of duty on his part.[28]

It is worthwhile to note that Section 178 of the IT Act, which codifies the earlier position of priority of the IRA in the waterfall under the Companies Act, 1956, has been amended in 2016 to give effect to the revamped IBC waterfall.[29] However, Section 179, dealing with directors' liability remains conspicuously unamended, leaving it open for the IRA to entrap the directors during the relevant FY.

22 PCIT v. Monnet Ispat & Energy Ltd, (2018) 18 SCC 786 (Supreme Court) upholding order of PCIT v. Monnet Ispat & Energy Ltd, (2018) 304 CTR 234 (Delhi High Court).
23 Leo Edibles and Fats Limited v. Tax Recovery Officer, (2018) 407 ITR 369 (Telangana and Andhra Pradesh High Court).
24 CBDT Circular No. F. No. 225/423/2017-ITA.II dated December 29, 2017.
25 Section 252(3), IT Act.
26 Section 179(1), IT Act; Susan Chacko Perumal v. ACIT, (2017) 399 ITR 74 (Gujarat High Court); Pratibha Garg v. CIT, (2014) 264 CTR 520 (Allahabad High Court).
27 Ashita Nilesh Patel v. ACIT, (2020) 115 taxmann.com 37 (Gujarat High Court); Bhupatlal J. Sheth v. ITO, 2012 (114) BomLR 2604 (Bombay High Court).
28 Susan Chacko Perumal v. ACIT, (2017) 399 ITR 74 (Gujarat High Court).
29 The Third Schedule, Insolvency and Bankruptcy Code, 2016.

Impact of Covid-19 on IRA and the CIRP

The discussion in this story would be incomplete without reference to the currently omnipresent COVID-19 pandemic. In order to absorb the effects of the expected business losses, owing to the pandemic, on fragile corporates, and to prevent their degeneration during the ongoing economic slump, the Government has increased the minimum amount of default to trigger insolvency proceedings from INR 1,00,000 to INR 1,00,00,000.

As a debtor-friendly move, it is aimed at eliminating frivolous initiation of the insolvency process, particularly during a period of market recession across the world. More than any category, the increase in minimum default hits operational creditors, such as the IRA, hard. This is because a financial creditor may satisfy the minimum default requirement either individually or along with defaulted debts of other financial creditors.[30] However, there is no such leeway for accumulating default on debts owed to operational creditors, as they are required to meet the threshold individually in order to initiate the CIRP.[31]

Please note that operational creditors may join CIRP initiated in accordance with the IBC and enforce their claims, regardless of the amount of default, and the minimum default stipulation is applicable only to initiation of CIRP. It has not been customary for the IRA to initiate CIRP on the assessee for failure to pay tax dues, since there are other mechanisms built into the IT Act, which allow the IRA to recover its claim, such as attachment of property, freezing of accounts, etc. Therefore, unless CIRP has been initiated by other (financial) creditors, it is unlikely that the IRA will wish to be embroiled in CIRPs, and consequently be affected by the recent increase in minimum dues.

Further, amendments have been brought into the IBC to stipulate that CIRPs cannot be initiated against a company under the IBC for defaults arising on or after March 25, 2020, for a period of six months, which may be further extended to one year.[32] The newly introduced Section 10A of the IBC declares that all CIRPs, including CIRP that the CD may initiate against itself, are suspended during the suspension period. In essence, the Government does not intend for the pandemic to become a trigger event for CIRPs against struggling businesses. Therefore, corporates that are unable to pay debts, solely on account of the pandemic, will now be protected and exempted from IBC proceedings perpetually.

However, in addition to the above suspension, no CIRP can ever be initiated under the IBC for defaults occurring during the suspension period in the absence of any retrospective enabling amendment.[33] Before analysing the impact of this prohibition on IRA claims, it would be worthwhile to understand the process of notifying a default and raising a claim under the IBC.

Section 3(12) of the IBC defines "default" as "non-payment of debt when whole or any part or instalment of the amount of debt has become due and payable and is not paid by the debtor..." From the notice of demand relating to regular assessments issued by the IRA under Section 156 of the IT Act, it may be seen that dues must be paid by the assessee generally within thirty days of service of the notice or the date stipulated otherwise. This may, therefore, allude to the fact that a "default" under the IBC may occur upon the expiry of this specified period or the thirty-day period, as per Section 220 of the IT Act. Thereafter, the IRA, as an operational creditor, must deliver a demand notice to the CD as stipulated in Section 8 of the IBC, to register its demand with the CD[34], providing a deadline of ten days to fulfil the demand. If the CD fails to do so, then CIRP may be initiated against it. It has been held by the NCLAT that CIRP may be initiated only upon the occurrence of default, which is to be followed by demand of notice.[35] As a mandatory provision of the IBC, Section 8 cannot be bypassed by issuing notices under any other statutes, say Companies Act, 2013.[36] Therefore ,the IRA must mandatorily serve a notice of demand in Form 3 as specified under the IBC,[37] in order to initiate CIRP and the service of other notices of demands under the IT Act may not suffice.

A reading of Section 10A would suggest that any "default" arising during the suspension period must not trigger CIRP under the IBC. However, once the total default amount from debts (not including defaults during the suspension period) meets the INR 1,00,00,000 threshold, collectively by financial creditors or individually by operational creditors (as elaborated above), it is likely that any operational and financial creditor may join the CIRP and make claims, even relating to defaults that arose during the suspension period. This is of course subject to contrary interpretation by the NCLT or the NCLAT, a plain reading of the provision indicates this conclusion.

Conclusion

The IBC is hailed as the beginning of a transformative journey for Indian businesses and it certainly can be regarded as a step in the right direction. However, as with every other developing legal system, there are creases that remain to be ironed out. The jurisprudence and precedents surrounding the IBC, especially relating to the confluence of the IT Act and the IBC, are relatively primitive and conflicting at some points. The ITATs and Courts have not had the opportunity yet, to be faced with a number of intricate and contentious issues in this arena. One has to wait and watch which way the wind blows – in favour of the IRA or the stressed taxpayers, already grappling with CIRP and hoping for survival.

30 Section 7(1), IBC.
31 Section 8, IBC.
32 Section 10A, IBC.
33 Proviso to section 10A, IBC.
34 Section 8, IBC.
35 Era Infra Engineering Ltd. v. Prideco Commercial Projects Pvt. Ltd., (2017) 205 CompCas 511 (NCLAT).
36 *Id.*
37 Rule 5, Insolvency and Bankruptcy (Application to Adjudicating Authority) Rules, 2016.

CASE LAW UPDATES- DIRECT TAX

INTERNATIONAL TAX

Guarantee Fee Does Not Qualify As FTS Or Interest Under The India-Netherlands DTAA

In the case of ***Lease Plan India Pvt. Ltd***[38], the Delhi bench of ITAT held that guarantee fee paid by a taxpayer to its Dutch parent was not subject to withholding tax under Section 195 of the IT Act and as such a fee was not taxable under the India-Netherlands DTAA, either as FTS or interest, or under any other article. Accordingly, the ITAT deleted the disallowance of such a fee under Section 40(a)(i) for non-deduction of tax at source.

Facts

Lease Plan India Pvt. Ltd ("**Assessee**") was a company engaged in the business of leasing of motor vehicles, financing services, fleet management, etc. During the assessment proceedings, the AO noted that the Assessee had made certain payments on account of guarantee fees to its Associated Enterprise ("**AE**") based in the Netherlands, without deducting any tax on the same. The AO disallowed the deduction of such guarantee fee under Section 40(a)(i) of the IT Act for of non-deduction of tax at source. Aggrieved by the AO's order, the Assessee preferred an appeal before the CIT(A). The CIT(A), placing reliance on his / her orders in the previous AYs, held that guarantee fee would qualify as income from a debt claim and accordingly the same would be taxed as interest income under the India-Netherlands DTAA. Additionally, it also held that corporate guarantee granted by the AE was in the nature of consultancy services and thus, the guarantee fee was as FTS. The CIT(A) upheld the disallowance since tax was required to be withheld on the payment of guarantee fee. Aggrieved by the order of the CIT(A), the Assessee approached the ITAT.

Issue

Whether guarantee fee paid by Assessee to its AE was subject to tax in India under the India-Netherlands DTAA and whether any tax was required to be withheld on such payment?

Arguments

The Assessee relied upon the decision of ***Johnson Matthey***[39], where the ITAT, while interpreting the India-UK DTAA, had held that guarantee fee did not qualify as interest under the India-UK DTAA and in the absence of any specific provision, the same was taxable as per the Article dealing with 'other income'. On this ground, it was contended by the Assessee in the instant case that guarantee fee did not fall within the definition of interest under the India-Netherlands DTAA. Further, it was also clarified that the India-Netherlands DTAA did not contain any 'other income' Article and, therefore, the same could not be taxed therein. The Assessee also argued that corporate guarantee did not involve rendering of any technical or consultancy services and hence, the guarantee fee could not be treated as FTS. Further, it was pointed out that in order to qualify as FTS under the DTAA, the services had to be made available to the Assessee. On the basis of the aforesaid arguments, it was argued that since the "make available" requirement could not be satisfied in the instant case, the guarantee fee could not be taxed as FTS.

The IRA placed reliance on the orders of the lower authorities to argue that the guarantee fee qualified as interest and FTS under the DTAA and the same was subject to withholding tax.

38 Lease Plan India Pvt. Ltd v. DCIT. ITA No. 6461 & 6462 of 2015 (Delhi ITAT).
39 Johnson Matthey India Pvt. Ltd. v. DCIT (2017) 88 taxman.com 127 (Delhi ITAT).

Decision

The ITAT observed that the India-Netherlands DTAA defined interest to include 'income from a debt claim'. Accordingly, it noted that broadly all income from provision of capital by way of debt claim would constitute interest. The ITAT held that in the instant case, there was no provision of capital by the AE, it only provided a promise to reimburse the lenders of the Assessee in the event of default. Thus, it held that the guarantee fee did not qualify as interest under the DTAA. The ITAT also relied upon the decision of the ***Container Corporation***[40], wherein the issue before the Court was whether the guarantee fee paid towards guaranteeing debt of a subsidiary company was more analogous to "service" than interest.

The ITAT also clarified that corporate guarantee was in the nature of financial services and by no stretch of imagination, it could be treated as consultancy or technical service. Further, it also pointed out that corporate guarantee could not satisfy the 'make available' requirement under the FTS Article of the India-Netherlands DTAA and thus, it held that the guarantee fee was not in nature of FTS. The ITAT further held that guarantee fee constituted ordinary business income, which was not taxable in India as the AE did not have a PE in India.

On the basis of the aforesaid arguments, the ITAT held that since the guarantee fee was not required to be taxed in India, no tax was required to be withheld at the time of its payment and thus, reversed the order of the lower authorities and the deleted the disallowance.

Significant Takeaways

This decision of the Delhi ITAT appears to be in line with its recent decision in the case of ***M/s. JCDecaux S.A.***[41], where the ITAT held that corporate guarantee fees received by a French company from its Indian AE, was not in the nature of FTS, either under the India-France DTAA or the IT Act. Having said the above, it would

be relevant to note that in the instant case, as noted by the ITAT, the IRA could not tax corporate guarantee fees under the Article dealing 'other income', considering the India-Netherlands DTAA did not specifically provide for the same. However, it would be pertinent to note that in the case of ***Johnson Matthey***, the Delhi bench of the ITAT had concluded that though corporate guarantee fee was not taxable as interest or FTS, the same was subject to tax under the 'other income' Article under the India-UK DTAA. Additionally, in the case of ***Capgemini S.A.***[42], Mumbai bench of ITAT held that the guarantee fee paid by an Indian subsidiary to its French AE for giving a corporate guarantee to a French Bank, would not be taxable as per the 'other income' Article under the India-France DTAA, as such an income did not accrue or arise in India.

Thus, even though a corporate guarantee fee may not fall within the definition of interest or FTS, the taxability of the same would have to be determined under other articles of the DTAA, having regard to the factual matrix of the case at hand.

> **"Payment of guarantee fee by an Indian does not give rise to any income under the India-Netherlands DTAA."**

40 Container Corporation v. Commissioner of Internal Revenue of United States Tax Court Report 134 T.C. 122 (USTC 2010).
41 M/s. JCDecaux S.A., v. ACIT, TS 183 ITAT 2020 (Delhi ITAT).
42 Capgemini S.A v ADIT, TS 177 ITAT 2016 (Mumbai ITAT).

SC holds activities carried on by liaison office in relation to remittance services to be *"preparatory or auxiliary"* in nature

In the case of ***U.A.E. Exchange Centre***[43], the SC held that its Liaison Office ("**LO**"), which was engaged in providing certain remittance related services for transferring funds from the U.A.E. to India could not be considered as carrying out any business activity in India. The SC held the activities to be of preparatory and auxiliary nature.

Facts

U.A.E. Exchange Centre ("**Assessee**") was a limited company, incorporated in the UAE, engaged in offering remittance services for transferring funds from the UAE to various places in India. During the relevant AY, the Assessee had transferred funds either by telegraphic transfer or by sending cheques to beneficiaries in India.

The issue involved in this case was with respect to the second mode of remittance wherein the LO in India was involved in (a) downloading particulars of remittances through the main server in the U.A.E. and (b) printing cheques or drafts, which were then couriered to the beneficiaries in India. In this regard, the Assessee filed an application before the AAR to determine whether there was any income accruing to the Assessee in India on account of carrying out the aforesaid activities in India.

The AAR held that the LO constituted a PE of Assessee in India and so much of the income as was attributable to the LO was taxable in India, since there was a business connection in India in terms of Section 9(1)(i) of IT Act. It also observed that the business of the Assessee was being carried out in the U.A.E and the contract for remittance was also entered outside India and the commission from the same was earned outside India. However, without the LO, the transactions of remittance to India could not be completed and hence there was a real relation between the commission received by the Assessee in the U.A.E and the activities carried out by the LO in India. Therefore, income in relation to the activities carried out in India was taxable in India.

The AAR further analysed the applicability of exclusionary clause provided under Article 5(3)(e) of the India-U.A.E DTAA, which provides that merely carrying on any activity, which was of a preparatory or auxiliary character did not constitute a PE. It observed that the word 'auxiliary' in common English usage meant helping, assisting or supporting the main activity. In respect of the above, it held that the first activity carried out by the LO with respect to telegraphic transfers was auxiliary and the second activity was an important part of the main work itself and was nothing short of performing the contract of remitting the amounts at least in part, hence could not be said to be of an auxiliary character.

On the basis of the above findings, the AAR held that LO would constitute as a PE in India in respect of the second mode of remittances. Being aggrieved by the order of AAR, the Assessee filed a writ petition before the HC.

The HC in its order stated that the AAR proceeded on a wrong premise, by first examining the efficacy of Section 9(1)(i) of the IT Act, instead of applying the provisions in Articles 5 and 7 of the relevant DTAA as provisions of the DTAA override the provisions of the IT Act. Article 5(3) of the relevant DTAA clearly stated that notwithstanding clauses 1 and 2 of Article 5, it was still not a PE, if any of the clauses in Article 5(3) were applicable. The HC also ruled that the activity performed by the LO in India was only supportive of the transaction carried on in the UAE and Article 5(3)(e) did not imply that if a transaction cannot be completed without the role played by LO, it would imply that its work was not auxiliary in nature as in this way, no activity can ever be construed as auxiliary.

The HC also relied on the SC decision in the case of ***Morgan Stanley***[44] in which the SC had held that back office operations supporting the front office functions were auxiliary and preparatory in nature.

Against the order of the HC, an SLP was filed by the IRA in the SC.

Issue

Whether the activities carried on by the LO in India would qualify as "preparatory or auxiliary" in character?

Arguments

The Assessee reiterated its arguments before the SC i.e. the activity of remitting funds to beneficiaries in India was merely "auxiliary" in nature and did not involve any trading, commercial or industrial activity. Therefore, the LO could not be said to have constituted a business connection in India. The Assessee also argued that it fell within the exclusionary clause contained in Article 5(3)(e) of DTAA.

However, the IRA contended that the activities under consideration were not preparatory or auxiliary in nature as they were with respect to downloading particulars of remittances through electronic media by accessing the main server located in the U.A.E. and then printing cheques/drafts drawn on the banks in India, which, in turn, were dispatched to the beneficiaries in India. The IRA also tried to distinguish the SC judgement in the case of ***Morgan Stanley*** by arguing that the aforesaid case was in respect of a service PE and SC should look at the entire transaction to see whether it was back office or auxiliary work.

43 Civil Appeal No. 9775 of 2011(SC).
44 2007(7) SCC 1 (SC).

Decision

The SC observed that Article 5(3) of the DTAA opened with a *non-obstante* clause, which implied that notwithstanding the provisions of Article 5(1) and 5(2) of the DTAA, the Assessee would not have a PE if any of the clauses in Article 5(3) were applicable. It held that a functional test regarding the activity in question was essential.

It also held that even if it were assumed that the activities of the LO were regarded as business activities, the same being of preparatory or auxiliary in nature, would still fall within the ambit of Article 5(3)(e) of the DTAA. Thus, the SC agreed with the findings of the HC that on account of the onerous stipulations specified by the RBI, it could be concluded that the activities in question of the LO were circumscribed by the permission given by the RBI and were in the nature of preparatory or auxiliary character and also concurred with the reliance placed by the HC in the case of ***Morgan Stanley*** .

The SC also held that the Assessee's role in remittances did not constitute as business activity as the limited permission from the RBI demonstrates that it cannot carry on any primary business activity or establish a business connection in India. The SC also observed that limited permission provided by the RBI specifically excluded entering into a contract with anyone in India or rendering any consultancy or any other service or receiving any remuneration in respect of the activities carried out in India.

Keeping with the above, the SC upheld the order of the HC and held that the core issue that was required to be answered was whether the stated activities of the Assessee would qualify as being of a preparatory or auxiliary character and since it was clear that the concerned activities were of preparatory or auxiliary in nature, no tax was required to be paid in India.

Significant Takeaways

Overseas companies tend to set up a liaison office in India in order to understand the market conditions here as well as to act as a communication centre between the head office and its Indian offices. The scope of activities that can be carried out by a LO are restricted and pre-defined by the RBI, whose approval is mandatory for setting up any LO office in India.

In the past few years, the activities carried out by LOs have been subject to significant amount of scrutiny in India by the IRA. Courts have also held that certain activities of LOs are not merely liaising in nature, but, indeed, a business activity.

Therefore, it is pertinent to analyse the functions actually carried out by the LO in India to determine whether or not it carries on a business activity or whether or not the exclusionary clause provided under the relevant DTAA as discussed above is applicable or not.

It is to be noted that India has also executed an MLI under the BEPS Action Plan. In view of the same, 'preparatory and auxiliary' exclusionary clause has been amended to prevent the breakup of an operating business into several small business units in order to benefit from the preparatory or auxiliary exclusion. As a result, the activities performed are to be combined (analysed on an aggregate basis) when assessing whether they can be regarded as preparatory or auxiliary in nature.

In the instant case, however, the LO in India was merely delivering the cheques to the beneficiaries in India. It is to be noted that the head office in the UAE processed the entire transactions from outside India i.e. collection of money, collecting details of the beneficiaries in India, debiting and crediting the relevant accounts, etc. The LO merely prints the cheques in India and delivers it to the beneficiaries. Therefore, even as per the provisions of MLI, the activities of the Assessee cannot be regarded as business activities.

> **“ Delivery of cheques to beneficiaries in India by the LO is preparatory or auxiliary character. ”**

Non-compete fees to key US employees characterised as 'Salary'

In the case of ***M/s. Sasken Communication Technologies Ltd.***[45], the Karnataka HC characterised the non-compete fees received by US employees as salaries and granted treaty benefits under the India-US DTAA.

Facts

M/s. Sasken Communications Technologies Ltd. ("**Assessee**") was an Indian company, having a subsidiary in the USA. The said subsidiary was merged with the Assessee company in AY 2006-07 and the Assessee offered employment to two employees of the subsidiary company as they were in key strategic positions in the subsidiary. The Assessee entered into non-compete agreements with the two employees for which payments were made to the said employees after they became employees of the Assessee. Thus, there were three agreements entered into between the Assessee and the two key employees – employment agreement, non-disclosure agreement and employee non-compete agreement.

The Assessee filed a CA certificate with the remitter bank with the endorsement that no tax was required to be deducted at source as the remittance was towards consideration under non-compete Agreement and is covered under Article 16(1) of the India-US DTAA.

The AO issued show-cause notice to the assessee to show cause as to why it should not be treated as assessee in default under Section 201 of the IT Act. Subsequently, the AO passed an order that the agreements and payments made to the two employees were sham and created only for the purpose of avoiding payment of tax in India. The order was challenged by the Assessee before the CIT(A).

