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tax scout

Tax Scout | April – June, 2022

Main Stories

Dear Readers,

We are delighted to present the latest issue of Tax Scout, our quarterly update on the recent developments in the field of direct and indirect tax laws for the three months ending June 30, 2022.

In our main story, we have dealt with mutual agreement procedures under the relevant double taxation avoidance agreements, their relevance and significance in the emerging tax jurisprudence and the impact of the recent guidelines issued by the Central Board of Direct Taxes in June 2022.

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

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
Cyril Amarchand Mangaldas

India's leading law firm

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REGULATORY DIRECT TAX UPDATES

REGULATORY INDIRECT TAX UPDATES

Mutual Agreement Procedure (MAP): An Alternative to Ceaseless Litigation and its Progress in India

"An ounce of mediation is worth a pound of arbitration and a ton of litigation!" — Joseph Grynbaum

The past few decades have witnessed a spurt in cross-border transactions as businesses transcended borders, which led to disputes arising due to overlapping claims of taxing rights by various jurisdictions. Businesses seeking to operate across countries need to understand the various complicated laws of the respective countries. Each time a business delves into an uncharted territory, it is crucial that it analyses the tax landscape of the place much prior to setting up operations there. Often, these multinational companies find themselves on the wrong side of the law from a tax perspective despite making conscious efforts to discharge all their tax obligations in a systematic and timely fashion.

Such is the complexity of the various tax laws that simply following the best of the tax practices does not guarantee the absence of complications with the tax authorities of the respective state(s). In fact, often these multinational companies (MNCs) suffer merely due to a dispute between two countries over their right to tax the same stream of income. This leads to such MNCs suffering through lengthy and harrowing tax proceedings in either or both the countries.

Since tax demands emanating from these proceedings are huge, covering multiple years at once, most businesses are wary of getting embroiled in a tax litigation as it consumes enormous amount of management bandwidth and resources. Businesses are forced to tackle these issues by devoting precious time and resources, instead of spending time pursuing better opportunities for business growth.

India, in fact, ranked 63rd among 193 countries in "Ease Of Doing Business" in 2020, and one of the reasons behind India's low ranking is and has always been its lengthy and unending adversarial taxation and litigation system.

Redundancy of classic litigation

It takes no less than 10-15 years for any tax matter to reach a logical conclusion in India i.e. to attain finality.

The first appellate authority under the (Indian) Income tax laws i.e. the CIT(A) is a member of the income tax department itself. It can be quite challenging for any taxpayer to obtain relief at the CIT(A) level since it is inclined towards safeguarding the interests of the IT department itself. However, in the subsequent appellate levels, consisting of the Income Tax Appellate Tribunal (ITAT), the concerned High Courts (HCs) and the Supreme Court (SC), taxpayers may expect a fair hearing and justice since they are presided over by members independent of the government machinery and are often known to pass impartial orders.

Since there are no timelines mentioned under Indian legislations, tax litigations remain stagnant and pending for long periods of time before every level i.e. the CIT(A), the ITAT, the HC and SC. The possibility of a matter remaining pending for 5-6 years or even more at every level cannot be ruled out.

Demand for MAP - an alternative dispute resolution mechanism

There has been a manifold increase in tax disputes in the past few decades, especially in cross-border taxation matters. It needs to be appreciated that these cross-border transactions, including incoming foreign investments, are highly conducive and essential for the overall economic growth of the country. Realising the importance of resolving international tax issues emanating from these transactions in a timebound and efficient manner, a globally acceptable alternate dispute resolution mechanism prevalent in the global taxation system was suggested under the relevant Double Taxation Avoidance Agreements (DTAAs).

Thus, an alternate dispute resolution (ADR) mechanism in the form of MAP has been provided for under the respective DTAAs entered between various countries and it is centred around a bilateral negotiation process between the tax authorities of two countries.

Juridical Double Taxation

Same income gets taxed twice in the hands of the same entity in two different countries.

Economic Double Taxation

Same income gets taxed in the hands of two separate entities in two different countries even though both these entities are associated enterprises, i.e. they belong to the same group.

MAP is an ADR mechanism, facilitating discussions and negotiations between treaty partners to reach an amicable solution that is acceptable to both sides, putting a conclusive end to the issue at hand. Therefore, the main feature of a MAP proceeding is that it is a closed door process between the tax authorities of two countries, who work to find a resolution that is acceptable to both sides, rather than undergoing a harsh litigious process. The negotiation takes place between Competent Authorities ("**CAs**") of the involved countries, without any formal participation from taxpayers in either of the countries.