The CIT(A) upheld the order of the AO, stating that the payments received by the employees under the non-compete agreement are taxable under Article 23(3) of the DTAA as Other Income and the appellant has not been able to show that that the two employees have paid taxes either voluntarily or otherwise in the US.

On appeal to the ITAT, the ITAT allowed the appeals of the Assessee, stating that the amount paid to the employees under the non-compete agreements would fall under 'salary' or 'profits in lieu of salary'. It also held that the amounts were in the nature of salaries, which were not taxable in India in view of Article 16 of the DTAA and, therefore, it was not necessary for the Assessee to approach the appropriate authority under Section 195(2) of the IT Act to obtain a certificate for not withholding any tax. Accordingly, the ITAT ruled that the Assessee could not have been treated as assessee in default.

Aggrieved by the ITAT order, the IRA filed an appeal before the HC.

Issues

i. Whether the ITAT was correct in holding that payments made to employees under the non-compete agreement were in the nature of 'salary' or 'profits in lieu of salary' and not 'business income'?

ii. Whether payments made to the Assessees under the non-compete agreements were income, which had arisen in the hands of the concerned employees in the US and not in India under Article 16 of India-US DTAA?

iii. Whether the Assessee was bound to deduct tax at source on the amounts paid to the employees under non-compete agreements and failure to do so would make the Assessee an" assessee in default" under Section 201(1) of the IT Act?

iv. Whether the non-compete agreements entered into by the Assessee and the employees were only sham transactions to avoid tax?

Arguments

The IRA argued that once the Assessee had already entered into a non-disclosure agreement, there was no requirement for the Assessee to enter in to a separate non-compete agreement. Further, the non-compete agreement created a prohibition on the employees with respect to employment with certain companies situated in India and, therefore, the amount paid to the employees under the non-compete agreement was covered under Section 5(2) of the IT Act. The IRA also argued that the agreement was a sham transaction for the purpose of tax evasion. Lastly, relying on the SC decisions in the case of ***Performing Right Society Ltd.***[46] and ***Pilcom***[47], the IRA argued that payments received under the non-compete agreements ought to have been treated as income from other sources under Article 23(2) of the India-US DTAA.

The Assessee argued that the amount paid to the employees under the non-compete agreements was not chargeable to tax in India and the tax, if any, had to be levied in the US as per Article 16 of the India-US DTAA. The Assessee placed materials on record to show that the employees had not rendered any services in India. The Assessee also argued that the last fact-finding authority is the ITAT and a decision on facts by the ITAT can be reviewed by the HC only if the factual assessment arrived at by the ITAT is regarded as perverse. However, no such question was referred to the HC. The Assessee also argued that no substantial question of law arose for consideration before the HC. The Assessee also argued that the non-disclosure agreement and non-compete agreement were two different agreements, where the former applied while the employee was

45 Director of Income-tax v. M/s. Sasken Communication Technologies Ltd. ITA no. 241 of 2011 (Karnataka HC).
46 Performing Right Society Ltd. v. Commissioner of Income-tax, (1977) 106 ITR 11 (SC).
47 Pilcom v. CIT West Bengal – VII, Civil Appeal no. 5749 of 2012 (SC).

in employment, whereas the latter could be applied when the employment ceases to exist. The Assessee also distinguished its case from the cases relied upon by the IRA on facts and instead argued that the IRA had, in previous instances, made submissions that non-compete fees should be treated as salary and the same was accepted by the Delhi HC.

Decision

The HC agreed with the argument of the Assessee that the findings of facts recorded by the ITAT have not been assailed as perverse in the appeal. There was no material placed on record to demonstrate that the findings of facts recorded by ITAT were perverse. Therefore, the substantial question of law did not arise in this case as the matter stands concluded by findings of facts.

Further, the amounts paid to the employees under the non-compete agreement were covered by the expression 'salary/ profits in lieu of salary'. The HC also observed that Section 17(3) of the of the IT Act defines 'profits in lieu of salary', which includes under clause (iii) –

Any amount due to or received whether in lump sum or otherwise by any assessee from any person –

Before his joining any employment with that person; or

After cessation of his employment with that person

Thus, it was evident that expression profits in lieu of salary includes any amount received before joining or cessation of employment with that person.

The HC also looked into Section 9(1) explanation 7 clause (ii), which stated that income shall fall under the head "Salaries" if it was earned in India for services rendered in India. Considering the present case where the services were rendered exclusively in the US, non-compete fee received by the employees would not fall under Section 9(1) explanation 7 clause (ii).

Further Article 16 of the India-US DTAA states that salaries, wages and other similar remuneration derived by a resident of a contracting state shall be taxed in that state only, unless the employment is exercised in the other contracting state. Considering that the employees were tax residents in the US and were exercising employment in the US only, the salary shall be taxed in the US only as per the India-US DTAA.

The HC also rejected the argument of the IRA that the non-compete agreement was a sham transaction. The HC agreed with the argument of the Assessee and the reasoning of the ITAT that non-disclosure agreement was different from non-compete agreement and no clause in the employment agreement or non-disclosure agreement governed the subject matter of the non-compete agreement, which was to refrain the assessee from joining any of the competitors of the Assessee, considering the two employees were key employees.

Given the same, the HC dismissed the appeal of the IRA and upheld the decision of the ITAT.

Significant Takeaways

The arguments of the IRA in the present case are contradictory to the position taken by the IRA before the Delhi HC in the case of ***Kanwaljit Singh***[48] wherein the IRA had argued that the non-compete fee received by the employee was in the capacity of an employee in order to refrain the employee from carrying on the business similar to that of their employer. In this case, the IRA had relied on the definition of 'salary' under Section 17 of the IT Act and argued that the said definition covered any fees, wages, commission, bonus, perquisite or profit in lieu or in addition to salary. The Delhi HC had upheld the arguments of the IRA and had characterised the non-compete fees as salary. This was highlighted by the Assessee in the present case as well while arguing before the Karnataka HC.

In the present case, the IRA had failed to establish that the finding of the ITAT were perverse. The IRA also attempted to make a hypothetical connection of the non-compete fees with India by arguing that since the non-compete was in relation to Indian competitors, the payment was subject to tax in India. Regardless of the vain attempt of IRA, the decision is an important addition in characterisation of non-compete fee.

"Karnataka HC characterises non-compete fee as salary and grants DTAA benefits to the Assessee."

48 Commissioner of Income – Tax – XIII v. Kanwaljit Sing, (2012) 28 taxmann.com 28 (Delhi HC).

CASE LAW UPDATES- DIRECT TAX

TRANSACTIONAL ADVISORY

Bombay HC upholds the rule of *lex domicilii* to determine the status of a corporation

In the case of ***Aberdeen Asia Pacific Including Japan Equity Fund***[49], the Bombay HC applied the principles of private international law and held that the status of a corporation must be decided according to the laws of the country of its domicile. Accordingly, the HC allowed the three sub-trusts of a Delaware based mother trust to carry forward and set-off their losses, post the conversion of the mother trust into an LLC, considering the LLC was deemed to be the same entity as the erstwhile trust as per the applicable laws of Delaware.

Facts

Aberdeen Asia Pacific, including Japan Equity Fund, Aberdeen Emerging Market Equity Fund and Aberdeen Asia Pacific, excluding Japan Equity Fund ("**Petitioners**"), were sub-funds of Aberdeen Institutional Commingled Funds, LLC ("**AICFL**"), a Delaware based LLC, which were set-up *inter alia* to invest in securities in India. AICFL was originally set-up as a trust, under the applicable trust laws of Delaware, with the Petitioners as its sub-trusts.

Subsequently, AICFL was converted into an LLC and the Petitioners were consequently converted into sub-funds of the LLC. Such conversion was undertaken in accordance with the applicable laws of Delaware, which stipulated that the LLC would be deemed as the same entity as the erstwhile trust, and the sub trusts i.e. the Petitioners would continue as sub-funds of the LLC, without any dissolution.

Prior to the conversion, the Petitioners had accumulated tax losses under the head of capital gains, which were sought to be carried forward as per the provisions of the IT Act. AICFL approached the AAR to determine if such carry forward of losses was permitted in light of the said conversion.

The AAR held that though Delaware laws created a deeming fiction that the AICFL continued to be the same entity as the erstwhile trust, such deeming fiction cannot be imported into the IT Act in the absence of a specific provision. The AAR further held that the IT Act restricts the claim of carry forward of losses only to the taxpayer entity, which has actually incurred the relevant loss. Thus, considering AICFL had not incurred any loss in India, it could not be permitted to carry forward any losses incurred by the Petitioners, which were separate entities. Aggrieved of the order of the AAR, AICFL and the Petitioners filed a writ petition before the Bombay HC. The Bombay HC removed the Petitioners from the writ petition, as the same were not parties to the proceeding before the AAR. Subsequently, the HC held that as per the rules of private international law, the status of a foreign entity had to determined as per the laws of the country of its domicile. Accordingly, the HC held that AICFL continued to be the same entity under the laws of Delaware, even after its conversion. Therefore, the benefit of carry forward of losses could not be denied only on the grounds of change in status of AICFL, from trust to LLC. However, the HC observed that AAR had actually denied the benefit of carry forward of losses on the grounds that AICFL was not the entity, which had incurred the losses and clarified that the decision of the AAR would not have a bearing on the claim of the Petitioners to carry forward losses in accordance with the IT Act.

However, despite the aforementioned Bombay HC ruling, the IRA commenced reassessment proceedings against the Petitioners on the grounds that the Petitioners where not the same entity as the sub-trusts and accordingly, they were not entitled to carry forward losses. These proceedings were sought to be quashed by the Petitioners vide a writ petition before the Bombay HC.

Issue

Whether the Petitioners could be considered as the same entity post the conversion of AICFL, for the purposes of allowing the

49 Aberdeen Asia Pacific Including Japan Equity Fund v DCIT, Writ Petition No. 2796 of 2019, 2803 of 2019 and 3525 of 2019 (Bombay HC).

benefit of carry forward of losses and accordingly, whether the reassessment proceedings against the Petitioners where liable to be quashed?

Arguments

The Petitioners placed reliance on the SC decision in the case of ***Technip SA***[50] and argued that it was a settled position that the question of status of an entity would have to be decided having regard to the laws of the place of its incorporation. Further, it was pointed out that the Bombay HC in the writ filed by AICFL, had held that AICFL would continue to be deemed to be the same entity, even after its conversion, in light of the deeming fiction under the law of Delaware. Thus, it was argued that the basis on which the IRA re-opened the assessment of the Petitioners i.e. that the Petitioners were not the same entity as the sub-trusts was wholly untenable in law.

The IRA on the other hand sought to challenge the writ petition on the technical grounds that writ petition against the re-assessment notice could not be entertained when the draft assessment orders had already been passed.

Decision

The Bombay High Court rejected the argument of the IRA and held that the Petitioners, as sub-funds of the AICFL, were not distinct from the Petitioners as sub-trusts. The HC placed reliance on the SC decision in the case of *Technip SA*, where the SC observed that a corporation is an artificial body created and governed by law. Accordingly, all questions regarding the creation or dissolution of corporate status of such a corporation have to be determined in accordance with such law, unless it is contrary to public policy. Thus, the SC held that all that questions as to the status of a corporation must be decided according to the laws of the country of its domicile or incorporation, subject to certain exceptions, including the exception of domestic public policy.

Accordingly, placing reliance on the aforementioned decision and its decision in the writ filed by the AICFL, the HC held that if under the laws of Delaware, AIFCL continued to be the same entity even after the conversion, the same would hold true in India as well. Therefore, the benefit of carry forward of losses

cannot be denied to AIFCL only on the basis of change in its status from trust to LLC. Therefore, by extension, it was also held that the Petitioners could not be denied benefit of carry forward of losses as they continued to be the same entity even post conversion. Thus, the court held that reopening of the assessment of the petitioner was erroneous as the same was based on the change in the status of the Petitioners, post the said conversions.

Significant Takeaways

This decision is of a great significance as the Bombay HC in the instant case has imported the principles of private international laws into tax matters. The Bombay HC has recognised the principle of *lex domiclii* for the purpose of determining the status of foreign entities in India i.e. questions related to the status of an entity would be determined having regard to the law of the place of incorporation of an entity.

In today's liberalised world, taxpayers are using various foreign corporations/entities to invest into India and the Courts find themselves determining the taxability of such entities, which are not specifically dealt with under the Indian taxation laws. Considering Indian taxation laws cannot possibly deal with scenarios involving foreign entities, like protected cell companies, LLCs, etc., this decision holds relevance in this regard.

> **" Status of a corporation must be determined having regard to the laws of its place of domicile. "**

50 Technip SA v. SMS Holding (P) Ltd., (2005) 5 SCC 465 (SC).

No Deemed Dividend In The Hands Of Substantial Shareholder In The Absence Of Any Benefit From Loan Transaction Between Investee Companies

In the case of ***Jayesh T. Kotak***[51], the Gujarat HC held that no deemed dividend would arise in the hands of the shareholder assessee in the case of a loan transaction between investee companies, wherein no benefits were received by the shareholder assessee.

Facts

Jayesh Kotak ("**Assessee**"), an individual, held 27.49% shareholding in M/s. J.P. Infrastructure Private Ltd., now known as J.P. Iscon Limited ("**JP Iscon**"). Further, the Assessee also held 50% shareholding in Gujarat Mall Management Co. Pvt. Ltd. ("**Gujarat Mall**") and 29% shareholding in Aryan Arcade Pvt. Ltd. ("**Aryan Arcade**"), both of which were sister concerns of JP Iscon. During the relevant AY 2008-09, JP Iscon extended loans to both Gujarat Mall and Aryan Arcade. The Assessee had filed his return of income for the same AY showing a total income of INR 1.49 crore.

The Assessee's case was selected for scrutiny assessment by the AO. During the scrutiny assessment, the Assessee was asked to clarify why the loan extended by JP Iscon to its sister concerns should not be considered as deemed divided in the hands of the Assessee under Section 2(22)(e) of the IT Act. The Assessee filed appropriate replies to the queries of the AO and the assessment order was passed, making six additions to the income of the Assessee. The AO also examined the issue of deemed dividend to the Assessee under Section 2(22)(e) of the IT Act, as a result of inter-group loans by JP Iscon. However, no additions were made by the AO in this regard. The Assessee challenged the order of the AO before the CIT(A) for the six additions made by the AO.

After a gap of more than four years from the end of relevant AY, in March 2015, the AO reopened the case of the Assessee for AY 2008-09 under Section 148 of the IT Act. In response to this notice, the Assessee made certain legal submissions and also requested for a copy of reasons recorded for reopening of assessment by the AO. In the copy of the reasons supplied by the AO, the issue of intra-group loans by JP Iscon to Gujarat Mall and Aryan Arcade was raised by the AO. The reasons further stated that the Assessee was required to declare the inter-group loans given by JP Iscon to Gujarat Mall and Aryan Arcade as per Accounting Standards ("**AS**") 18. However, the Assessee had only declared its shareholding in all the three companies, and did not disclose the fact that there was inter-group loan extended from JP Iscon to Gujarat Mall and Aryan Arcade. Accordingly, as per the AO, appropriate disclosures with respect to these intra-group loans were not made by the Assessee and that these unsecured loans by JP Iscon to its sister concerns were to be treated as deemed dividend. Based on the above, the AO was of the opinion that the income had escaped assessment for AY 2008-09. The Assessee filed his objections to the reopening of assessment. Further, the AO also issued show-cause notice to the Assessee, asking him to show-cause why the loan extended by JP Iscon, should not be treated as deemed dividend, considering the Assessee held more than 10% shareholding in the sister concerns. The Assessee clarified that this very issue had already been dealt with in his objections to the reopening of assessment filed by him. However, the objections of the Assessee were rejected and the AO reiterated that the notice has been issued in accordance with applicable laws.

Aggrieved by the decision of the AO rejecting the objections filed by the Assessee against the reopening of the assessment, the Assessee filed a writ petition before the Gujarat HC, asking for the quashing of the re-opening of assessment by the AO.

Issues

Whether the Assessee was taxable under Section 2(22)(e) as substantial shareholder of JP Iscon, i.e. the company extending the loan to its sister concerns?

Arguments

Before the HC, the Assessee made a *prima facie* argument that the issue was already dealt with in detail during the scrutiny assessment for the same AY, therefore, it was not justified for the AO to reopen assessment with respect to the same issue.

One of the reasons recorded by the AO in the reasons for reopening the assessment was that the Assessee did not disclose the transaction with related parties as per AS. In this connection, the Assessee argued that AS 18, which deals with Related Party Disclosures, is mandatory only to certain enterprises and not to all enterprises. The two categories mentioned in AS 18 are - (i) which relates to enterprises whose equity or debt securities are listed on a recognised stock exchange; and (ii) relates to all commercial, industrial and business reporting enterprises, whose turnover for the accounting period exceeds INR 50 crore. The Assessee argued that it did not fall under either of the two categories and hence, AS 18 was not applicable to it and there was no mandatory requirement for it to disclose such a transaction.

The Assessee also argued that Section 2(22)(e) created a fiction by which certain receipts or part thereof were treated as dividends for levy of income-tax. Relying on the decision of SC in the case of ***Mukundray K. Shah ("M. Shah")***[52], the Assessee argued that there were two factors required to be fulfilled for invoking Section 2(22)(e) of the IT Act, first, whether the petitioner had received some benefit from extending the loan and second, whether on the date of payment there existed "accumulated profits" in the concern which advanced the loan.

51 Jayesh T. Kotak v. Deputy Commissioner of Income-tax (2020) 116 taxmann.com 426 (Gujarat).
52 Commissioner of Income Tax v. Mukundray K. Shah, (2007) 290 ITR 433 SC.

The Assessee argued that it did not receive any benefits from advancing of loans by JP Iscon to its sister concerns. The Assessee drew the attention of the HC to the objections raised by him on reopening of assessment to point that this contention was raised by the Assessee in the objections as well.

Relying on the first proviso to Section 147 of the IT Act, the Assessee argued that re-assessment proceedings beyond a period of four years from the end of the relevant AY, would be without any jurisdiction and bad in law if all the material facts were furnished before the AO and there remained no omission or failure on the part of the Assessee to disclose fully and truly all material facts. The Assessee argued that the onus was on the Assessee to reveal the primary facts and it was the responsibility of the AO to draw the inferential facts from them. Once the Assessee had made full and complete disclosure of facts at the time of scrutiny assessment, no change of opinion was permissible merely because there was some error earlier on the part of the AO himself or because he chose not to opine on the issue. The Assessee placed reliance on the jurisdictional HC's decision in the case of ***Viren Surender Shah***[53], which in turn had relied on another decision of the jurisdictional HC in the case of ***Niko Resources Ltd.***[54] to further his argument. The Assessee stated that there was no failure on his part to disclose truly and fully all material facts necessary for assessment with respect to deemed dividend under Section 2(22)(e) and hence the initiation of the impugned re-assessment was not permissible.

In response to the above arguments, the IRA clarified that during the scrutiny assessment, the assessment of deemed dividend under Section 2(22)(e) of the IT Act was in respect of different parties. The transaction with JP Iscon with Gujarat Mall and Aryan Arcade was not analysed in further detail at the stage of the assessment. The IRA agreed that while the petitioner had given details of the direct loans received by him, no details were provided in respect of the subject transactions. The re-assessment in this case was opened on the basis of the information received from DCIT, TDS Circle.

The IRA also contended that the basic requirement for triggering Section 2(22)(e) was that there should be a loan given by a company to either its shareholders or to another company in which such shareholder had substantial interest. The IRA argued that it was an established position that the scope of deemed dividend under Section 2(22)(e) contemplated loans or interest to a concern, wherein the shareholder had an interest. It was also an established fact that the Assessee's shareholding in JP Iscon, Gujarat Mall and Aryan Arcade were more than 10% of the voting power. The next aspect of whether the Assessee had received any money or not, would have to be evaluated at the assessment stage. At the stage of formation of opinion regarding the applicability of Section 2(22)(e) for the purposes of sending a reassessment notice under Section 148 of the IT Act, all that the AO had to do was to be satisfied that the basic requirement of advancement of loan by a company to another company in which the shareholder had substantial interest, was fulfilled. If the assessee was in a position to point out that no benefit had been received as a result of the advancement of such loan, the assessment would then fail. Therefore, the principles stated by the SC in ***M Shah*** were only triggered subsequently after the AO had framed an opinion on the applicability to Section 2(22)(e). The applicability of Section 2(22)(e) did not depend on these principles.

The IRA also argued that the Assessee had failed to make a full disclosure of facts at the scrutiny assessment stage, which mandated the re-opening of assessment by the AO under Section 147 of the IT Act.

Decision

The Gujarat HC examined the facts of the case in light the decision of the SC in the case of ***M Shah***, which in turn had placed reliance on the decision of ***Alagusundram Chettiar***[55], wherein it was held that the word "payment" in Section 2(22)(e) of the IT Act meant the actual act of paying. Accordingly, only payments made to the company for the benefit of the shareholder was assessable as deemed dividend in the hands of the shareholder, to the extent of accumulated profits. Thus, the conditions laid down by the SC in the case of ***M Shah*** are to be applied while testing the applicability of deemed dividend provision on the shareholder of the company in receipt of the loan. In this case, while it had been established that there were loans advanced by JP Iscon to its sister concerns in which the Assessee held substantial interest, there was no information to the effect that such payment was made for the benefit of the Assessee. There was no satisfaction recorded by the AO that the payment in the form of loan benefitted the Assessee in any manner. The HC observed that the intent of the legislature was to tax funds ultimately received by the shareholder, holding more than 10% voting power, through different conduits. Thus, the HC held that only such amount would be taxed as deemed dividend which was received by the shareholder as a result of the loan advancement. There was no such assertion made by the AO that amount was for the benefit of the Assessee. Therefore, *prima facie*, the transaction was not for the benefit of the Assessee and cannot be considered as deemed dividend.

The HC also agreed with Assessee's argument that AS 18 was not applicable on the Assessee and therefore there was no requirement for him to make any related party disclosures or to disclose the present transaction. Thus, this could not have formed a reason recorded by the AO for reopening the assessment.

With respect to re-opening of assessment under Section 147, the HC held that the re-opening can only be done wherein there is an

53 Viren Surender Shah v. Assistant Commissioner of Income-tax, (2015) 63 Taxman.com 104 (Gujarat HC).
54 Niko Resources Ltd. v. ADIT, (2014) 51 Taxmann.com 568 (Gujarat HC).
55 Commissioner of Income-tax v. Alagusundaram Chettiar, (1977) 109 ITR 508 (Madaras HC).

income chargeable to tax, which had escaped assessment due to failure to disclose fully and truly, material facts necessary for the assessment. As per the IRA, while the Assessee did disclose its shareholding in JP Iscon, Gujarat Mall and Aryan Arcade, it did not specify about the loan being extended from JP Iscon to the sister concerns, at the stage of scrutiny assessment. However, the HC also appreciated that as per AS 18, there was no requirement on the Assessee to disclose the advancement of loans unless he had received any benefit from the loan transactions. The HC held that the Assessee may not even be aware of such transactions if they were not for his benefit. Thus, the HC held that the re-opening of assessment happened without due application of mind. Therefore, the proceedings undertaken under Section 148 of the IT Act were quashed and set aside.

Significant Takeaways

Kerala HC in the case of ***PV John***[56] has laid down a very important precedent with respect to interpretation of Section 2(22)(e) of the IT Act, wherein, it has said that considering the provision creates a deeming fiction with respect to the amounts paid otherwise than as dividends, in the ambit of dividends, it must, therefore, be given a strict interpretation. The payment of cash to the shareholder becomes a crucial factor. As argued by the Assessee in this case, payment would mean actual payment to the shareholder and this is *in tandem* with the strict interpretation requirement laid down by the Kerala HC. This is what has been re-emphasised by the SC in the landmark ruling of ***M Shah*** by laying down the two qualifying factors to invoke the deeming fiction under Section 2(22)(e) of the IT Act, first, receipt of benefit by the shareholder and second, existence of accumulated profits. Both these requirements are fundamental to the application of Section 2(22)(e) of the IT Act. However, the IRA had claimed in this case that the above factors would only be triggered at the assessment stage and that the Assessee should have taken Section 2(22)(e) into account while computing its taxable income. This approach of the IRA has been unequivocally frowned upon by the HC in the instant case, as well as by the SC in other cases like M Shah.

> **“ No taxability u/s 2(22)(e) for 'substantial' shareholder absent benefit from loan transactions between investee companies. ”**

56 CIT v. PV John, (1990) 181 ITR 1 (Kerala HC).

Doctrine of mutuality not applicable to AMP contribution by franchisees

In the case of ***Yum! Restaurants (Marketing) Private Limited***[57], the SC held that exemptions must be interpreted strictly and failure to satisfy the elements of doctrine of mutuality would result in denial of exemption.

Facts

Yum! Restaurants (Marketing) Private Limited ("**Assessee**") was incorporated by Yum! Restaurants (India) Private Ltd. ("**YRIPL**") as its fully owned subsidiary, for the purposes of economisation of the cost of advertising and promotion of the franchisees as per their needs, pursuant to an approval from the Secretariat for Industrial Assistance ("**SIA**"). The approval from SIA was granted on the condition that YRIPL and the franchises would contribute a fixed percentage of their net revenues on a regular basis and the Assessee would operate on a non-profit basis on the principles of mutuality. The approval also stipulated that no part of the contribution should be applied for the benefit of any individual contributor.

Further to the approval from SIA, the Assessee entered into a Tripartite Operating Agreement ("**Agreement**") with YRIPL and its franchisees. The Agreement provided that the Assessee would receive fixed contributions of 5% of the revenue for providing advertising, marketing and promotional services for the benefit of YRIPL and its franchisees. The terms of the Agreement also stipulated that YRIPL may, at the request of the Assessee and subject to its discretion, pay the Assessee any amount and YRIPL did not have any obligation to pay any sum to the Assessee.

The Agreement also provided that the Assessee may retain surplus left (if any), for spending on marketing activities during the subsequent accounting period. Alternatively, the Assessee could refund the surplus to the contributors, subject to the approval of its board of directors. Apart from the contributions from the parties to the Agreement, the Assessee also received contributions from M/s Pepsi Foods Ltd. ("**Pepsi**") under a separate agreement.

The Assessee had filed its returns for AY 2001-02 declaring its income to be "Nil" income. The AO did not accept the claim of the Assessee relying on the Agreement, which stipulated that YRIPL had no legal obligation to pay any amount as contribution. The AO observed that the Agreement stipulated that YRIPL has absolute discretion to pay the Assessee any amount as it deemed appropriate, which is contrary to the SIA approval that requires YRIPL and the franchisees to contribute a fixed percentage of its revenue.

The CIT(A) upheld the imposition of liability by the AO that the excess of receipts over the expenditure of the Assessee was liable to tax. The CIT (A) held that activities undertaken by the Assessee had commercial elements and therefore, the essence of mutuality was not satisfied. The CIT (A) observed that the underlying purpose of the arrangement was solely for commercial consideration. The CIT(A) also held that the nature of marketing services was intrinsically commercial and therefore must be distinguished from activities of a club, which were undertaken with social and cultural objectives. The CIT(A) also held that the essence of mutuality is not satisfied in the case of the Assessee.

The ITAT held that the elements of the doctrine of mutuality viz. the contributors to the common fund are either to participate in the surplus or they are beneficiaries of the contribution, was not satisfied as: (i) the Assessee received contributions from non-members such as Pepsi and (ii) the Assessee also received contributions from YRIPL when YRIPL is not under any obligation to pay. Since there was surplus in the hands of the Assessee, which was a result of contributions in contravention of the doctrine of mutuality, the same was subject to taxation.

The High Court upheld the ITAT order as the elements of doctrine of mutuality was not satisfied.

Being aggrieved by the order of the HC, the Assessee approached the SC.

Issue

Whether the Assessee would qualify as a mutual concern in the eyes of the law and thus, be exempt from tax liability?

Arguments

The Assessee had contended that its sole objective was to carry on marketing activities for the group on a non-profit basis and to work for the benefit of such contributors. The Assessee also reiterated that it does not levy any charge on the franchises for providing the services. In relation to the contribution by Pepsi, the Assessee contended that under a marketing agreement, the franchisees are required to serve Pepsi drinks at their outlets and Pepsi was also advertised by the franchisees in their advertising and promotional material. Further, in relation to the contribution by YRIPL, the Assessee contended that YRIPL was the parent company and earned fixed percentages from the franchisees by way of royalty and, therefore, benefited directly from the increased sales of the franchisees. The Assessee also contended that for the satisfaction of the doctrine of mutuality, it was necessary that an identity between contributors and beneficiaries should be there and the said doctrine does not require each member to contribute equally to the common fund or benefit from it in the same manner.

IRA contended that the moment a non-member joins the common pool of funds created for the benefit of the contributors, the taint of commerciality begins, and mutuality

57 Yum! Restaurants (Marketing) Private Limited v. CIT Civil Appeal No. 2847 of 2010 (SC).

ceases to exist. The Assessee was alleged to have operated in contravention of the SIA approval as contributions were received from Pepsi, a non-member.

Decision

The SC analysed the facts of the case in relation to the elements of the doctrine of mutuality. The SC held that in accordance with the doctrine of mutuality, a person cannot engage in business with themselves. If the identity of the seller and the vendor in a transaction is marked by oneness, then a profit motive cannot be attributed to the transaction. Therefore, with the lack of profit motive, the surplus of an entity cannot be taxed under the IT Act. The SC referred to the case of ***CIT v. Bankipur Club Ltd.***[58], wherein the SC had decided that if persons carrying on a trade do so in such a way that they and the customers are the same person, no profits or gains are yielded by the trade for tax purposes and, therefore, no assessment in respect of the trade can be made.

The SC emphasised that the legal position on what constitutes a mutual concern has been settled. Relying on judicial precedents[59], the SC held the following to be the elements of the doctrine of mutuality:

(i) Common identity of the contributors to the fund and the recipients from the fund;

(ii) the mutual concern must be obedient to their mandate; and

(iii) there must exist an impossibility of profits from the mutual operations.

In relation to the first limb of the doctrine of mutuality, the SC held no person should contribute to the common fund without having the entitlement to participate as a beneficiary in the surplus. The moment a transaction opened itself to non-members, either as contributor or as a recipient, the uniformity of the identity was impaired, and the transaction was rendered commercial in nature. In the present case, the contributions from Pepsi did not satisfy the common identity element. Even if indirect benefit was being enjoyed by Pepsi, the same was not as a consequence of being a member of the common fund, but due to an independent agreement among the franchisees and Pepsi.

In relation to the second limb, the SC held that according to the approval provided by SIA, YRIPL and the franchisees were required to make a contribution to the Assessee. However, the Agreement departed from the mandate of the SIA approval by giving YRIPL the discretion to contribute to the common fund. YRIPL and the franchisees were not treated similarly under the Agreement.

In relation to the third limb, the SC held that under the Agreement, the franchisees did not have any right over the surplus of the Assessee. The Assessee may refund the surplus subject to board approval. Even if the surplus was carried forward for the subsequent accounting period, the liability of the franchisees to make the 5% payment under the Agreement was not waived. The only entity that could derive a benefit from the surplus was YRIPL.

The SC held that the doctrine of mutuality requires satisfaction of certain elements to qualify for exemption and the exemption was to be interpreted strictly. Since the Assessee had failed to satisfy the elements of mutuality, the contention of the Assessee that it was a mutual concern did not survive. The SC held that the Assessee was liable to pay tax on the surplus held by it over expenditure.

Significant Takeaways

The decision of the SC further entrenches the principles of the doctrine of mutuality and upholds HC decisions[60] of similar nature. The SC makes an important distinction between operations carried on by the taxpayer and clubs. The SC held that there are structural differences between the operations carried out by companies like the taxpayer and clubs. Clubs are exempt from tax as they operate for the common benefit of the members intending to enter into a social exchange with no commercial intent. Clubs were means of social and cultural interactions and were not formed for the facilitation of any commercial activity. The Assessee, on the other hand, was engaged in commercial operations. This distinction drawn by the SC makes it clear the nature of activities performed by the mutual entity also plays a vital role in determining its taxability.

More importantly, the judgement brings the tax issues of the franchise model in limelight. A franchisor typically collects fees towards branding from franchisees, the judgement brings to the table issues that could arise where a particular entity is collecting franchisee fees or fees towards marketing and brand promotion. These issues would need to be critically evaluated at the time of structuring of the transactions and appropriate models adopted by the business would need to be vetted from a tax efficiency perspective.

> **“Contribution received by other affiliates for advertisement could be taxable unless principle of mutuality is established and substantiated.”**

58 (1997) 5 SCC 394 (SC).
59 Bangalore Club v. CIT, (2013) 5 SCC 509 (SC); CIT v. Royal Western India Turf Club Ltd., AIR 1954 SC 85 (SC).
60 CIT v. Salem District Urban Bank Ltd. (1940) 8ITR 269 (Mad HC); Automobile Association of Bengal v. CIT (1968) 69 ITR 878 (Cal HC).

CASE LAW UPDATES- DIRECT TAX

MISCELLANEOUS

SC upholds Constitutional validity of Section 43B(f)

In the case of ***Exide Industries Limited & Anr.***[61], SC upheld the constitutional validity of Section 43B(f) of the IT Act, which provides that amount payable by the employer in lieu of leave encashment is allowed as a deduction only when such amount is actually paid to the employees.

Facts

Exide Industries Limited ("**Assessee**") had filed a writ petition before the Calcutta HC contending that Section 43B(f) of the IT Act was *ultra vires* the constitution of India and was liable to be struck down as it was unreasonable, arbitrary and inconsistent with the object disclosed while inserting Section 43B of the IT Act. Section 43B of the IT Act provides a list of certain deductions, which could be claimed by the taxpayer, only when the actual payment with respect to such deductions is made and not at the time when they accrue in the books of the Assessee. Some of such deductions are, deduction for taxes, duty, contribution to provident fund, gratuity fund, etc. Clause (f) of Section 43B, which was the relevant clause for consideration, provides that "any sum payable by the taxpayer as an employer in lieu of any leave at the credit of his employee" could also be claimed as a deduction only at the time of actual payment to the employees.

The single bench of the Calcutta HC *vide* its order dated April 13, 2005, dismissed the writ petition. On appeal before the division bench of the Calcutta HC, the HC reversed the decision of the single bench and struck down the validity of Section 43B(f) of the IT Act by its order dated June 27, 2007[62]. The HC struck down the validity on primarily three grounds – (i) non-disclosure of objects and reasons behind enactment and insertion of Section 43B(f); (ii) inconsistency of clause (f) with other clauses of Section 43B and the absence of nexus with the clause with the original enactment; and (iii) enactment had been triggered solely to nullify the decision of SC in ***Bharat Earth Movers v. CIT***,[63] ("**Bharat Movers**"). This order of the division bench of the Calcutta HC was assailed before the SC.

Issues

Whether Section 43B(f) of the IT Act was unconstitutional?

Arguments

Assessee contended that Section 145 of the IT Act offered a choice of method of accounting and accordingly, they computed their profits and gains of business in accordance with the mercantile system, under which income and expenditure were to be determined on the basis of accrual or provision and not on the basis of actual receipt/payment. Assessee contended that Section 43B, which carved out an exception to the afore-stated rule, was applicable only in limited set of cases covering statutory liabilities like tax, duty, cess, etc., and other liabilities created for the welfare of employees and, therefore, the liability under the leave encashment scheme being a trading liability could not be subject to the exception under Section 43B of the IT Act. The Assessee further contended that the nature of this liability was neither in sync with the objects and reasons of the original section, nor with the other clauses added to it over the years.

The Assessee placed reliance on the judgment in the case of ***Bharat Movers***, wherein it was held that liability on account of leave encashment was not a contingent liability, and where a business liability had arisen definitely, deduction could be claimed against the same in the year in which it was actually

61 (2020) 116 taxmann.com 378 (SC).
62 (2007) 164 Taxman 9 (Calcutta HC).
63 (2000) 6 SCC 645 (SC).

accrued, even if it was not finally discharged. The Assessee argued that Section 43B(f) was enacted with the sole consideration of subjugating the legal position expounded in the case of ***Bharat Movers***, without removing the basis thereof.

Decision

The SC upheld the constitutional validity of Section 43B(f) of the IT Act. The SC held that the choice of the Assessee to opt for the method of accounting, under Section 145 of the IT Act, was subject to the income computation and disclosure standards for accounting prescribed by the Central Government. The SC observed that Section 43B started with a *non-obstante* clause and thus, had an overriding effect on the other provisions of the IT Act. The SC then analysed the legislative history around the provision and noted that there was no oneness or uniformity in the nature of deductions under Section 43B and various dissimilar entries have been added from time to time to cater to different fiscal scenarios, as determined by the government.

The SC analysed each of the grounds basis which the Calcutta HC had struck down the constitutionality of the provision and provided its observations. On the first ground, that was non-disclosure of objects and reasons behind insertion of Section 43B(f), the SC held that though objects and reasons were an external aid to the interpretation of a provision, however, the presence or absence of objects and reasons *per se* had no impact on the constitutional validity of a provision as long as the literal meaning of the provision enabled the courts to comprehend its true meaning with sufficient clarity. On the second ground, that was absence of nexus of clause (f) with other clauses under Section 43B, the SC held that Section 43B covered diverse nature of deductions, which fell within the broad objective of enacting Section 43B, which was to protect larger public interest, primarily of revenue, including welfare of the employees. On the final ground, that the clause was enacted to nullify the judgment in ***Bharat Movers***, the SC held that though the legislature could not directly overrule the decision or make a direction as not binding on it, but had the power to make the decision ineffective by removing the base on which the decision was rendered. The SC noted that when 43B(f) was inserted *vide* Finance Act, 2001, the deduction against the liability of leave encashment stood regulated, however, the amendment did not reverse the nature of liability nor it disallowed the deduction.

Significant Takeaways

Though the ruling is not in favor of taxpayers as it defers the right of the employer to claim deduction in the year in which the amount on account of leave encashment is actually paid, however, it provides clarity and certainty to the taxpayers with regard to the treatment of the deduction. It is pertinent to note that prior to this judgment, the SC had issued a stay against the judgment of the division bench of the Calcutta HC on September 8, 2008, which resulted in contradictory judgments from various forums on the time at which the deduction under clause 43B(f) was available. In the case of ***Metrex Technologies Ltd v. ACIT***[64] and ***Eimco Elecon (India) Ltd v. ACIT***[65], the ITAT held that the taxpayer was eligible for deduction on account of leave encashment in the year in which the provision was made for such expenses. However, in the case of ***South India Bank Ltd. v. CIT***,[66] and ***Nainital Almora Khsetriya Gramin Bank v. ACIT***,[67] it was held that the taxpayer was ineligible for deduction on account of leave encashment until the actual payment was made on such behalf.

In light of the above judicial pronouncement, now there is no uncertainty among the taxpayers as to the time period during which the deduction could be claimed. The present precedent further provides a much-needed clarity on the issue.

> **“Deduction on account of leave encashment can be claimed only at the time of its actual payment.”**

64 (2012) 24 taxmann.com 68 (Chennai ITAT).
65 (2013) 33 taxmann.com 476 (Ahmedabad ITAT).
66 (2014) 45 taxmann.com 428 (Kerala HC).
67 ITA No. 4240/Del/2012 (Delhi ITAT).

Addition under Section 68 in case of accommodation entry provider restricted to "commission" income, order upheld by Bombay HC

In the case of ***Alag Securities Pvt. Ltd.***[68], the Bombay HC held that where the Assessee was only concerned with the commission income earned on providing accommodation entries, the entire amount of cash credit should not be added to the income of the Assessee. It also took into consideration that the cash credits had been accounted for in the respective assessments of the beneficiaries.

Facts

Alag Securities Private Limited ("**Assessee**") was a limited company, which was found to be engaged in the business of providing accommodation entries to entry seekers. A search action under Section 132 of IT Act was carried out in case of a group of companies to which the Assessee belonged, consequent to which, assessment in the case of Assessee was reopened by the AO. It was mentioned in the reasons recorded by the AO that the Assessee along with the thirty-four odd companies forming a part of the same group of companies, were engaged in fraudulent billing activities and were also providing bogus entries. The said group of companies were also found to be engaged in activities of laundering unaccounted cash of various clients by having the cash deposited in the bank accounts of their companies, transferring of funds between these group companies and issuing of cheques, etc., to the clients with bogus bills.

At a certain stage of the proceedings before the IRA, the Assessee admitted that its customers made deposits with it in cash and in turn took cheques for slightly lesser amounts, the difference representing the commission and that it earned commission at the rate 0.15% for providing these accommodation entries.

The AO in his order held that the identity, source and credit worthiness of the parties from whom cash deposits amounting to INR 4,78,94,000 were received by the Assessee could not be proved and hence, he made additions in respect of the entire amount of cash deposit as cash credit under Section 68 of the IT Act.

Aggrieved by the order, the Assessee filed an appeal before CIT(A), which held that the ITAT in several appeals pertaining to companies in the same group like ***Mihir Agencies Pvt. Ltd.***[69] had already held that 0.15% of the total deposits was the income from commission, which should be added in a particular case since the Assessee was only concerned with the commission earned on providing accommodation entries. ITAT had also taken into consideration that the cash credits had already been accounted for in the respective assessment of the beneficiaries and noted that the average percentage of the commission was between 0.15% to 0.25% in the earlier cases, which was reasonable and since the Assessee itself had declared the commission at 0.15%, the same ought to have been accepted. Since the facts in the instant case were identical, the CIT(A) directed the AO to adopt 0.15% of the total deposits as commission in the hands of the Assessee and delete the balance additions.