MAP in India

India has a large network of tax treaties and has signed bilateral tax treaties with more than 90 countries. These DTAAs, *inter alia*, provide rules and mechanisms for allocation of taxing rights among treaty partners. Most of these treaties contain a separate Article on MAP, inspired by the provisions of Article 25 of the United Nations Model Convention and OECD Model Tax Convention on Income and on Capital, which mandate an alternate dispute resolution mechanism in the form of MAP clause in tax treaties. A taxpayer derives legal right to apply for MAP proceedings based on the Article on MAP in the respective tax treaty entered into by India with another country, read with section 90 or section 90A of the IT Act. To systematise the process, the governments of the respective countries can develop appropriate procedures, methods and techniques for implementation of MAP in their respective countries. As per the MAP article in the DTAAs entered into by India, MAP proceedings can be invoked under the following circumstances:

Where taxation is not in accordance with the provisions of the DTAA eg. where it involves the question of interpretation or application of the DTAA.

For elimination of double taxation in case not otherwise provided for in the DTAA.

Three-year limitation period

As per most of the tax treaties entered into by India, an application for MAP can be filed within three years from the first notification of the action that gives rise to such taxation. It is pertinent to note that Article 25(1) of the OECD Model Tax Convention also recommended a three-year limitation period for submission of a MAP request and such timeline is also prescribed under the Action 14 Final Report of the BEPS project. India plans to make this limitation period uniformly applicable in its tax treaties through amendments brought through the MLI that has already come into effect from October 1, 2019, or through bilateral negotiations with the remaining treaty partners.

Escalation of transfer pricing cases and CBDT clarifications

In recent years, the number of transfer pricing disputes has increased exponentially due to a rise in cross-border transactions and an aggressive approach adopted by many countries in such matters. Transfer pricing disputes essentially involve a highly contentious benchmarking exercise based on several assumptions, estimates and is, therefore, susceptible to a lot of litigation due to different methodologies or estimates adopted by various adjudicating bodies.

Companies of the same group have faced incidences of double taxation across jurisdictions due to such transfer pricing disputes. However, the respective group companies opted for MAP provisions in cases of transfer pricing disputes, and there were problems related to non-acceptance of MAP applications by India due to the absence of Article 9(2) of the OECD Model Tax Convention on "corresponding adjustments" in certain DTAAs entered into by India, for instance India's tax treaty with the UAE, Germany, France, etc.

Article 9(2) of the OECD Model Tax Commentary provides for profit adjustment where transactions have been entered into with associate enterprises (AEs) and transfer pricing adjustments have led to economic double taxation i.e. taxation of the same income in the hands of two entities in different jurisdictions. Where any adjustment is carried out in respect of transactions between two group entities, paragraph 2 of Article 9 requires that a corresponding adjustment be made to the profits of the AEs in the other state. Where enhanced income is taxed in one country, the other country shall provide a tax relief to the extent of enhancement.

The CBDT *vide* a Press Release dated November 27, 2017 ("**Press Release**"), clarified that it shall accept MAP applications in transfer pricing matters even where a DTAA entered into by India does not contain Article 9(2), pertaining to corresponding adjustment. Post this, countries can now engage in MAP negotiations with Indian CAs even if Article 9(2) is missing from the respective DTAAs, thereby aiding in the elimination of double taxation.

Relaxation of Article 9(2) norms by India opened the doors for bilateral negotiations with many countries. This is another major step by India towards amicable settlement of disputes and to avoid economic double taxation. The granting of access to MAP in transfer pricing cases is also one of the minimum standards of BEPS Action Plan 14, which is intended to be implemented by means of Article 17 of the MLI.