On an appeal filed before ITAT by the IRA, ITAT also placed reliance on similar ITAT orders passed in the cases of other entities of the same group such as ***M/s. Goldstar Finvest Pvt. Ltd.***[70], wherein on similar facts, the addition was restricted to 0.15% of commission income earned. The ITAT in the instant case noted that the only difference being in the amount of cash credit involved in these cases and since the Assessee belonged to the same group, the ITAT order in case of other group entities was applicable and thus, the appeal of IRA was dismissed.

Against aforesaid ITAT order, an appeal was preferred by the IRA before the HC.

Issue

Whether the addition on account of unexplained cash credit in case of Assessee was to be restricted to the amount of commission income calculated at the rate of 0.15%?

Arguments

The IRA argued that since the Assessee failed to discharge its onus under Section 68 of the IT Act, the entire amount of cash deposit should have been added in case of Assessee and there was no justification for restricting the addition to only a percentage of commission as low as 0.15%. In this regard, the IRA placed reliance on the SC ruling in the case of ***NRA Iron and Steel (P) Ltd.***[71] ("**NRA Iron & Steel**") wherein it was held that the onus was on the Assessee to satisfactorily explain the source, nature, genuineness and credit worthiness of the cash credit.

The Assessee argued that it had already admitted during the course of the proceedings before the IRA that it was involved in the business of facilitating and providing accommodation entries to the beneficiaries for which it earned commission income at the rate of 0.15%. Section 68 of the IT Act was not attracted because the cash credits did not belong to or formed part of the income of the Assessee. It was also argued that around the same issue, in case of its sister concerns forming a part of the same group of entities, the ITAT had already taken a similar view and added the same amount as commission i.e. to the tune of 0.15% of total deposits.

68 ITA No. 1512 of 2017 (Bombay HC).
69 ITA No. 4912/Mum/2005 (Mumbai ITAT).
70 ITA No. 4625/Mum/2005 (Mumbai ITAT).
71 (2019) 103 Taxmann.com 48 (SC).

Decision

The HC agreed with the view taken by the ITAT and held that Section 68 was not applicable as it was applicable only when the Assessee was not able to offer an explanation about the nature and source of the cash deposit or its explanation was not satisfactory. However, in the instant case, the Assessee took a consistent stand that it had earned commission income out of said deposits and the cash amount deposited with the Assessee had already been accounted for in the relevant assessment orders of such beneficiaries. Hence, cash credits should not be added to the income of the Assessee when it was only concerned with the commission earned.

With respect to the percentage of commission that was assessable in the hands of Assessee, the HC held that since the ITAT had held 0.15% commission to be reasonable in some other cases and accepted the commission rate as 0.15% as disclosed by the Assessee itself in the instant case, it cannot be contended that the amount was arrived at in an arbitrary manner.

As far as reliance placed by the IRA on the decision of SC in the case of ***NRA Iron and Steel*** was concerned, the HC held that the facts of that case were clearly distinguishable as in that case the Assessee had claimed the cash credit as its income, but failed to establish the identity and credit worthiness of the investor companies. In comparison, the Assessee in the instant case had admitted during the course of the assessment proceedings that the cash credit was not its income, rather it earned only the commission amount from the accommodation entries provided by it. The HC also observed that the cash credits had been accounted for in the respective assessment of the beneficiaries.

Keeping with the above, the HC upheld the order of the ITAT and restricted the addition in case of Assessee to commission income at the rate of 0.15%.

Significant Takeaways

Section 68 seeks to tax any sum found credited in the books of accounts of the Assessee for which the Assessee offers no explanation about the nature and source thereof or the explanation offered by him is found to be unsatisfactory. The practice of conversion of unaccounted money is subjected to careful scrutiny by the tax authorities through the provisions of Section 68.

Usually accommodation entry providers pass on the money appearing as cash credit in their books as their own money for

the obvious reason that they would not want to admit to being accommodation entry provides. As a result, the tax authorities usually tax the entire amount both in the hands of the entry providers under the provisions of Section 68 in case they are unable to discharge their onus and explain the nature and source of the amount received.

In contrast, in the instant case, at a certain stage of the proceedings before the IRA, the Assessee had itself admitted that it was providing accommodation entries and that it only earned commission income thereon. Both the ITAT and the HC have taken a pragmatic view of the situation. Considering that the amounts credited in the books of the Assessee have already been taxed in the hands of the beneficiaries, the addition in the case of the Assessee has been restricted to the amount of commission. Hence, it can be said that the order of the HC is as per the specific facts and circumstances of the case and failure to tax such amounts in the hands of the respective beneficiaries could have possibly led to different results hereinabove.

Along similar lines, the Bombay HC in the instant case has distinguished the recent ruling of the SC in the case of ***NRA Iron and Steel*** wherein the cash credit pertained to the amount of share capital/ share premium received by an assessee, bringing it entirely within the ambit of Section 68. Whereas in the instant case, the Assessee itself claimed that only an amount to the tune of 0.15% pertained to be the income of Assessee.

“ In case of an entry operator earning commission income for providing accommodation entries, addition could be restricted to amount of commission. ”

Deduction allowed only if consideration received in foreign exchange is for services rendered from India

In the case of ***Ramnath & Co v. CIT***[72], the SC held that deduction under Section 80-O of the IT Act would be permissible only if sufficient material was provided to substantiate that the services were provided from India.

Facts

Ramnath & Co. ("**Assessee**") is a firm engaged in the business of providing services in connection to marine products/ seafood. The Assessee provided services to foreign enterprises that purchased Indian marine products under agreements with foreign enterprises. The services provided to foreign enterprises were in the nature of: (i) locating reliable sources of quality and assured supply of frozen seafood for the purpose of import and communicating its expert opinion and advice on the same; (ii) keeping a close liaison with agencies concerned with bacteriological analysis and communicating the result of inspection, along with expert comments and advice; (iii) making available full and detailed analysis of seafood supply situation and prices; (iv) advising and informing about the latest trends in manufacturing and markets; and (v) negotiating and finalising the prices for Indian exporters of frozen marine products and communicating such other related information to foreign enterprises.

Towards the provision of the aforementioned services, the Assessee received service charges in foreign exchange. For AY 1993-94, the return was filed with a 50% deduction claim, amounting to INR 22.39 lakh under Section 80-O of the IT Act. The deduction was in relation to income of INR 44.79 lakh received by it as service charges from foreign enterprises, in foreign exchange.

The Section 80-O of the IT Act provides for deduction in respect of income, where an Indian resident receives consideration for the use of patent, invention, design or trademark, in foreign convertible exchange in India or brings such income to India after having received it outside India. Clause (iii) of Explanation to Section 80-O of the IT Act provides that services rendered outside India include services rendered from India, but do not include services rendered in India.

The AO denied the deduction under Section 80-O of the IT Act after analysing the agreements of the Assessee with two foreign enterprises, with the finding that the Assessee had not been rendering services from India to qualify for deduction under clause (iii) Explanation to Section 80-O of the IT Act. The AO observed that the services rendered by the Assessee were 'services rendered in India' and not the 'services rendered from India' and were, therefore, beyond the ambit of deduction under Section 80-O of the IT Act, in lieu of clause (iii) of the Explanation to Section 80-O of the IT Act. The AO also held that the Assessee was merely an agent of the foreign enterprise in the matter of procurement of marine products from India and all services performed or stipulated in the agreements were incidental to the core or predominant function of acting as an agent.

On appeal, the CIT(A) rejected the AO's order on the ground that the requisite services were rendered by the Assessee to the foreign enterprises from India and, therefore, the Assessee was eligible for deduction under Section 80-O of the IT Act. The CIT(A) also observed that the phrase 'from India' meant that some of the activities would spring out of or would be in India. In relation to the present case, the CIT(A) observed that the Assessee supplied information with regard to sea-food processing, manufacturing details, government policies, etc., to the foreign enterprises and negotiated and finalised prices for the products purchased by the foreign enterprises. The Assessee was held to have rendered services from India to the foreign enterprises and the Assessee's information and experience had been effectively utilised by the foreign enterprises.

On appeal, the ITAT held that services were rendered from India in accordance with clause (iii) of the explanation to Section 80-O of the IT Act. The ITAT observed that the Assessee was supplying information with regard to markets, government policies, exchange fluctuations, etc., to the foreign enterprises, based on which the foreign enterprises decided whether they should buy a product from India or not. Further, the ITAT also observed that the service rendered by the Assessee helped the foreign enterprises import marine products from India, and thus, qualified as a specialised and technical service and, therefore, the Assessee was entitled to claim deduction under Section 80-O of the IT Act.

On appeal by the IRA before the Kerela HC, the Kerala HC disallowed the claim for deduction by the Assessee, reiterating the finding that the Assessee was merely a marine product procuring agent for the foreign enterprises and, therefore, the services did not qualify as 'services rendered from India' for the purpose of Section 80-O of the IT Act. The Kerala HC reiterated the principles laid down in the case of ***Continental Construction Ltd.***[73] and ***Khursheed Anwar***[74] and held that not every receipt in convertible foreign exchange ipso facto qualified for deduction under Section 80-O of the IT Act and that the burden was on the taxpayer to prove with the aid of cogent materials that the commission was for the services it had rendered, and that it fell within the scope of the provision.

Issues

Whether the services rendered by the Assessee to foreign enterprises would qualify as 'services from India' for the purpose of claiming deduction under Section 80-O of the IT Act?

72 Civil Appeal No. 2510 of 2020 (SC).
73 Continental Construction Ltd. v. CIT, (1992) 195 ITR 81 (SC).
74 CIT v. Khursheed Anwar, (2009) 311 ITR 468 (Mad HC).

Arguments

The Assessee contended that the Kerala HC judgement had misunderstood the objective of Section 80-O of the IT Act and adopted a pedantic approach to interpreting the provision. The Assessee contended that the purpose of Section 80-O of the IT Act was to give an incentive to earn foreign exchange and the Kerala HC had adopted a literal construction of the provision without context to the same. Further, the Assessee also relied on the case of *Baby Marine Exports*[75] to contend that an incentive provision had to be construed broadly and liberally. For the purpose of Section 80-O of the IT Act, the incentive should be granted if the object of earning foreign exchange was achieved. Further, it was also contended that commission related to ordinary commercial activities was also covered under Section 80-O of the IT Act. For this contention, the Assessee relied on the case of ***J.B. Boda & Co.***[76]***,*** wherein it was held that the commission received by the reinsurance broker, who only sent information to the foreign reinsurance company regarding the risk involved and other data, was entitled to the benefit of Section 80-O of the IT Act. The Assessee contended that the findings of the ITAT were not perverse and there was no scope for interference by the Kerala HC.

The IRA, on the other hand, contended that the objective of Section 80-O of the IT Act was to encourage Indian industries to develop technical know-how and services and make them available to foreign companies in order to augment foreign exchange earning of India and to establish a reputation of Indian technical know-how in foreign countries. The IRA also relied on the decision of SC in the case of ***Dilip Kumar & Co.***[77] ("**Dilip Kumar**") to contend that it is trite law that taxing statutes were subject to the rule of strict interpretation and the benefit of ambiguity in case of an exemption provision must be interpreted in favour of the revenue as it increased the burden on unexempted taxpayers. The IRA also contended that in the case of ***J.B. Boda & Co.,*** the issue was only about the method of receipt of foreign exchange, which would qualify for Section 80-O deduction and not the nature of the activity. Further, the IRA also contended that the CBDT circular no. 700/1995, which was relied upon by the Assessee, only clarified that the foreign recipient of the services may utilise the benefit of such services in India, however, in the present case, the Assessee was merely acting as an agent and rendering services in India.

Decision

The SC analysed the history of Section 80-O of the IT Act to examine its objective. The SC duly observed that the core objective of the provision was to promote export of technical know-how and augmentation of foreign exchange reserves of India. Clause (iii) of the explanation to Section 80-O of the IT Act clarified that services rendered 'in India' would not qualify for deduction thereunder.

Relying on the ***Dilip Kumar*** *case*, the SC held that the burden of proof would lie on the taxpayers when adjudicating the applicability of exemption/deduction/incentive. The following principles upheld by the SC in the *Dilip Kumar* case were reiterated:

"66.1. Exemption notification should be interpreted strictly; the burden of proving applicability would be on the assessee to show that his case comes within the parameters of the exemption clause or exemption notification.

75 Continental Construction Ltd. v. CIT, (1992) 195 ITR 81 (SC).
76 CIT v. Khursheed Anwar, (2009) 311 ITR 468 (Mad HC).
77 CIT v. Dilip Kumar & Co. and Ors, (2018) 9 SCC 1 (SC).

66.2. When there is ambiguity in exemption notification which is subject to strict interpretation, the benefit of such ambiguity cannot be claimed by the subject/assessee and it must be interpreted in favour of the Revenue."

The SC held that only upon satisfaction of the twin tests i.e. (i) the nature of activities prescribed under Section 80-O of the IT Act; and (ii) receiving foreign exchange, a liberal interpretation could be given to the same. The SC also held that for comprehensive understanding of the provision, literal interpretation was necessary.

Examining the facts of the present case, the SC held that unlike the judicial precedents relied upon, the Assessee in the present case had merely acted as an agent. While the clauses of the agreements use words such as *'analysis', 'advice', 'technical guidance'*, etc., the clauses of the agreements must be read as a whole. The Assessee was merely acting as an agent to procure merchandise for its principals and all other services were incidental to the same. The consideration received by the Assessee was only on the basis of the amount of invoice pertaining to the goods. Moreover, if the foreign enterprises were not satisfied with the goods purchased, the Assessee would be denied payment.

The SC also observed that even if it were to be argued that some of the services provided by the Assessee were in the nature prescribed under Section 80-O of the IT Act, the onus was on the Assessee to establish the same and the Assessee failed to submit particulars of the information supplied. Therefore, the SC upheld the Kerala HC judgement and denied the deduction under Section 80-O of the IT Act to the Assessee.

Significant Takeaways

The SC clarified that merely receiving income in foreign exchange would not qualify for the benefit under Section 80-O of the IT Act. A twin test has been entrenched in the application of Section 80-O of the IT Act, namely, (i) the nature of services rendered must be of the prescribed nature under the provision and (ii) there must be a receipt of foreign exchange. Therefore, it is imperative that the taxpayers procure and maintain relevant material to substantiate their claim to satisfy both the tests under Section 80-O of the IT Act.

Further, the SC has reiterated the position on interpretation of exemption provisions. It has emphasised on the principles laid down in ***Dilip Kumar*** case, wherein it was held that an exemption provision must be interpreted strictly and in case of ambiguity, the interpretation must be in favour of the revenue to prevent unfair tax burden on unexempted taxpayers. In relation to Section 80-O of the IT Act, the SC permitted a liberal interpretation after the stage of determining applicability of the provision based on the twin tests discussed above. The judgement has provided clarity on the applicability and scope of Section 80-O of the IT Act. The judgement also forms an exception to the general rules of interpreting tax incentives or beneficial provisions liberally, where such interpretation defeats the purpose of the provisions of the law enacted by the legislature.

> **"For bringing any particular foreign exchange receipt within the ambit of Section 80-O for deduction, it must be a consideration attributable to information and service contemplated by Section 80-O."**

CASE LAW UPDATES- INDIRECT TAX

AAR RULINGS

Minimum human intervention with individual customers to be the determining factor for services to qualify as OIDAR services

In the case of ***NCS Pearson Inc***[78], the Karnataka AAR held that online tests in a designated test centre, requiring physical administration and supervision by an invigilator, would be considered as a naturally bundled activity, supplied along with online information and database access or retrieval services ("**OIDAR service**"). Therefore, such a supply will be treated as a composite supply, where the principal supply is OIDAR service i.e. supply of online tests.

Facts

NCS Pearson Inc ("**Applicant**") was a US-based corporation, engaged in the business of hosting computer-based tests, prepared and owned by clients, along with providing administrative solutions to clients. Clients of the Applicant are generally educational institutions or professional licencing organisations. The Applicant was offering three kinds of tests in India, as follows:

a) Type 1 test contained multiple choice questions ("**MCQ**"). The candidates took tests from any location digitally without any human intervention. The results were generated immediately after the completion of the test through a computerised algorithm.

b) Type 2 test was similar to Type 1 test. However, the candidates were required to visit a designated test centre to take exams under the supervision of an invigilator. The results were generated immediately after completion of the test through a computerised algorithm.

c) Type 3 test was a mixture of MCQ and analytical writing assessment (essay based) sections. The candidates were required visit a designated test centre and give exams under the supervision of an invigilator. The result for the MCQ section was generated immediately after completion of the test and an indicative score for the writing assessment section was generated through a computerised algorithm. However, the writing assessment section was reviewed and assessed further by an evaluator based in the USA for final scoring. An expert evaluator further evaluated the test in limited circumstances before declaring the final results.

In order to undertake any of the abovementioned tests, the candidates i.e. the non-taxable online recipients ("**NTOR**") were required to register and make payment on the electronic portal of the Applicant. The Applicant would collect payments from the candidates for undertaking the online test.

The Applicant had obtained a GST registration and was discharging IGST in terms of Section 14(1) of the IGST Act, as it was a supplier located in a non-taxable territory supplying Type 1 test (online with no human intervention) i.e. OIDAR services to NTOR.

Issue

Whether the service provided for Type 2 and Type 3 tests would be classified as OIDAR? If not, would the Applicant be liable to pay IGST on such services?

Arguments

The Applicant submitted that a supply was required to fulfil the following four key ingredients to qualify as OIDAR services in

78 In re NCS Pearson Inc, 2020-VIL-131-AAR (Karnataka AAR).

terms of the definition of OIDAR under Section 2(14) of the IGST Act:

a) The services were to be delivered over internet or an electronic network;
b) Such services were to be fully automated;
c) The services involved minimal human intervention; and
d) The delivery of services was impossible in the absence of information technology.

The Applicant contended that Type 2 and Type 3 tests did not satisfy the ingredients of the definition of OIDAR services as the tests were attempted by candidates at designated test centres under mandatory supervision of invigilators. A service would qualify as OIDAR service only when there was minimal or no human intervention.

The Applicant resorted to the clarification of OIDAR services under service tax regime as such definition was *pari materia* to the definition of OIDAR services under IGST Act. The service tax legislation clarification provided that workbooks completed by pupils online and marked automatically, without human intervention would be treated as OIDAR services.[79] Further, the Applicant placed reliance on the Guidelines released by the VAT Committee of the European Commission dated February 28, 2017 ("**Guidelines**"), which provided the following two pronged criteria to determine whether "minimal human intervention" had been violated:

a) human involvement on the side of the supplier and not on the side of the customer; and
b) every individual supply made to a customer required human intervention.

While conducting the Type 2 and Type 3 test, the physical presence of invigilators was necessary to verify the identity of each of the candidates, monitor/ supervise them during the tests, address any queries/ issues faced by the candidates at the test centres, and provide the score reports on completion of the tests. Thus, human involvement in the form of test administration and invigilation from the side of the supplier was more than the minimal human intervention contemplated for OIDAR services. Therefore, the Type 2 test would not qualify as OIDAR services. Further, in type 3 test as well, more than minimal human intervention was required for evaluation and scoring of the writing assessment section. Hence, Type 3 test would also not qualify as OIDAR services.

With respect to their taxability, the Applicant contended that since supply of Type 2 and Type 3 tests were not covered within the ambit of specified services under Section 13 of the IGST Act, they were covered by the general entry under Section 13(2) of the IGST Act, which applied to services other than specified services. Hence, the place of supply for Type 2 and Type 3 test services was the location of the recipient i.e. India. As the Applicant's place of business was outside India, such supply of services would be treated as an import of service in terms of the IGST Act. In terms of serial no. 10(a) of Notification No. 9/2017-Integrated Tax (Rate), dated June 28, 2017 ("**Exemption Notification**"), services (other than OIDAR services) supplied by a person in a non-taxable territory to a recipient in the taxable territory for a purpose other than in relation to commerce, industry or business were exempt from GST levy. Therefore, the Applicant was exempt from GST levy on supply of Type 2 and Type 3 test services.

Decision

The AAR held that supply of Type 2 test services would not qualify as OIDAR services. The AAR relied on Para 2.2. of the Guidelines and noted that the Applicant was incorrect in considering the role of invigilators in the entire process of verification, monitoring and providing the test reports to candidates. The human intervention was not to be considered in respect of each individual candidate. It was actually to be focused on the whole environment at the test centres, whereby, such human intervention fell within the scope of minimum human intervention. Hence, supply of Type 2 tests qualified as OIDAR services.

The AAR observed that provision of verification and registration, provided by human intervention, was a naturally bundled activity along with the main supply of providing Type 2 tests. Both supplies were supplied in conjunction with each other in the ordinary course of business and therefore, the bundled supply was in the nature of a composite supply defined under Section 2 (30) of CGST Act, 2017. Therefore, the AAR held the principal supply of Type 2 test services to be OIDAR services, which were outside the scope of the Exemption Notification.

However, with respect to Type 3 test services, as the writing assessment section for individual candidates was evaluated by an evaluator outside India for determination of the final score, such activity was outside the scope of "minimal human intervention". Therefore, the AAR held that supply of Type 3 test services was outside the purview of the OIDAR services and would be exempt by the virtue of the Exemption Notification.

Significant Takeaways

The jurisprudence in relation to OIDAR services is dynamic and vastly unchartered under the GST regime. This ruling provides significant insight on how the constituents of OIDAR services (i.e. scope of supply over electronic network, degree of minimal human intervention, etc.) would be analysed by the GST

79 Serial number 16(5)(b), Circular No. 202/12/2016-Service Tax dated November 09, 2016.

authorities in order to classify a given supply within its ambit. Covid-19 has changed the way services are supplied. Online supplies such as online lectures, trainings, etc., are substituting the traditionally physical methods of supply of services. Therefore, the degree of human intervention in the supply of such services will play a key role in determining their classification as OIDAR services.

Prima facie, every supplier of OIDAR service in India is required to obtain registration in India and discharge GST if the supply is made to a NTOR i.e. person is receiving OIDAR services for purposes other than commerce, industry or any other business or profession. The Karnataka AAR in the case of *Springer Nature Customer Service Centre GmBH*[80] held that the onus of establishing whether the supply is made for business / commerce purposes or not lies on the supplier of OIDAR services. This may potentially create an immense burden on OIADAR service providers based outside India as they now have the additional responsibility of ascertaining the nature of usage of OIDAR service provided by them.

> **“Online tests conducted at designated test centres may qualify as OIDAR services with minimal human supervision where no part of the test is assessed by humans.”**

80 Springer Nature Customer Service Centre GmBH TR 882 AAR 2019 NT (Karnataka AAR).

High Sea Sales for supplying goods to a foreign customer would be exigible to GST

In the case of ***M/s Sterlite Technologies Limited***[81], the Authority for Advance Ruling, Gujarat ("**AAR**") held that the thumb-rule for determining taxability of high sea sales is to ascertain whether such transactions would amount to 'supply' in terms of the provisions of the GST legislation.

Facts

M/s Sterlite Technologies Limited ("**Applicant**") was an entity registered in the state of Gujarat and engaged in the business of development and supply of software and hardware. In relation to certain supplies of hardware, the Applicant would receive orders from customers located outside India and would instruct their vendors outside India to ship the goods directly to such customers. The vendors would raise the invoice on the Applicant, who would make payment in foreign currency. In turn, the Applicant would raise an invoice on its customer and receive payment in foreign currency. The goods involved in such transactions would not physically enter India.

Issue

a) Whether GST was payable on goods procured from foreign vendors if the goods were not brought to India?

b) Whether GST was payable on goods sold to foreign customers if the goods were directly shipped from a vendor's premise to the customer's premise?

Arguments

The Applicant submitted that in terms of their *modus operandi*, they would receive orders from customers located outside India, and would immediately place back-to-back orders with their vendors located outside India. Thereafter, such goods would be shipped from a foreign location of the vendor to the foreign location of the customer. The consideration for the two legs of transaction would be in foreign currency.

Decision

The AAR relied on various provisions of the Customs Act, the IGST Act and the Customs Tariff Act to determine whether the subject goods dealt with by the Applicant were imported in India. *Prima facie*, Section 2(7) read with Section 5 of the IGST Act provides that the supply of goods imported into India, till they cross the customs frontier, would be treated as a supply of inter-state trade and IGST would be levied on all inter-state supplies.

However, Section 3 of the Customs Tariff Act provided that IGST would be levied on goods imported to India on the value as determined at the point when the custom duties was levied. Section 12 of the Customs Act, provided that the custom duty would be levied on goods which were imported in India i.e. when the goods were brought into India from a place outside India. Additionally, as per Section 15 of the Customs Act, the applicable rate of customs duty would be the existing rate as on date the bill of entry was signed for goods entered for home consumption or cleared from the warehouse. Therefore, IGST on goods imported into India would be levied when the rate of customs duty was determined.

The AAR also took reference to Circular No. 33/2017-Customs dated August 01, 2018 ('**High Sea Sales Circular**"), which had clarified the issue of leviability of IGST on high sea sales of imported goods i.e. whether IGST would be paid twice viz. at the time of customs clearance and when they cross the customs frontier. The High Sea Sales Circular reiterated that IGST on high sea sales would be levied and collected at the time when import declarations are filed before the customs. Therefore, the AAR ruled that there would be no GST liability on goods procured from foreign vendors, which were not brought into India as bill of entry and/ or import declarations were not filed with respect to such goods.

However, in order to determine the taxability of transactions where goods were sold and directly shipped to foreign buyers from the premises of the foreign vendors, the AAR stated that it was necessary to check whether such transaction could be classified as a supply under Section 7 of the CGST Act. The AAR classified such a supply as an inter-state supply in terms of Section 7(5) of the IGST Act, as the Applicant (i.e. the supplier) was located in India and the place of supply was outside India. Therefore, the AAR held that IGST would be payable on the said transactions. In addition, the Applicant failed to show that the said supplies of goods were exempt under any notification. The supplies would also not constitute export of goods as there was no movement of goods from India to outside India as required by the definition of export under Section 2(5) of the IGST Act. Accordingly, the AAR ruled that the Applicant would be liable to pay IGST on the goods sold and directly shipped to foreign customers from the premises of the foreign vendors.

Significant Takeaways

This AAR ruling seems to run contrary to the provisions of schedule III to the CGST Act. Para 7 to the said schedule deems supplies of goods from one non-taxable territory to another without such goods entering India to be neither supply of services nor goods. By virtue of this entry, goods sold and directly shipped from a place outside India to another place outside India are not exigible to GST.

81 2020 (6) TMI 485 (Gujarat AAR).

This position of law was reiterated by the Kerala AAR in the case of ***In re M/s Synthite Industries Limited***[82], where the AAR held that as there were no documents to be filed for customs clearance in India, the incidence of IGST would not arise on any party of the transaction where goods were procured from China and supplied to foreign customers.

Therefore, the reasoning of the AAR in the present ruling needs to be revisited. As the same is contradictory to the provisions of the GST legislations, the AAR ruling is likely to be appealed/ challenged as unconstitutional.

> **“Supply of goods to foreign customers from the premises of foreign vendors would tantamount to taxable inter-state supplies, even where such goods do not enter the Indian taxable territory.”**

82 2018 (4) TMI 583 (Kerala AAR).

Sale of developed plots with infrastructural amenities is a supply of construction services

In the case of ***In re: M/s Sree Dipesh Anil Kumar Naik***[83], the Gujarat AAR held that the activity of selling plotted land, along with primary infrastructural amenities would be treated as supply of construction services and therefore, would be taxable under GST.

Facts

M/s Sree Dipesh Anil Kumar Naik ("**Applicant**") had a vacant land, which he intended to sell as plots to individual buyers. The Applicant had obtained all the necessary approvals for the said activity from the Plan Passing Authority ("**PPA**"). However, as per the approval of PPA, the Applicant was required to develop primary amenities like sewerage and drainage line, water line, electricity line, telephone line, pipe line for drinking water, land levelling, street lights, etc., on the vacant land before selling the same to individual buyers. The Applicant did not undertake any further construction service on such developed land.

Issue

Whether GST was applicable on sale of developed plots with primary amenities by the Applicant?

Arguments

The Applicant contended that he would develop the land with primary infrastructure as per the requirement of approval from PPA. Post the development, no construction activity was to be undertaken. The Applicant was to only sell the developed plots to individual buyers with those primary amenities. Therefore, it was argued by the Applicant that GST was not payable on sale of such developed plots.

Decision

The AAR observed that supply as defined under GST laws, only excluded activities exclusively dealing with transfer of title or transfer of ownership of land, which was immoveable property. However, the AAR observed that in the instant case, the Applicant was involved in forming vacant land into layout, comprised of individual sites/plots. The activity of plot development included undertaking activities such as laying of underground cables and water pipelines, laying of underground sewerage lines with sewer treatments plant, etc. Such developed site was thereafter to be sold to individuals who would construct houses/ villas thereon.

The AAR noted that the sale of plots after such development was on a super built-up area basis and not on actual measurement of land. The super built-up area included the infrastructures on a proportionate basis. The Applicant would collect consideration for the land as well as common amenities on a proportionate basis.

In light of the aforementioned, the AAR held that the activity of sale of developed plot was not equivalent to sale of land, but was a different transaction. It held that the said activity was covered under the category of services by way of 'construction of a complex intended for sale to a buyer'. Therefore, sale of developed plots was taxable to GST.

Significant Takeaways

The present AAR ruling definitely comes as bad news to all those developers who were engaged in sale of developed plots, without discharging any GST liability on the same. It also goes against the fundamental framework of the GST legislation, which excludes the sale of land or any immovable property from the ambit of supply.

The AAR has failed to understand the nature of the transaction and has treated a vacant plot and developed plot differently for the purpose of levy of GST. The AAR has equated the sale of developed plots with the activity of development of a plot, which is otherwise treated differently under GST. It also contradicts the view of the AAAR, Karnataka, in the case of ***In Re: Maarq Spaces Private Limited***[84], wherein the AAAR while adjudicating on a joint development agreement executed between a developer and owner for development of plot, held that "there are two activities involved viz., development of land and sale of plots/land, out of which the former is a supply and latter is not a supply". In other words, what is taxable under GST is the activity of development of land and not the sale of the developed land. Therefore, the present AAR Ruling does not seem to be a correct ruling and may also not even hold any ground in higher forum.

> **"The activity of sale of developed plots cannot be equated with sale of land itself and will treated as supply of construction services."**

83 Advance Ruling No. GUJ/GAAR/R/2020/11 (Gujarat AAR).
84 Order No. Kar/AAAR-19//2020-21 dated May 4, 2020 (Karnataka-AAAR).

Resolution plan is not binding on the Government where it is not involved in the insolvency resolution process

In the case of ***Electrosteel Steels Limited***[85], the HC held that even where the Government was not involved in the insolvency resolution process for a corporate debtor, it could initiate garnishee proceedings for recovery of VAT dues, pertaining to the period prior to the date of approval of the resolution plan by the NCLT.

Facts

Electrosteel Steels Limited ("**Petitioner**") had its registered office in Jharkhand. The Garnishee Order dated November 21, 2019, issued under Section 46 of the Jharkhand VAT Act, 2005 ("**Garnishee Order**"), *inter alia* required the State Bank of India to deposit Rs 37.41 crore into the Government treasury from the bank account of the Petitioner in respect of VAT dues for the financial years 2011-12 and 2012-13. The Petitioner had duly collected VAT from its customers, but had failed to deposit the same in the Government treasury, utilising the same towards business operations from financial year 2011-12 onwards.

Meanwhile, the corporate insolvency resolution process ("**CIRP**") had been initiated against the Petitioner on July 21, 2017, and the resolution plan filed by Vedanta Limited was approved by the NCLT on April 17, 2018, which was prior to the issuance of the Garnishee Order. Accordingly, the Petitioner filed a writ petition before the HC challenging the Garnishee Order.

Issue

Whether the Respondent was barred from realising the VAT dues in terms of Section 31 of the IBC[86]?

Arguments

The Petitioner argued that the Respondent was deemed to be an operational creditor under Section 5(20) of the IBC[87]. Its claim for tax dues was required to be made during the CIRP, prior to the approval of the resolution plan by NCLT. As the Respondent had not made any such claim, it was barred from initiating such claim after the approval of the resolution plan in terms Section 31 of the IBC.

The Petitioner also contended that the Garnishee Order was illegal, void *ab-initio* and without jurisdiction and could not be sustained since the resolution plan (where the Respondents had not made any claim) had already been approved by the NCLT and was binding upon the Petitioner and all of its creditors, including the State Government in terms of Section 31(1) of the IBC.

The Petitioner relied upon Section 238 of the IBC, pursuant to which the IBC would have an overriding effect on all other laws and the decision of the SC[88], wherein it was held that the IBC was an exhaustive code in itself. The Petitioner also relied on several other rulings[89] wherein it was held that the dues payable to the Government would come within the meaning of operational debt under Section 5(21) of the IBC, making the Government an operational creditor in terms of Section 5(20) of the IBC, and also that the claims of the Government would have to be adjudicated and paid solely in a manner prescribed in the resolution plan as approved by the NCLT. The Petitioner also relied on the decision of the SC in the case of ***Essar Steel India Limited***[90] to contend that no fresh claims could be made once the resolution plan is approved.

The Petitioner submitted that in terms of para 3.6 of the resolution plan, all claims of taxes and liabilities, whether admitted or not and whether or not set out in the provisional balance sheet, would stand extinguished once the NCLT approves the resolution plan. Thus, taxes even if accrued the same could not be realised from the Petitioner.

The Respondents challenged the maintainability of the writ petition since the Petitioner had already availed the alternative remedy by filing a revision petition along with stay petition against VAT re-assessment order before the Revisional Authority. Further, the Respondents argued that the Petitioner had committed the offence of criminal breach of trust by not depositing the tax collected from its customers/purchasers with the department.

Further, the Respondents pointed out that the IBC was enacted in 2016. Since, the right of the State Government to recover the tax from the Petitioner accrued during the period 2011-2013, the said right cannot be said to have been affected by IBC.

The Respondents also contended that they were never afforded an opportunity to make a claim since they were not aware of the initiation of the CIRP proceedings against the Petitioner. Section 13 of the IBC requires the making of a public announcement of the initiation of the CIRP and inviting of claims from the

85 Electrosteel Steels Limited v. The State of Jharkhand & Ors., W.P.(T). No. 6324 of 2019 (Jharkhand HC).

86 Section 31(1) of IBC- If the Adjudicating Authority is satisfied that the resolution plan as approved by the committee of creditors under sub-section (4) of section 30 meets the requirements as referred to in sub-section (2) of section 30, it shall by order approve the resolution plan which shall be binding on the corporate debtor and its employees, members, creditors, 3[including the Central Government, any State Government or any local authority to whom a debt in respect of the payment of dues arising under any law for the time being in force, such as authorities to whom statutory dues are owed,] guarantors and other stakeholders involved in the resolution plan.

87 "operational creditor" means a person to whom an operational debt is owed and includes any person to whom such debt has been legally assigned or transferred.

88 Innovative Industries Limited v. ICICI Bank & Anr,2018 (1) SCC 407 (SC).

89 Embassy Property Developments Pvt. Ltd. v. State of Karnataka & Ors., reported in Manu/SC/1661/2019 (SC); Swiss Ribbons Pvt. Ltd. & Anr. v. Union of India & Ors. (2019) 4 SCC 17, (SC); Pr. Commissioner of Income Tax v. Monnet Ispat & Energy Ltd. (Special Leave to Appeal (c) No.6483 of 2018) (SC).

90 Committee of Creditors of Essar Steel India Limited, through authorized Signatory v. Satish Kumar Gupta & Ors., (SCC OnLine SC 1478) (SC).

creditors. This announcement, which should have been made in Jharkhand, where the registered office of the Petitioner was situated, was never published in Jharkhand, but was published solely in Kolkata. As such, the Respondents never became aware of the CIRP proceedings.

The Respondents further contended that under Section 31 of the IBC, an approved resolution plan could be binding on the stakeholders only if they were involved in the resolution plan. However, due to non-publication of the public notice, the Respondents were never made aware of the CIRP proceedings and could not file a claim and hence, the resolution plan would not be binding on them.

Decision

The HC held that tax dues would typically fall within the definition of operational debt for the purpose of the IBC. However, with respect to VAT dues in the present case, the HC stated that the act of collecting taxes from customers, but not depositing the same with the department and utilising the same for its business purposes, amounted to criminal misappropriation of Government money and therefore, it would be inappropriate to bring such amount under the ambit of operational debt under the IBC.

The HC has further observed that since in the present case, VAT had already been realised by the Petitioner from its customers on behalf of the State Government, it was not a direct debt of the Petitioner owed to the Government. The HC held that the decisions cited by the Petitioner were in the context of income-tax dues, which were the direct debt of the Petitioner owed to the Government, unlike VAT dues in the present case.

Basis the IBC provisions, the HC observed that public announcement of CIRP was required to be made in Jharkhand. Further, the HC also expressed that since the resolution plan was approved by the NCLT and not interfered even with by the Supreme Court, they were not required to look into the legality or otherwise of the resolution process. However, due to the non-publication of the public notice in Jharkhand, the Respondents had no opportunity to make their claim in the CIRP and thus, it was not binding on them in terms of Section 31 of the IBC.

Further, it was observed that the amendment in Section 31(1) of the IBC to make the approved resolution plan binding on Government authorities, in relation to statutory dues was made effective on August 16, 2019, whereas the resolution plan in the present case was approved prior to that date. The HC held that amendment to Section 31(1) of the IBC would not be applicable retrospectively.

Accordingly, the HC held that the resolution plan would not be binding upon the Respondents since they were not involved in the resolution process.

Significant Takeaways

The observation of the HC that tax dues are operational debts and the State Government is an operational creditor is a welcome step towards implementation of the IBC. However, the remaining observation has rendered the said observation practically nugatory. Furthermore, the HC also distinguished the nature of VAT dues from that of income-tax dues and has expressed a doubt if the same could be regarded as an "Operational Debt". Such distinction appears to be contrary to the provisions and intent of the IBC, as well as the recent decision of the HC of Rajasthan in the case of ***Ultratech Nathdwara Cement Limited***[91], wherein no distinction has been made between direct tax dues and indirect tax dues. Given the difference of opinion among the HCs, we need to wait for the decision of the SC to resolve the issue of status of indirect tax dues under the IBC.

Interestingly, in rendering the above decision, the Court also held that amendment to Section 31(1) of the IBC, making the resolution plan binding on the Government and statutory authorities, is only applicable in respect of resolution plans approved after August 16, 2019. The HC failed to appreciate that the Statement of Objects and Reasons in relation to the Insolvency and Bankruptcy (Amendment) Bill, 2019, categorically provided that the amendment to Section 31(1) of IBC was brought about to clarify that the resolution plan approved by the NCLT shall also be binding on the Central Government, any State Government or any local authority. Accordingly, the amendment should have been held to be declaratory in nature, whereby it would be applicable retrospectively even to resolution plans approved prior to the said date.

"VAT liability, not being a direct debt of the corporate debtor towards the State Government, may not be an operational debt under IBC."

91 Ultratech Nathdwara Cement Ltd v. Union of India (Civil Writ Petition No. 9480/2019) (Rajasthan HC).

CASE LAW UPDATES- INDIRECT TAX

OTHER JUDICIAL PRONOUNCEMENTS

Rectification of return shall be allowed in the same period in which the error has occurred

In the case of ***Bharti Airtel Limited***[92], the Delhi HC allowed rectification of Annual Return in Form GSTR 3A to claim ITC pertaining to the period from July 2017 to -September 2017. It read down the circular, which restricted the rectification of returns filed during the same period, as no such restriction was provided under the CGST Act. The HC held that the Government cannot impose conditions, which go against the scheme of the statutory provisions in the law.

Facts

Bharti Airtel Limited ("**Petitioner**") was engaged in the business of providing telecommunication services. During the initial phase of GST, the Petitioner faced issues in the GSTN created by the Government, which impacted the tax paid, the output liability and ITC availed by the Petitioner. It led to several inadvertent errors wherein invoices were missed in GSTR-3B, credit notes were overlooked and resultantly, the output tax liability was over-reported during the period from July 2017 to -September 2017 ("**Relevant Period**").

Separately, as the details of ITC were unknown at the time of filing GSTR 3B, it was recorded on an estimate basis. As a result, the Petitioner was compelled to discharge its tax liability in cash, even though ITC was available with it, as it was not reflected in the system on account of lack of data. In October, 2018, when the Government operationalised Form GSTR-2A for the past periods and precise details were computed, the Petitioner realised that ITC had been under reported for the Relevant Period and there was an excess payment of tax amounting to INR 923 crore.

As the aforesaid error occurred due to non-operationalisation of GSTR forms and non-availability of auto-check in Form GSTR 3B, the Petitioner wanted to rectify its return. However, such rectification was not allowed under Circular No. 26/26/2017-GST, dated December 29, 2017 ("**Circular**"), which stated that Form GSTR-3B could be corrected only in the month in which the errors were noticed.

Issues

Whether the Circular was *ultra vires* the provisions of CGST Act as well as in violation of Articles 14, 19(1)(g), 265 and 300A of the Constitution?

Arguments

The Petitioner argued that due to the failure of the IT system of the GST portal, Form GSTR 3B was introduced in the absence of Form GSTR-2 and 3. The Petitioner contended that Form GSTR 3B was only a summary return, which was required to be filed manually without any inbuilt checks and balances that could ensure that the data uploaded by the Petitioner was accurate, verified and validated. It was argued by the Petitioner that in the absence of such validation, coupled with the humongous task of collation of the enormous data, the chances of incorrect data being uploaded could not be eliminated.

The Petitioner also argued that the delay in operationalising Form GSTR-2A would not defeat its rights to take and use credit in the month in which it was due. It relied on several judgements of the HCs wherein the Courts had observed that GST was still in a "trial and error" phase and therefore, permitted the assessees to rectify/revise the returns.

Lastly, the Petitioner argued that the revision of Form GSTR-3B is revenue neutral since the Department ("**Respondent**") had already realised the tax leviable under the law.

92 Bharti Airtel Limited v. Union of India, W.P.(C) 6345/2018, CM APPL. 45505/2019 (Delhi HC).

On the other hand, the Respondent argued that the Circular provided for rectification of mistakes, pertaining to the earlier tax period in the return of the subsequent tax period when such error was noted. However, such changes were not in Form GSTR-3B of the original tax period.

The Respondent also contended that the tax paid on outward supplies by the Petitioner entitled the recipient of such supplies to avail ITC for the same. Thus, if changes made to particulars furnished by the supplier were allowed to be reflected in the previous relevant tax period (Form GSTR-3B for which return has already been filed), it would require modification of the particulars furnished in Form GSTR-3B (of such earlier tax period) by the recipient as well and therefore, increase the compliance burden of the recipient.

In light of the above complications, which could arise, the Respondent argued that Circular and the relevant provisions provided for rectification of GSTR-3B in the period subsequent to when the error, etc., was noticed by an assessee and not for the period to which such error, etc., pertained to.

Decision

The HC, before getting into the merits of the case, looked into the original scheme of filing of returns envisaged under various provisions under the GST legislations. It observed that the CGST Act contemplated a self-policing system under which the authenticity of the information submitted in the returns by registered person was not only auto-populated, but was verified by the supplier and confirmed by the recipient in the same month. Thus, the GST legislation provided a right to a registered person under which it would be able to ensure that the ITC availed and returns would be corrected in the very month to which they relate to.

The HC further noted that in the absence of GSTR 2 and GSTR 3, rule 61(5) and the rule 61(6) were introduced in the CGST Rules to provide for filing of monthly return in Form GSTR-3B, which was only a summary return. The HC agreed with the Petitioner that as the checks and balances prescribed in the original forms were effaced, the possibility of inaccuracies to creep in the data that was required to be filled in, could not be ruled out.

So, if Form GSTR-2 and GSTR 3 were operationalised, the Petitioner would have known the correct ITC available to it and discharged its liability through ITC available with it (though it was not reflected in the system on account of lack of data), instead of cash.

The HC noted that the refund provision did not provide a mechanism for refund of tax paid in cash by the Petitioner in the present case, as it did not squarely fall under the ambit of 'payment of excess tax'. But the HC also noted that the facts of the present case were different, where the Petitioner had paid taxes in cash, only because the extent of ITC could not be computed automatically, due to non-operationalisation of forms on account of lack of technical infrastructure.

The HC held that in the absence of a provision restricting such rectification, the constraint introduced by para 4 of the Circular, was arbitrary and contrary to the provisions of the CGST Act and hence, read down the Circular to the extent of para 4, which restricted the rectification of Form GSTR-3B in respect of the period in which the error had occurred.

Lastly, the HC stated that the Petitioner would not be denied the benefit due to the fault of the Respondents. Therefore, it held that as the refund provisions did not address the grievance of the Petitioner, it would be allowed to rectify the Form GSTR 3B.

Significant Takeaway

The decision of the HC in the present case brings relief to many large taxpayers who are aggrieved due to the lack of proper IT infrastructure to support the implementation of GST. The HC also recognised that the assessees have a statutory right to rectify or adjust their ITC details in the period to which is pertains. However, what is important to note here is that though the HC has quashed the restriction on rectification of mistake in the same period and allowed such rectification, the Government has not yet provided any mechanism to undertake rectification in such returns.

The Respondent has filed an SLP, challenging the order in the present case before the SC. Therefore, it seems that the litigation around this issue is not going to end soon and it would be interesting to see how the SC would look into the same.

> **“Assesses cannot be denied the benefit provided under the statute due to the fault of the department.”**

HC allows availment of transition credit by June 30, 2020

In the case of ***SKH Sheet Metals Components***[93], the HC held that the petitioner was permitted to revise the TRAN-1 Form on or before June 30, 2020, for transition of entire CENVAT credit to GST. Further, the HC directed the Government ("**Respondents**") to either re-open the online portal so as to enable the petitioner to file revised declaration TRAN-1 electronically, or to accept manual filing.

Facts

SKH Sheet Metals Components ("**Petitioner**") set up its unit at Pune, Maharashtra, to manufacture products for sale to original equipment manufacturers. The Petitioner had obtained registration under the erstwhile indirect legislations and availed input credit in terms of the CENVAT Credit Rules, 2004 and the Maharashtra VAT Act, 2002.

The Petitioner had filed Form TRAN-1 within the time period prescribed under the GST legislation. However, the details were not disclosed in the correct column, owing to which the total transitional credit was not reflected in the electronic credit ledger of the Petitioner. Thereafter, the Petitioner claimed that it filed a revised Form TRAN-1 Form and reflected the correct figures, however, the amount was still not transferred to the electronic credit register and was shown as "blocked credit". Thereafter, the Petitioner filed various letters and representations with the GST authorities and the GST helpdesk in relation to the same. Pursuant to failure of its efforts, the Petitioner filed a writ petition before the Bombay HC. The Bombay HC disposed of the petition with directions to the Petitioner to file a representation before the IT Grievance Redressal Committee ("**ITGRC**"). The Petitioner filed a representation with the ITGRC, but the same was rejected without elucidating any reasons for such a rejection.

The Petitioner then filed an RTI application, requesting for reasons behind the rejection. However, the request was turned down. Accordingly, the Petitioner invoked the extraordinary writ jurisdiction of the Delhi HC under Article 226 of the Constitution.

Issue

Whether the Respondents had acted in a reasonable manner by denying the Petitioner benefit of transitional provision without any cogent reason?

Arguments

The Petitioner contended that it had filed the Form TRAN-I within the specified time and filed a revised return correcting the bona fide error, however, the entire credit was not reflected in its electronic credit ledger. The Petitioner further argued that it had been tirelessly following up with the Respondents and submitted a litany of complaints and representations. The Petitioner also relied upon several decisions[94] to argue that several HCs had permitted similarly placed taxpayers to file Form TRAN-1 beyond the stipulated time period limit under GST legislation. The Petitioner also argued that HCs had in fact gone a step further and extended benefit to even those taxpayers, who may not have faced "technical glitches on the portal", but were otherwise prevented from filing Form TRAN-1, including on account of certain human errors or factors and reasons that were beyond their control. The Petitioner also relied upon the detailed decision rendered by the Delhi HC in ***Brand Equity Treaties Ltd.***[95] (batch of cases) and argued that its case was identical to one of the petitioners therein i.e. ***Micromax Informatics Ltd.***[96] Notwithstanding the benefit granted by the Delhi HC in the Brand Equity Treaties Ltd (Supra) case, the Petitioner submitted that since it had filed Form TRAN-1 well before the specified deadline under the GST legislation, it was entitled to transition the credit.

On the other hand, the Respondents argued that the Petitioner could not avail the benefit of the judgement in the case of Brand Equity Treaties Ltd. (supra), as the absence of power to prescribe a time limit for filing TRAN-1 was the critical factor that was catalytical in guiding the HCs to hold that the limitation period under Rule 117 of the CGST Rules for filing TRAN-1 was merely directory and not mandatory. However, by virtue of a retrospective amendment to Section 140 of the CGST Act, there has been a change in circumstances and the benefit of the judgement in the case of Brand Equity Ltd. (supra) was no longer available to the Petitioner.

The Respondents further argued that the Petitioner had not encountered any technical glitch on the portal and the discrepancy in electronic credit ledger was because of a human error. Hence, the Petitioner's request to file a revised TRAN-1 form beyond the limitation period was not acceptable.

Decision

The HC stated that the stand of the Respondents to condemn the Petitioner for a clerical mistake and not redress the grievance, was disagreeable and objectionable. Rather, the Government should endeavour to find a resolution.

93 SKH Sheet Metals Components v. UOI & Ors.,W.P.(C) 13151/2019 (Delhi HC).

94 Blue Bird Pure Private Limited v. UOI (W.P.(C) 3798/2019) (Delhi HC); Adfert Technologies Private Limited v. UOI (CWP No. 30949/2018(O&M)) (P&H HC); Vertiv Energy India Private Limited v. UOI & Ors. (W.P.(C) 10811/2018) (Delhi HC); Lease Plan India Private Limited v. Government of National Capital Territory of India & Ors. (W.P.(C) 3309/2019) (Delhi HC); Godrej & Boyce Manufacturing Company Limited v. UOI (W.P.(C) 8075/2019) (Delhi HC); JakapMetind Private Limited R/Special v. UOI (Civil Application No. 19951/2018) (Gujarat HC) and; Siddharth Enterprises R/Special v. The Nodal Officer (Civil Application No. 5758/2019) (Gujarat HC).

95 Brand Equity Treaties Ltd. And Ors. v. Union of India, (2020) 116 taxmann.com 415 (Delhi HC).

96 Micromax Informatics Ltd. v Union of India, WP© No. 196/2019 (Delhi HC).

The Delhi HC though refrained from evaluating the validity of the decision of Brand Equity Treaties Ltd. (Supra), but remarked that the decision was not merely based on the fact that the CGST Act does not prescribe a time limit for availment of transition credit and that there were several other reasons in the decision that continue to apply with full rigour even today, regardless of the amendment to Section 140 of the CGST Act.

The HC observed that Rule 117A of the CGST Rules was not sacrosanct and the proviso to Rule 117 of the CGST Rules was vague, as the concept of 'technical difficulty on the common portal' had not been defined in the CGST Act and discrimination on the basis of this criterion was bad in law. Thus, denying availment of transition credit to the Petitioner on the ground that the Petitioner could not avail transition credit due to "human error" and not due to "technical difficulty on the common portal" were held to be unreasonable, arbitrary and in violation of Article 14 of the Constitution. The HC further stated the GST Council during its 32nd meeting recognised that there could be errors apparent on the face of the record that could be non-technical in nature and held that such cases merit leniency.

The HC held that the transition provisions and the language of Section 140 of the CGST Act even after the amendment manifest that the intention behind the said provision was to save the accrued and vested ITC under the existing law. If the legislature allows migration of the transition credit, the rules would be interpreted with this objective in focus. Keeping in mind this objective of the legislation, the courts had held that transition credit stood accrued and was a vested right. The same was protected by Article 300A of the Constitution and could not be taken away without the authority of law.

The HC stated that Rule 120A of CGST Rules was an enabling provision that could be resorted to, by the taxpayers to revise the TRAN-1 Form on the common portal within the time specified in the rules or such further period as may be extended by the Commissioner. Therefore, the revision could not be treated as a fresh filing, especially, keeping in view the spirit of the 32nd meeting of GST Council.

The HC also observed that the Petitioner, as a matter of right, should have known the specific reasons for the rejection of its case so that it could assail the same. The approach of the Respondents was grossly unjust.

In view of the foregoing observations, the HC held that the Petitioner should be permitted to revise TRAN-1 Form on or before June 30, 2020, and transition the entire ITC, subject to verification by the Respondents. Further, the HC issued a writ of mandamus to the Respondents to either open the online portal so as to enable the Petitioner to revise Form TRAN-1 electronically, or to accept the same manually.

Significant Takeaways

The decision is a welcome one, as it supports the argument that transition credit has already accrued, and is a vested right of assessees that is constitutionally protected under Article 300A of the Constitution, and that such substantive rights cannot be denied because of procedural issues. The decision also contributes to the debate on constitutional validity of the discrimination made between taxpayers who faced technical glitches on the portal and other taxpayers under Article 14 of the Constitution.

However, considering that some of the other HCs have taken a contrary view, whereby, the filing/ revising of TRAN-1 has been allowed beyond the statutory timeline prescribed only in cases where taxpayers faced technical glitches on the portal, this decision does not completely settle the issue involved. Moreover, the decision in Brand Equity Treaties Ltd. (Supra) has been stayed by the SC and the outcome is awaited.

Further, as the portal has not been re-opened even after various HCs directing the department to do so; in case a taxpayer intends to claim for transition credit in line with the decision of the Delhi HC, it is advisable to file a letter with the authorities stating the same.

> **"Interpreting procedural timelines to be mandatory would defeat the purpose for which the transitionary provisions have been provided."**

Design Services related to post importation activities would not form a part of transaction value for the levy of customs duty

In the case of ***Steel Authority of India Limited***[97] the SC held that the valuation rule pertaining to adjustment of any payment made or to be made as a condition of sale of imported goods would not be automatically applicable to every import, which has surface features of a turnkey contract.

Facts

Steel Authority of India Limited ("**Respondent**") imported plant and machinery in connection with modernisation, expansion and modification of its plant at Durgapur in West Bengal. The Respondent registered itself with the customs authorities for the purpose of availing project import benefits. The Respondent floated seven global tender contract packages, out of which the custom valuation was challenged in relation to imports under two contracts. Both contracts were entered into with different consortiums, comprising an offshore entity and an Indian entity for modernisation of rolling mills at the aforementioned plant of the Respondent.

The consortia were to supply plant, equipment and spares along with certain basic designs and supervisory services at site. The Respondent, at the time of import, claimed that import duty was chargeable only on the plant and equipment, which included cost of all designs and engineering for their manufacture. However, the designs and drawings specified in the schedule of the contract were separate and related to post-importation project implementation activities. The valuation was scrutinised by the special valuation branch. The revenue authority sought to include the value of basic design and engineering fee and foreign supervision charges to the transaction value of imported equipment as per rule 9 (1) (e) of the Customs Valuation (Determination of Price of Imported Goods Valuation) Rules, 1988 ("**Valuation Rules**"). The Valuation Rules require the addition of any payment made or to be made by the importer as a condition of sale of imported goods to their transaction value for the levy of customs duty. The said authority observed that the contractor was entrusted with the work on a turnkey basis, where the entire supplies and services were dependant on each other. The said order was later reaffirmed by the Commissioner of Customs (Appeals). However, on further appeal, CESTAT ruled in favour of the Respondents.

Issue

Whether the basic design and engineering fee and foreign supervision charges are liable to be added to the invoice values of the imported equipment under the Valuation Rules?

Arguments

The revenue authority contended that intangible items such as drawings, design, engineering and supervision were integrally linked with supply of the equipment. Their price formed an integral part of the price of the imported equipment. Therefore, the supply of such services was a condition for importation of the equipment.[98] Accordingly, on the basis of a combined reading of Section 14 of the Customs Act, read with Rules 4 and 9(1)(e) of the Valuation Rules, the entire contract value had to be treated as transaction value for the purpose of charging customs duty. By relying on the judgement in the ***ABB Ltd case***[99], the revenue authority further contended that in turnkey contracts, the condition was implied and even the post-importation activities should be treated as condition of import of the equipment.

On the other hand, the Respondent contended that Rule 9 of the Valuation Rules was only a mode of arriving at the transaction value of imported goods, in line with the customs valuation provision. As per the interpretative notes to the said rules, where the seller of goods undertook their erection or assembly after their importation into India, and where charges for the same were separate and distinguishable from the price actually paid or payable for the imported goods, such charges would not form a part of the value of the imported goods. The interpretative notes did not permit the addition of value of post importation services to the value of the imported goods. The Respondent contended that the intangible items related to post importation activities of the Respondent in India for implementation of their project. The Respondent also submitted that in terms of the agreement, the Respondent had the right to change the goods to be supplied by the supplier at any time.

The Respondent was of the view that the "condition" clause contained in Rule 9(1) (e) of the Valuation Rules would not get

97 Commissioner of Customs (Port), Kolkata v. Steel Authority of India Ltd., 2020 (4) TMI 774 (Supreme Court).
98 CC (Prev.), Ahmedabad v. Essar Gujarat, (1997) 9 SCC 738 (Supreme Court).
99 Commissioner, Delhi Value Added Tax v. ABB Limited, (2016) 6 SCC 791 (Supreme Court).

attracted automatically, where an importer of equipment undertakes to obtain drawings and designs for undertaking post importation activities relating to the equipment from the same overseas supplier. The design and drawings were not necessary for the procurement of the imported equipment. Thus, only imported equipment could be subject to customs duty and not the designs and drawings and supervision activities relating to the same.

Decision

The SC affirmed the decision of CESTAT by upholding the non-inclusion of charges for design, drawing and supervision services in the transaction value for the levy of customs duty. The SC observed that the value of equipment imported was distinguished from the cost of post importation services in the contract entered into by the Respondent. The SC also noted that the revenue authorities had failed to prove that the disputed items of the contract i.e. drawing, design and supervision services do not relate to post importation activity.

The expression "condition" in general parlance means that something could be done only if another thing was also done. The SC relied on ***Feredo case***[100] and reiterated that the implied condition into the contracts would be impermissible in the absence of any other material to demonstrate subsistence of such condition. There was no material before the SC to suggest that import of equipment was effected with simultaneous obligation to procure designs. The SC was of the view that there was no material before them, which suggested that the import of equipment was effected with a simultaneous obligation of Respondent to import services from the same entity. In other words, no condition of sale can be implied in the absence of any contrary material.

The SC relied upon various precedents[101], which held that the value or charges of items, which were to be used or utilised for post importation activities were not permissible to be included in the assessable value. Thus, the SC was of the view that different components of a contract or multiple contracts may attribute the transaction with the characteristic of a turnkey project. However, it would not lead to any specific finding on existence of the "condition" as contemplated in clause 9 (1) (e) of Valuation Rules. This addition would also be contrary to the provisions of the interpretative note, which specifically excluded addition of post-importation charges, subject to other conditions.

The SC further distinguished the cases that were relied upon by the revenue authorities. The case of *Essar Gujarat* was distinguishable on the ground that the subject of import in the said case carried a condition for entering into a licencing agreement with a third party, which was absent in the Respondent's case. Similarly, in the *ABB* case, while it dealt with turnkey contract, the same could not be relied upon as it pertained to a different statute, having a distinct mechanism for arriving at the transaction value.

Significant Takeaways

The SC has put to rest the issue in relation to inclusion of charges in the transaction value for levy of customs duty on post importation services provided in case of turnkey contracts. The SC highlighted that a single contract does not imply that the transaction value for import of equipment would by default include the value of post-importation activities. In other words, contents of the contract would be the determining factor rather than the form of contract.

Rule 10(1)(e) of the Customs Valuation (Determination of Value of Import Goods) Rules, 2007, is *pari materia* with Rule 9(1)(e) of the erstwhile Valuation Rules. Therefore, the aforementioned ruling would continue to guide the new valuation rules.

> **"A single turnkey contract does not automatically imply the inclusion of charges for post-importation services in the transaction value of imported goods for levy of customs duty."**

100 Commissioner of Customs v. Ferodo India (P) Ltd., (2008) 4 SCC 563 (Supreme Court).

101 Commissioner of Customs v. Essar Steel, (2015) 8 SCC 175 (Supreme Court); M/s Tata Iron & Steel Co. Ltd. v. CCE, (2000) 3 SCC 472 (Supreme Court); Commissioner of Customs v. J.K. Corp. Ltd., (2007) 9 SCC 401 (Supreme Court); Commissioner of Customs v. Hindalco Industries, (2015) 14 SCC 750 (Supreme Court); Commissioner, Customs v. Denso Kirloskar Industries, (2015) 16 SCC 506 (Supreme Court); Commissioner of Customs v. Toyota Kirloskar, (2007) 5 SCC 371 (Supreme Court).

CBDT issues circular to clarify period of lockdown to be ignored for purposes of determining residential status

On May 8, 2020, the CBDT issued Circular No. 11 of 2020 ("**Circular**") to clarify that for the purposes of determining the residential status under Section 6 of the IT Act during PY 2019-20, following periods shall not be taken into account:

Category of individual	Period to be ignored
Individual came to India on a visit before March 22, 2020, and was unable to leave India on or before March 31, 2020	Period of stay from March 22, 2020 to March 31, 2020
Individual came to India on a visit before March 22, 2020, and has been quarantined in India on account of COVID-19 on or after March 1, 2020, and has departed on an evacuation flight on or before March 31, 2020, or has been unable to leave India on or before March 31, 2020	Period of stay from beginning of his quarantine to his date of departure or March 31, 2020 (as applicable)
Individual came to India on a visit before March 22, 2020, and has departed on an evaluation flight on or before March 31, 2020	Period of stay from March 22, 2020 to his date of departure

The residential status of an individual is determined under Section 6 of the IT Act, based *inter alia* on the number of days such an individual is present in India. This circular is being issued for the benefit of individuals, who had unintentionally become residents of India in FY2019-20, because of the forced lockdown imposed by the Indian Government to control the COVID-19 outbreak. While the instant circular is applicable for FY2019-20, the income tax department had indicated that a similar circular for FY2020-21 would be issued in due course of time.

Reduction in TDS and TCS rates

In order to ease the cash crunch faced by taxpayers due to the sudden lockdown imposed by the Indian Government, the Finance Minister, as part of Atmanirbhar Bharat Abhiyan or Self-Reliant India Movement, proposed that TDS rates for non-salaried payments made to residents and rates of TCS for the specified receipts shall be reduced by 25% of the existing rates.

Pursuant to the announcement, the CBDT released a Press Release dated May 13, 2020 ("**Press Release**"), prescribing the new TDS and TCS rates for various kinds of payments. The new rates have been made effective from May 14, 2020, and would continue to apply till the end of FY2020-21, i.e. till March 31, 2021. It is pertinent to note that such reduced rates would not be applicable where the tax is required to be deducted or collected at higher rates due to non-furnishing of PAN / Aadhar.

An indicative table setting out the TDS and TCS rates before and after the Press Release has been provided below:

Nature of payment	Section	Old rates (applicable till May 13, 2020)	New rates (applicable from May 14, 2020 to March 31, 2021)
TDS Rates			
Interest on securities	193	10%	7.5%
Dividend	194	10%	7.5%
Interest other than 'interest on securities'	194A	10%	7.5%
Payment to contractors	194C	1% (payee is individual or HUF) 2% (others)	0.75% (payee is individual or HUF) 1.5% (others)
Insurance Commission	194D	5%	3.75%
Payments in respect of life insurance policy	194DA	5%	3.75%
Payments in respect of deposits under National Savings Scheme	194EE	10%	7.5%
Payments on account of repurchase of units by Mutual Funds or UTI	194F	20%	15%
Commission, prize, etc., on sale of lottery tickets	194G	5%	3.75%
Commission or brokerage	194H	5%	3.75%
Rent on immovable property	194I(b)	10%	7.5%
Rent on plant and machinery	194I(a)	2%	1.5%
Payment for acquisition of immovable property	194-IA	1%	0.75%
Payment of rent by individual or HUF	194-IB	5%	3.75%
Payment for Joint Development Agreements	194-IC	10%	7.5%
Fees for professional or technical services, remuneration, fees or commission to director, royalty	194J	2% (FTS, certain royalties, call centre) 10% (others)	1.5% (FTS, certain royalties, call centre) 7.5% (others)
Payment of dividends by Mutual Funds	194K	10%	7.5%
Payment of compensation of acquisition of immovable property	194LA	10%	7.5%
Payment of income by Business Trust	194LBA	10%	7.5%
Payment of income by Investment Fund	194LBB	10%	7.5%
Income in respect of investments in securitisation trust	194LBC	25% (Individual/HUF) and 30% (others)	18.75% (Individual/HUF) and 22.5% (others)

Nature of payment	Section	Old rates (applicable till May 13, 2020)	New rates (applicable from May 14, 2020 to March 31, 2021)
Payment of commission or brokerage, etc., by an Individual and HUF	194M	5%	3.75%
TDS on e-commerce participants	194O	1% (w.e.f. October 1, 2020)	0.75%
TCS Rates			
Grant of licence, lease, etc., of parking lot, toll plaza, mining and quarrying	206C(1C)	2%	1.5%
Sale of tendu leaves	206C(1)	5%	3.75%
Sale of timber obtained under a forest lease or from any other mode as well as sale of forest leaves not being timber/tendu leaves	206C(1)	2.5%	1.875%
Sale of scrap and minerals, being coal or lignite or iron ore	206C(1)	1%	0.75%
Sale of motor vehicles above INR 1 million	206C(1F)	1%	0.75%
Sale of any other goods	206C(1H)	0.1%(w.e.f. October 1, 2020)	0.75%

Buyer to Buyer ("B2B") business need not maintain prescribed modes of electronic payments, subject to certain conditions

In order to promote cashless economy, Section 269SU was introduced into the IT Act, *vide* Finance (No.2) Act, 2019. Section 269SU obligates every person carrying on business and whose sales turnover or gross receipts from the business exceeds INR 50 crore in the immediately preceding year ("**Specified Taxpayer**"), to provide facilities for accepting payments through prescribed electronic modes. Subsequently, CBDT *vide* notification no. 105/2019, dated December 30, 2019, had introduced Rule 119AA, which notified Rupay-powered debit card, Unified Payments Interface ("**UPI**") and UPI Quick Response Code as the prescribed methods.

Subsequently, CBDT received various representations stating that the obligation imposed under Section 269SU was not very relevant for B2B businesses, which receive large payments through RTGS and NEFT, as the prescribed methods have a maximum payment limit per transaction or per day. Accordingly, the CBDT, in order to rationalise Section 269SU, *vide* circular no. 12, dated, May 20, 2020, clarified that the provision of Section 269SU would not be applicable to taxpayers, having only B2B transactions if at least 95% of aggregate of all amounts received during the relevant year are made by any mode other than cash. This clarification provides much needed relief to the B2B businesses as they would not be required to incur additional costs to maintain the prescribed electronic facilities.

CBDT exempts certain classes of persons from application of Section 56(2)(x) and Section 50CA

Section 56(2)(x) of the IT Act *inter alia*, provides that where any person receives any property[102] for a consideration that is less than its fair market value, then the fair market value of such property as exceeding the consideration is taxable in the hands of the person receiving such property. The existing clause (XI) of proviso to Section 56(2)(x) of the IT Act provides that Section 56(2)(x) shall not apply if the property is received from such class of persons, as may be prescribed by CBDT.

Pursuant to these powers, CBDT had inserted Rule 11UAC in the IT Rules, prescribing a class of persons to which Section 56(2)(x) shall not apply. CBDT, on June 29, 2020, issued Notification No. 40 of 2020 ("**Notification**"), replacing Rule 11UAC of the IT Rules.

In terms of the revised Rule 11UAC, which has been given a retrospective effect from April 1, 2020, following classes of persons would be exempt from applicability of Section 56(2)(x) of the IT Act:

i. Any immovable property, being land or building or both, received by a resident of an unauthorised colony in the National Capital Territory of Delhi, where the Central Government has regularised the transactions of such immovable property based on the prescribed documents in favour of such resident.

102 Property has been defined under explanation to section 56(2)(vii) of the IT Act.

ii. Unquoted shares of a company and its subsidiary and the subsidiary of such subsidiary received by a shareholder, where:

(a) The National Company Law Tribunal ("**NCLT**"), on an application moved by the Central Government for relief in cases of oppression and mismanagement under Section 241 of the Companies Act, 2013, has suspended the Board of Directors of such companies and appointed new directors nominated by the Central Government; and

(b) Such shares have been received pursuant to a resolution plan approved by the NCLT under Section 242 of the Companies Act, 2013, for prevention of oppression and mismanagement.

iii. Equity shares of Yes Bank Limited, received by the State Bank of India or other investor banks, allotted under the Yes Bank Reconstruction Scheme at a price specified in the said scheme.

Section 50CA of the IT Act provides that where the consideration received as a result of transfer of unquoted shares is less than its fair market value, then such fair market value shall be deemed to be the full value of consideration received for the purpose of computation of capital gains tax. CBDT *vide* another notification[103] dated June 30, 2020, inserted Rule 11UAD into the IT Rules to provide that the provisions of Section 50CA of the IT Act would not apply in case of transfer of unquoted shares of a company, its subsidiary and the subsidiary of such subsidiary as enlisted in point (ii) above (i.e. where such shares are received pursuant to a resolution plan for prevention of oppression and mismanagement approved by NCLT).

CBDT prescribes minimum threshold for remuneration payable to eligible fund managers to qualify for exemption from taxable presence in India

Section 9A of the IT Act was introduced to exempt certain offshore funds, eligible investment funds[104] ("**EIF**") from constituting a business connection in India and for preventing them from being regarded as a resident in India. In this regard, Section 9A prescribes several conditions, including a condition with respect to minimum remuneration payable to an eligible fund manager[105] ("**EFM**") under Section 9A(3)(m) of the IT Act.

Earlier, the provisions of Section 9A(3)(m) prescribed that payment of remuneration to an EFM should satisfy the arm's length standard. However, the aforesaid provisions were amended *vide* Finance Act, 2019, which removed the arm's length requirement as prescribed earlier and sought to replace it with a new method to be prescribed. Recently, the CBDT notified the Income-Tax (Tenth Amendment) Rules, 2020 ("**Amendment Rules**"), on May 27, 2020, *vide* which it prescribed the minimum renumeration to be paid by an EIF to EFM under the provisions of Section 9A(3)(m) of IT Act.

The Amendment Rules have removed sub-rule 5 to sub-rule 10 of Rule 10V of IT Rules w.e.f. April 1, 2019, onwards, which laid down rules under the erstwhile provisions of Section 9A(3)(m) of the IT Act, in relation to the determination of arm's length price in respect of remuneration paid by EIF to EFM.

Further, new rules have been prescribed vide Amendment Rules for computation of minimum threshold of remuneration payable to EFM. In this regard, a draft notification[106] dated December 5, 2019, was also issued by the CBDT to seek inputs from the public on the proposed manner of calculating remuneration to be paid to the EFM in terms of amended Section 9A(3) (m), which have now been adopted into the IT Rules.

As per the Amendment Rules now, finally notified by CBDT, following thresholds have been prescribed for payment of remuneration to EFM:

Particulars	Threshold
1. In case of Category-I foreign portfolio investor ("**FPI**")[107]	0.10% of asset under management ("AUM")
2. In other cases	0.30% of AUM
- In case of profit-linked manager remuneration	10% of profits in excess of the specified hurdle rate' "specified hurdle rate" herein means a pre-defined threshold beyond which the fund agrees to pay a share of the profits earned by the fund from the fund management activity undertaken by the fund manager.
- In case of funds with multiple investment managers	50% of the management fee, whether in the nature of fixed charge or linked to the income or profits derived by the fund from the management activity undertaken by the fund manager, as reduced by the amount incurred towards operational expenses, including distribution expenses.

103 Notification No. 42 of 2020.
104 defined under sub-section 3 of section 9A.
105 defined under sub-section 4 of section 9A.
106 F No 142/15/2015-TPL.
107 As per Regulations 5(a)(i) to 5(a)(iv) of the Securities and Exchange Board of India (Foreign Portfolio Investors) Regulations, 2019.

For this purpose, AUM has been defined as the annual average of the monthly average of the opening and closing balances of the value of such part of the fund, which is managed by the fund manager.

It may be noted that as per the new provisions, remuneration lower than the prescribed threshold may be paid, subject to an application being made to CBDT, providing reasons for the same and an approval being granted by CBDT.

Further, as per the amended provisions, EFM and EIF are no longer deemed to be related parties for the purposes of Indian transfer pricing regulations. Hence, the transfer pricing provisions would not apply unless EFM receives the fees from an associated enterprise.

A new Form 3CEJA has also been prescribed *vide* Amended Rules for reporting information regarding fulfilment of certain conditions under Section 9A, to be duly verified and furnished by an accountant.

Clarifications issued by CBDT in respect of recently launched '*Vivad se Vishwas Scheme*' for settlement of direct tax disputes

The Finance Minister in her Budget Speech on February 1, 2020, announced the "*Vivad se Vishwas*" scheme ("**the Scheme**") for resolution of pending direct tax disputes. Post announcement of the Scheme, The Direct Tax Vivad se Vishwas Act, 2020 ("**VsV Act**") was enacted on March 17, 2020, and the relevant rules were prescribed on March 18, 2020.

Due to several queries received from the stakeholders, the government issued a Circular[108] dated March 4, 2020, in the form of answers to 55 FAQs so as to clarify certain aspects related to the Scheme, which were earlier made subject to approval and passing of the Scheme, that later got enacted into law on March 17, 2020. These FAQs have now been re-issued *vide* a new Circular[109] dated April 22, 2020, with slight modifications in the prosecution related clarifications.

The Cover Story of our January-March 2020 issue of Tax Scout elaborately discusses the Scheme and its features. The issue can be accessed here.

Salient contents of the Circular dated April 22, 2020, are as follows:

i. Scheme will not be applicable in case of proceedings pending before AAR. However, the Scheme will be applicable where a writ is pending in HC against an order of AAR. Where order of AAR has not yet determined the total income, for instance where it has been held that there is existence of a PE, but the profits have not yet been attributed by the AO, the Scheme will not be applicable.

ii. If the amount of tax already paid by the appellant exceeds the amount payable under the Scheme, the excess shall be refunded without any interest under Section 244A of the IT Act.

iii. Where the assessment is cancelled by an appellate authority with a direction that assessment be framed de novo, the Scheme cannot be availed.

iv. However, where the appellate authority has set aside an order with directions for giving proper opportunity to the assessee or carry out fresh examination of certain issues with specific direction, the assessee is eligible to avail the Scheme. The assessee in such a scenario will of course be required to settle the remaining issues as well, which have not been set aside in that year, against which an appeal is pending or time limit to file the appeal has not expired.

v. Where quantum appeal and appeal in relation to penalty both are pending, the Scheme may be availed to settle both simply by paying the prescribed percentage of the disputed tax amount against quantum appeal only. However, penalty appeal cannot be settled independently where quantum appeal is still pending and is not being covered under the Scheme.

vi. Where quantum appeal and the appeal against imposition of fees under Section 234E or Section 234F of the IT Act are both pending, the settlement of disputed tax will not settle the disputed fee. Disputed fee may be settled by paying 25% or 30% of the disputed fee, as the case may be.

vii. Where a dispute consists of certain issues, which have been specifically excluded from the Scheme, for instance an issue pertaining to undisclosed foreign income, the Scheme cannot be availed. In any given case, an appellant must choose to settle all issues that form part of one pending appeal for an assessment year and cannot pick and choose the issues to be settled under the Scheme.

viii. Where there has been no determination of income as yet since a writ was filed against issuance of notice under Section 148 of the IT Act, the Scheme cannot be availed.

ix. The Scheme cannot be availed where only applications for waiver of interest under Section 234A/234B/ 234C of IT Act are pending before the competent authority and no appeal has been filed.

x. Where draft assessment order has been passed and objections have not been filed before the DRP as the assessee has decided to avail CIT(A) route, the assessee will be eligible to avail the Scheme even if the final assessment order has not yet been passed.

xi. Where original assessment order and reassessment order are both pending in separate appeals before various forums, say one at ITAT and the other with CIT(A), then only one of the said appeals may be settled under the Scheme or the assessee may combine both the appeals together.

108 Circular No. 7/ 2020 dated March 04, 2020.
109 Circular No. 9/ 2020 dated April 22, 2020.

xii. Where only notice for initiation of prosecution has been issued, but prosecution has not been instituted or a prosecution proceeding is compounded before filing declaration under the Scheme, the Scheme can be availed. It cannot be availed where prosecution has been instituted, unless it is compounded before filing the declaration under the Scheme.

xiii. Please note that this point has been covered in greater detail in this Circular as compared to the Circular dated March 4, 2020, which didn't separately clarify for the scenario where notice has been issued, but prosecution has not been instituted.

xiv. If an appeal has been filed before HC, but the same is pending for admission, the assessee is eligible to file declaration under the Scheme.

xv. Where rectification is pending with the AO on the specified date, which may increase or decrease the tax liability of an assessee, the disputed tax will be calculated on rectified income after giving effect to the rectification order to be passed.

xvi. Where an assessee settles TDS appeal or withdraws arbitration against an order under Section 201 of the IT Act, the deductee shall be allowed credit of taxes in respect of such matter as on the date of settlement of dispute. However, interest shall apply as applicable to deductee.

xvii. Where the assessee failed to deduct TDS, in consequence to which there are two appeals pending, one against order under Section 201 of the IT Act for TDS default and another quantum appeal for disallowance under Section 40a (i)/(ia) of the IT Act, if he settles the appeal against order under Section 201, he will not be required to pay any tax on the issue of disallowance as per the provisions of Section 40a (i)/(ia) of IT Act. Subsequently, if all the issues in quantum appeal are also settled, no taxes will be paid for the aforesaid disallowance under Section 40(a)(i)/(ia) of the IT Act and the same shall be ignored for the purpose of calculation of disputed tax.

xviii. Notwithstanding the above, in case of settlement of a quantum appeal, where the assessee already has a favourable order in an appeal against order under Section 201 of the IT Act, which has attained finality, he will not pay any disputed tax on issue of disallowance in quantum appeal.

xix. Where an assessee settles his dispute in a matter in respect of which there is also an order under Section 201 for non-deduction of tax on his payer, such payer-cum-deductor will no longer be liable to pay the TDS amount. Deductor though would still be liable to pay interest under Section 201(1A) of IT Act, which may be separately settled under the Scheme.

xx. Where substantive addition is settled under the Scheme, protective addition on the same issue in case of same assessee or another assessee shall also be deleted by the AO, by passing a rectification order.

xxi. Where the ITAT has passed orders adjudicating certain issues in favour of assessee and other issues against him and time to file appeal has not yet expired for the tax department, the assessee has three options available. He can either settle his own appeal, or settle the appeal that may be filed by the department or settle both. If the issues where assessee got relief are not settled under the Scheme, the department is free to file appeal against the same.

xxii. Where an issue is covered in favour of the assessee by order of SC, since the matter has attained finality, in case of another dispute pending before HC settled under the Scheme consisting of various issues, no tax needs to be paid on such a covered issue.

xxiii. Where declaration has been filed under the Scheme, but payment has not been made owing to financial difficulty, such a declaration would be void.

xxiv. The designated authority has power to amend its order to rectify any patent errors.

xxv. The result of the Scheme cannot be applied to the same issues pending before the AO. Making a declaration under the Scheme shall not amount to conceding the tax position either by tax authority or by assessee.

xxvi. Despite settlement of a transfer pricing dispute under the Scheme, the provisions of secondary adjustment under Section 92CE of the IT Act will still be applicable

xxvii. Separately, it is important to note that as per the measures undertaken in the Atmanirbhar Bharat Abhiyan of the Government, the time period for settlement of disputes under the Scheme without additional 10% penalty has been extended from June 30, 2020, to December 31, 2020.

CBDT notifies certain allowances which will be exempt for an employee availing concessional tax rate regime

The Finance Act, 2020, introduced an alternative concessional tax rate regime for individuals and for Hindu Undivided Family (HUF), subject to certain conditions, including *inter-alia*, non-availability of certain specified tax deductions/exemptions. CBDT *vide* Notification No. 38 of 2020, dated June 26, 2020 ("**Notification**"), has prescribed certain allowances, which will be exempt for an employee availing the concessional tax rate regime.

In terms of Section 10(14) of the IT Act, any such special allowance or benefit, (not being in the nature of a perquisite), specifically granted to meet expenses wholly, necessarily and exclusively incurred in the performance of the duties of an office or employment of profit to the extent to which such expenses are actually incurred for that purpose, shall be exempt from tax. Rule 2BB of the IT Rules provides the list of such allowances.

In terms of the Notification read with Rule 2BB of the IT Rules, following allowances can be claimed exempt by a taxpayer (being an employee), availing the concessional tax rate regime under Section 115BAC of the IT Act:

i. Allowance granted to meet the cost of travel on tour or transfer;

ii. Allowance granted on tour or for the period of journey in connection with the transfer, to meet the ordinary daily charges incurred by the taxpayer employee due to absence from his normal place of duty;

iii. Allowance granted to meet the expenditure incurred on conveyance in performance of duties of an office or employment of profit (subject to free conveyance not provided by the employer);

iv. Transport allowance not exceeding INR 3,200 per month, granted to an employee who is blind or deaf or dumb or orthopedically handicapped with disability of lower extremities, to meet the expenditure of commuting between the place of residence and the place of duty.

The Notification further provides that a taxpayer availing the concessional tax rate regime under Section 115BAC of IT Act shall not be eligible to claim exemption in respect of the free food/non-alcoholic beverages provided by an employer through paid vouchers.

CBDT revises norms for invoking MAP procedure

CBDT, *vide* Notification No. 23 of 2020, dated May 06, 2020, notified the Income Tax (8th Amendment) Rules, 2020, to amend Rule 44G of the IT Rules. The said amendment has consolidated Rule 44G and Rule 44H into Rule 44G only and thereby omitted Rule 44H.

The salient features of the revised Rule 44G are as follows:

i. The amended rule has inserted an additional term 'specified territory', in addition to a country to include a scenario where an assessee is aggrieved by action of the tax authorities of any country or specified territory. The usage of the term specified territory would now ensure that actions of tax authorities of territories such as Cayman Islands or Bermuda, also get covered under MAP;

ii. The amended rule also provides for an additional step of Competent Authority of India to convey its acceptance or otherwise of the MAP reference received from a Competent Authority outside India;

iii. The amended rule now also enables the Competent Authority to call for relevant records and documents, not only from the IRA, but also from the assessee or their authorised representatives in India and have discussions with them. Previously, the Competent Authority was only empowered to call for and examine the relevant records from the income-tax authorities;

iv. The amended rule also provides for a timeline of two months for MAP resolution. The provision uses the term 'average' time of 24 months, which is indicative of the fact that this timeline is for references resolved as a whole, however, on an individual case-to-case basis, this timeline may differ. This amendment is in accordance with BEPS Action Plan 14, which requires jurisdictions to seek to resolve MAP cases within an average time frame of 24 months;

v. The rule further provides that where MAP is invoked on account of action taken by an income-tax authority in India, the resolution arrived at shall not result in decreasing in the income or increasing the loss of the assessee in India, as declared by him in the return of income for the said FY;

vi. The resolution arrived at by the Competent Authorities shall be communicated to the assessee in writing;

vii. The assessee shall communicate his acceptance or non-acceptance of the resolution in writing to the Competent Authority in India within thirty days of receipt of the communication;

viii. The assessee's acceptance of the resolution shall be accompanied by proof of withdrawal of appeal, if any, pending on the issues that were the subject matter of the resolution arrived at;

ix. On receipt of acceptance from the Assessee, the Competent Authority in India would communicate the resolution arrived at and the acceptance by the assessee, along with proof of withdrawal of appeal, to the Principal Chief Commissioner or the Chief Commissioner or the Principal Director General or Director General, as the case may be, who in turn shall forward it to the relevant AO;

x. On receipt of communication, the AO is required to give effect to the resolution arrived at between the Competent Authorities, by an order in writing, within one month from the end of the month in which the communication was received by him and intimate the assessee about the tax payable determined by him, if any;

xi. The assessee will then accordingly pay the tax as determined within the time allowed by the AO and submit the proof of payment of taxes to the AO, who will proceed to withdraw the pending appeal, if any, pertaining to subject matter of the resolution, which were filed by the IRA;

xii. A copy of the order of the AO, shall be sent to the Competent Authority in India and to the assessee;

xiii. The amount of tax, interest or penalty already determined would be required to be adjusted in accordance with the resolution arrived at by the Competent Authorities and in the manner provided under the Act or the rules made thereunder to the extent that such manner is not contrary to the resolution arrived at;

xiv. The amendment notified the revised Form 34F to give effect to the amended Rule 44G.

CBDT further extends timelines under taxation laws

In our previous edition (January-March 2020) of Tax Scout, we had covered extension of timelines for direct tax compliances, effected by the Taxation and Other Laws (Relaxation of Certain Provisions) Ordinance, 2020 ("**Ordinance**").

In furtherance to the same, CBDT *vide* notification 35/ 2020, dated June 24, 2020 ("**CBDT Notification**"), has further extended timelines for various direct tax compliances, which were previously extended by the Ordinance. While the Ordinance had extended timelines for compliances falling between March 20, 2020 and June 29, 2020, to June 30, 2020, the CBDT Notification has further extended the said due dates and due dates of few other compliances falling between July 1, 2020 and December 31, 2020.

Following table gives the revised timelines for the various compliances, as notified by the CBDT notification:

Compliance	Revised Due Date
Filing of revised and belated Income-tax return for FY 2018-19	July 31, 2020
Due date for making investments / payments for claiming deduction under Chapter VI A – B of the IT Act for FY 2019 - 20	July 31, 2020
Furnishing of TDS / TCS statements and issuance of TDS / TCS certificates pertaining to FY 2019-20	July 31, 2020 – for furnishing TDS/ TCS statements; August 15, 2020 – for issuance of TDS/ TCS certificates
Date for making investment / construction / purchase for claiming rollover benefit / deduction in respect of capital gains under Section 54 to 54 GB of IT Act	September 30, 2020
Date of commencement of operation for SEZ units for claiming deduction under Section 10AA of the IT Act for units which received necessary approvals by March 31, 2020	September 30, 2020
Filing of Tax Audit Report (Form 3CD) for FY 2019-20	October 31, 2020
Filing of income-tax return for all taxpayer for FY 2019-20	November 30, 2020
Payment of self-assessment tax for FY 2019-20 in the case of taxpayer whose tax liability is up to INR 1 lakh	November 30, 2020
Passing of order or issuance of notice by the authorities and various compliances under various Direct Taxes & Benami Law, which are required to be passed/ issued/ made by December 31, 2020	March 31, 2021
Due date for linking Aadhar with PAN	March 31, 2021

CBDT issues clarification regarding short deduction or collection of tax due to increase in surcharge rates

The Finance (No. 2) Act, 2019, provided for an increase in the rates of surcharge in the following manner:

S. No.	Income Slab (in INR)	Surcharge prior to increase	Enhanced surcharge provided under the Finance (No. 2) Act, 2019
1.	Less than 5 million	Nil	Nil
2.	5 million to 10 million	10%	10%
3.	10 million to 20 million	15%	15%
4.	20 million to 50 million	15%	25%
5.	Above 50 million	15%	37%

The enhanced rates of surcharge are applicable for FY2019-20 and accordingly, the taxpayer was required to take into account the increased rates while computing tax liability for AY2020-21. Additionally, tax was to be deducted or collected upon, based on the increased surcharge rates. In various instances, tax authorities have held deductors/collectors to be assessee in default for short deduction/collection of tax in relation to transactions executed prior to the tabling of the Finance (No. 2) Act, 2019, before the Parliament on July 5, 2019. Requests were made by such taxpayers that in such instances, the deductor/ collector should not be considered an assessee in default under Section 201 of the IT Act.

The CBDT had issued the Circular No. 8/2020 dated April 13, 2020 ("**Circular**"), which clarified that a person responsible for deduction/ collection of tax under the provisions of the IT Act will not be considered an assessee-in-default in relation to transactions where:

(i) the transaction has been completed and the entire consideration has been paid to the deductee / payee on or before July 5, 2019, and there is no subsequent transaction between the deductor / collector and the deductee / payee in the FY2019-20, wherein the shortfall of tax could have been adjusted;

(ii) the sum of tax deducted or collected was in accordance with the rates in force, prior to the enactment of Finance (No. 2) Act, 2019,

(iii) the sum of tax deducted or collected has been deposited with the Central Government within the stipulated due date for depositing the same; and

(iv) Appropriate TDS/TCS statement has been furnished by such person, within the due date for filing the same.

The Circular further clarifies that the concerned person will not be eligible for the benefit under the Circular, if such a person does not fulfil any of the conditions stipulated above in relation to the short deduction/collection. Moreover, the Circular also clarifies that interest on the shortfall of tax deducted/ collected will not be levied, in the event that the deductor/collector has collected the shortfall after July 5, 2019, from subsequent transactions after July 5, 2019. It is important to note that the relaxation provided in the Circular will not absolve the deductee/ payee from paying tax in accordance with enhanced rates of surcharge by advance tax or self-assessment tax and filing of return of income after the payment of such tax.

The clarification provided by the Circular is a welcome step as it prevents harassment of deductors/ collectors by tax authorities, providing relief to taxpayers. It also enshrines the doctrine of legitimate expectation by preserving certainty in terms of tax liability and preventing penalisation due to change in law, subsequent to the transaction.

CBDT issues clarification regarding option to be taxed at concessional rate under Section 115BAC of the IT Act

A new provision, Section 115BAC of the IT Act was introduced *vide* the Finance Act, 2020, with effect from FY2020-21. Section 115BAC of the IT Act, *inter alia*, provides an alternative regime of tax for a person who is an individual or Hindu Undivided Family, having income, other income from business or profession, may exercise an option to be taxed at a concessional rate under Section 115BAC of the IT Act. The concessional rate under Section 115BAC of the IT Act can be opted, subject to certain conditions under Section 115BAC, wherein total income will be computed without certain exemptions, deductions, set-offs and additional depreciation.

However, due to the option given to the taxpayer under Section 115BAC of the IT Act, there had been uncertainty on whether the employer should withhold tax on salaries under the alternative tax regime or the old regime. CBDT on April 13, 2020, *vide* its circular C1/2020 ("**Circular**") clarified that a taxpayer having income other than income under the head "profit and gains of business or profession" may intimate their employer of their intention to opt for the concessional rate under Section 115BAC of the IT Act and the employer would then have to deduct tax at source in accordance with the new regime. However, once the taxpayer has made an intimation to an employer, he/she may not modify the same during the relevant FY. Further, the Circular clarifies that if no intimation is made by the taxpayer, the employer should deduct TDS in accordance with the old regime.

It is important to note that the Circular also clarifies that the intimation to the employer would not be considered as exercising the option under Section 115BAC(5) of the IT Act. The option will be considered to have been exercised at the time of filing the return and the same could be different from the intimation made to the employer.

In respect of income under the head "profit and gains of business or profession", once the option is exercised under Section 115BAC, the same cannot be modified in subsequent Fys.

The Circular provides clarity and reduces ambiguity on the employer's responsibility in relation to the new taxation regime under Section 115BAC of the IT Act, while computing TDS. The clarifications provided in the Circular aim to reduce hardship and inconvenience of both the employer and the taxpayer in claiming refund of excess TDS under the new regime, respectively.

CBIC notifies special procedure for corporate debtors undergoing insolvency resolution

Notification No. 11/2020- Central Tax, dated March 21, 2020, read with Notification No. 39/2020 - Central Tax, dated May 05, 2020, Circular No.134/04/2020-GST dated March 23, 2020, and Circular No. 138/08/2020-GST dated May 06, 2020, provide the following clarifications/ procedures required to be followed in relation to a corporate debtor (i.e. the company undergoing insolvency resolution process):

a) <u>Registration:</u>

i. The corporate debtor and the resolution professional ("**RP**")/ interim RP shall be treated as a distinct person from the corporate debtor, with effect from the date of appointment of RP. The RP shall be liable to take a new registration for the corporate debtor in each of the States or Union Territories in which it was previously registered, within thirty days of his appointment or by June 30, 2020, whichever is later. Where the interim RP and RP are different persons, only the authorised signatory of the new registration shall be amended. However, no new registration is required to be obtained for the corporate debtor where the returns for all the tax periods prior to the appointment of RP have been furnished.

ii. The erstwhile GSTIN of the corporate debtor shall not be cancelled but may be suspended by proper officer, if need be. Where the registration of a corporate debtor has been cancelled, wherever possible application for revocation of such cancellation shall be initiated in terms of the GST legislation.

b) <u>**First return:**</u> The RP shall file their first return declaring inter alia, the supplies made or received during the period between the date on which such RP became liable for registration and the date on which the registration was granted.

c) <u>**ITC:**</u> The RP in their first return can claim ITC on goods or services received since his appointment, but bearing the erstwhile GSTIN of the corporate debtor, subject to fulfilment of other prescribed conditions, except the time limit specified under the GST legislation for availing such ITC (section 16(4) of CGST Act) and restriction on availing unmatched ITC (rule 36(4) of CGST Rules). Similarly, the recipients of the corporate debtor shall be allowed to avail ITC on invoices issued using the erstwhile GSTIN of the corporate debtor for the period from the date of appointment of RP till the date of his registration.

d) <u>**Refund:**</u> The RP shall be eligible to claim refund of any amount deposited in the cash ledger under the erstwhile GSTIN of the corporate debtor. The CBIC has clarified that the above shall apply notwithstanding the fact that the corporate debtor may not have filed the relevant GST returns during the said period.

e) <u>**Past dues and returns:**</u> The dues pertaining to the period prior to commencement of resolution process will be treated as 'operational debt' and claims may be filed by the proper officer before the NCLT in accordance with the provisions of the IBC. No coercive action should be taken against the corporate debtor with respect to such dues. Further, RP shall not be responsible to file returns for period prior to commencement of resolution process.

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Waiver or reduction of fee or extension of timeline

1. **Furnishing annual return for FY 2018-19:** The due date for furnishing annual return for FY2018-19 has been extended till September 30, 2020.[110]
2. **Compliance of any action under GST legislation:** The time limit for completion or compliance of any action, by any authority or by any person, which falls during the period March 20, 2020, to August 30, 2020, has been extended up to August 31, 2020. However, this extension does not apply to registration requirements, issuance of tax invoices and credit notes, e-way bills, power to arrest, levy of late fee, interest on delayed payment.[111]
3. **Completion of any action under CE Act, Customs Act, CTA and Service Tax legislation:** The time limit for completion of any proceeding or issuance of any order, notice, intimation, notification or sanction or approval, etc., by any authority, commission, tribunal, or filing of any appeal, reply or application or furnishing of any report, document, return or statement has been extended up to the September 30, 2020. However, this extension does not apply on delivery of arrival/import/departure/export manifest, passenger and crew arrival/departure manifest, bill of entry and clearance of goods for home consumption.[112]
4. **Refund order:** Where a notice has been issued for rejection of refund claim, in full or in part and the time limit for issuance of order falls during the period March 20, 2020 to August 30, 2020, the time limit for issuance of order has been extended to the latter of fifteen days after the receipt of reply to the notice from the registered person or August 31, 2020.[113]
5. **Application for revocation of cancellation of registration:** Where the supplier has been issued notice for cancellation of GST registration on account of non-furnishing returns for three consecutive tax periods (composite levy supplier) or for a continuous period of six months (other supplier), the period of thirty days for filing application for revocation of cancellation of registration would start from the later of date of service of the said cancellation order or August 31, 2020.[114]
6. **Late Fee waiver:** The late fee would be waived where the registered person files Form GSTR 1 and GSTR 3B for the following months.[115]

Sl. No.	Month/ Quarter	Form	Dates depending on turnover and state
1.	March, 2020	GSTR 1	July 10, 2020
		GSTR 3B	July 03 or 05, 2020
2.	April, 2020	GSTR 1	July 24, 2020
		GSTR 3B	July 06 or 09, 2020
3.	May, 2020	GSTR 1	July 28, 2020
		GSTR 3B	September 12 or 15, 2020
4.	June, 2020	GSTR 1	August 05, 2020
		GSTR 3B	September 23 or 25, 2020
5.	July, 2020	GSTR 3B	September 27 or 29, 2020
6.	January to March, 2020	Quarterly GSTR 1	July 17, 2020
7.	April to June, 2020	Quarterly GSTR 1	August 03, 2020

Further, the late fee payable for furnishing GSTR 3B for period July 2017 to January 2020 in the month between July 01, 2020 to September 30, 2020 would be nil, where no GST is payable for the tax periods or INR 500 in other cases.[116]

Facility of verifying GST returns through electronic verification code (EVC) / short messaging service (SMS)

Notification No. 48 /2020 – Central Tax dated June 19, 2020, amended the second proviso to Rule 26 of the CGST Rules w.e.f. May 27, 2020. The said proviso provides that a supplier can verify the details of Form GSTR-3B for period April 21, 2020, to September 30, 2020, and Form GSTR-1 for period May 27, 2020, to September 30, 2020, through electronic verification code ("**EVC**").

Further, Rule 67A has been incorporated in CGST Rules to enable taxpayers who are required to file a nil GSTR 3B return[117] and GSTR 1 return, to do so though SMS w.e.f. June 08, 2020[118] and July 01, 2020[119], respectively. Such return shall be verified by a registered mobile number based one-time password facility.

110 Notification No. 41/2020 – Central Tax dated May 05, 2020.
111 Notification No. 35/2020 dated April 30, 2020 read with Notification No. 55/2020 – Central Tax dated June 27, 2020.
112 The Taxation And Other Laws (Relaxation Of Certain Provisions) Ordinance, 2020 read with Notification CBEC-20/06/08/2020-GST dated June 27, 2019.
113 Notification No. 46/2020 dated June 09, 2020 read with Notification No. 56/2020 – Central Tax dated June 27, 2020.
114 Central Goods and Services Tax (Removal of Difficulties) Order, 2020 No. 01/2020 dated June 25,2020.
115 Notification No. 52/2020 – Central Tax dated June 24, 2020 and Notification No. 53/2020 – Central Tax dated June 24, 2020.
116 Notification No. 52/2020 – Central Tax dated June 24, 2020 read with relevant state notification.
117 Notification No. 38 /2020 – Central Tax dated May 05, 2020.
118 Notification No. 44/2020 – Central Tax dated June 08, 2020.
119 Notification No. 58/2020 – Central Tax dated July 01, 2020.

Other important clarification issued by CBIC

1. **Limited applicability of restriction pertaining to refund:** Circular No. 139/09/2020-GST dated June 10, 2020, clarifies that the restriction imposed *vide* earlier circular[120] on refund of ITC in relation to missing invoices whose details were not reflecting in FORM GSTR-2A would not be applicable on ITC availed on imports, input service distributor invoices or GST paid under reverse charge mechanism.

2. **Adjustment/ refund of GST paid on advances received:** Circular No. 137/07/2020-GST dated April 13, 2020, clarifies that a supplier has the following options where GST is paid on advances received for a future event, which got cancelled subsequently:

   i. Where the invoice was issued before supply of services, the supplier can issue a "credit note" in terms of Section 34 of the CGST Act and adjust the output tax liability. However, in cases where there is no output liability against which a credit note can be adjusted, supplier may proceed to file a claim under "Excess payment of tax".

   ii. Where no invoice has been issued in terms of Section 31 (2) of the CGST Act, the supplier can issue a "refund voucher" and apply for refund of GST paid on such advances under the category "Refund of excess payment of tax".

3. **Adjustment/ refund of GST paid on return of goods:** Circular No. 137/07/2020-GST, dated April 13, 2020, clarifies that where goods supplied are returned by the recipient and tax invoice had been issued for such supply, the supplier can issue a "credit note" in terms of Section 34 of the CGST Act and adjust the output tax liability. However, in cases where there is no output liability against which a credit note can be adjusted, the supplier may proceed to claim refund of the GST paid under "Excess payment of tax".

4. **GST on Director remuneration:** Circular No. 140/10/2020-GST, dated June 10, 2020, has clarified the following in relation to leviability of GST on remuneration paid by a company to its directors:

   i. Whole-time directors, including managing director, who are employees of the said company: Directors' remuneration, which are declared as "Salaries" in the books of a company and subject to TDS under Section 192 of the IT Act, would not be taxable, being consideration for services rendered by an employee to the employer.

   ii. Independent directors or those directors who are not the employees of the said company: Remuneration to independent directors and directors' whose remuneration is declared separately, other than "salaries", in the books of a company and subject to TDS under Section 194J of the IT Act, as fees for professional or technical Services, would be outside the scope of schedule III of the CGST Act, which provides that services supplied by an employee to the employer in the course of or in relation to his employment would neither be supply of goods nor supply of services. Therefore, such supply would be exigible to GST in the hands of the company on RCM basis[121].

120 Circular No.135/05/2020 – GST dated March 31, 2020.
121 Notification No. 13/2017 – Central Tax (Rate) dated June 28, 2017

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
CbC	Country by Country Reporting
CBDT	Central Board of Direct Taxes
CBEC	Central Board of Excise and Customs
CCR	CENVAT Credit Rules, 2004
CEA	Central Excise Act, 1944
CENVAT	Central Value Added Tax
CESTAT	Hon'ble Customs, Excise and Service Tax Appellate Tribunal
CETA	Central Excise Tariff Act, 1985
CGST	Central Goods and Service Tax
CGST Act	Central Goods and Service Tax Act, 2017
CGST Rules	Central Goods and Service Tax Rules, 2017
CIT	Learned Commissioner of Income Tax
CIT(A)	Learned Commissioner of Income Tax (Appeal)
CRISIL	Credit Rating Information Services of India Limited
CST	Central Sales Tax
CST Act	Central Sales Tax Act, 1956
CT Act	Custom Tariff Act, 1975
CVD	Countervailing Duty
DCIT	Learned Deputy Commissioner of Income Tax
DIT	Learned Director of Income Tax
DGFT	Directorate General of Foreign Trade

GLOSSARY

ABBREVIATION	MEANING
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 Tech nical 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
IBC	Insolvency and Bankruptcy Code, 2016
IFSC	International Financial Services Centre
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

GLOSSARY

ABBREVIATION	MEANING
NAA	National Anti-profiteering Authority
NCLT	National Company Law Tribunal
OECD	Organization for Economic Co-operation and Development
PAN	Permanent Account Number
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
TRC	Tax Residency Certificate
UK	United Kingdom
US/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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