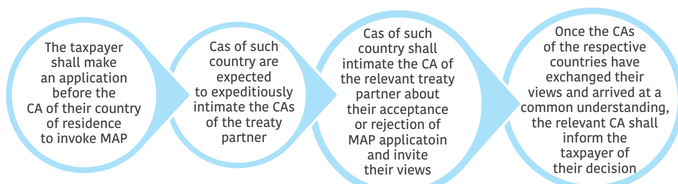
Procedure MAP - India

MAP Guidance issued in India

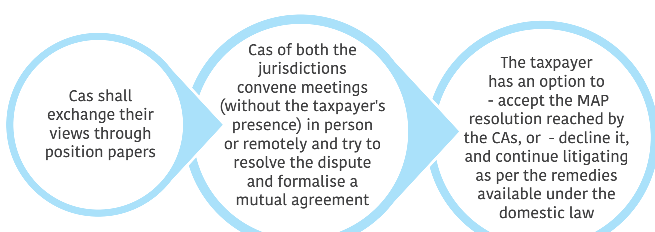
BEPS Final Report on Action 14 *"Making Dispute Resolution More Effective"* of the BEPS project of the G-20 and OECD countries adopted in 2015, provided for a peer review process to evaluate the implementation of BEPS minimum standard by a jurisdiction. The Peer Review Report[1] released by OECD for India (Stage 1) on October 24, 2019, required India to grant MAP access to questions concerning the applicability of anti-abuse rules under its domestic laws and their incompatibility with tax treaty obligations, publish a comprehensive MAP Guidance, etc. In accordance with this, the CBDT released its *Notification No. 23/ 2020*[2], dated May 6, 2020, thereby replacing the erstwhile rule under the income tax provisions with a new Rule 44G in the IT Rules, to give effect to the Peer Review Report's recommendations. Since time taken to conclude a MAP proceeding was an issue, as also recognised in the Peer Review Report, the new rule provided that the CAs in India shall endeavour to conclude MAP proceedings within an average timeframe of 24 months (as also recommended by BEPS Final Report on Action 14), which shows India's dedication for speedy dispute resolution through MAP.

Further, in line with the above, the CBDT issued a comprehensive MAP Guidance on August 7, 2020[3] ("**MAP Guidance**"), which *inter alia*, prescribed the following:

Making a MAP application in India



Formal process once a MAP application is accepted



As per MAP Guidance issued by CBDT, once the CAs of both the jurisdictions successfully resolve a MAP case and formalise a mutual agreement, the concerned CA would intimate the taxpayer who applied for a MAP resolution. While the acceptance or rejection of the MAP resolution is the prerogative of the taxpayer, irrespective of whether the taxpayer accepts the MAP proposal or not, the MAP application shall be deemed to

1 https://www.oecd.org/tax/beps/making-dispute-resolution-more-effective-map-peer-review-report-india-stage-1-c66636e8-en.htm
2 CBDT Notification No. 23/2020/F.No. 370142/31/2019-TPL dated May 6, 2020
3 CBDT F. No. 500/09/2016-APA-I titled MAP Guidance/ 2020 dated August 7, 2020

have been considered as "resolved" by the CAs of both the jurisdictions. Further, the MAP Guidance provided clarification on the following:

Other guidelines provided by MAP Guidance	***Tentative timeframe for resolving dispute:*** India has committed itself to "endeavour" to resolve MAP cases within 24 months, in conformity with the minimum standards under Action 14 Final Report of the BEPS project.
	Circumstances where India would provide access to MAP if they result in taxation not in accordance with the relevant DTAAs: India shall provide access to MAP in case of transfer pricing adjustments, where there is a question of existence of PE or attribution of profits to a PE, where an item of income or expense has been characterised as being taxable or where domestic anti abuse provisions have been invoked by the IRA. Further, where Unilateral APA is entered into by taxpayer in India or safe harbour provisions applied in India or ITAT order has been passed in case of a taxpayer in India, India would not deviate from such APA or safe harbour provisions or ITAT order, rather would only request the treaty partner for correlative relief.
	Circumstances where India can deny access to MAP: Where a taxpayer has exceeded the time period prescribed in DTAAs for making application under MAP, where CAs in India find the objection raised by the taxpayer in its MAP application to be unjustified, where incomeplete MAP application is submitted by the taxpayer and not rectified later as well, where income-tax settlement commission or AAR has already ruled on the same issue in case of taxpayer, where issues are purely governed by domestic laws of India.
	Procedural technicalities: Where adjustment was made by the treaty partner, Indian CAs may go below returned income to give effect to MAP resolution, recurring issues may be resolved based on the same principles as in a prior MAP resolution, interest and penal consequences shall continue to be governed by Indian laws, secondary adjustments shall be covered within the MAP resolution; where MOU is not entered separately by India with treaty partner for keeping tax collection in abeyance, it shall be governed by domestic laws, witholding tax paid by Indian taxpayer may be set off against non-resident's tax liability under the MAP resolution.
	Implementation of MAP: Intimation of acceptance of MAP resolution shall be made by the taxpayer within 30 days of receiving communication from Indian CAs, thereafter AO shall give effect to the MAP resolution within one month from the end of month in which intimation is received from Indian CAs.

It is noteworthy that India, in its MAP Guidance, has clearly stated that in matters where there are Advance Pricing Agreements (APAs) with the Indian government or where safe harbour provisions are applied in India or where ITAT order has already been passed in the case of the taxpayer, its role during the course of any MAP proceedings shall be restricted to asking the other jurisdiction for correlative relief, thus clarifying its stand that it shall not deviate from its own APAs or safe harbour provisions or ITAT order even during the course of bilateral negotiations under MAP.

It may be noted that this could become a roadblock during the course of MAP negotiations and hamper the process and the risk of double taxation could continue. For instance, in case of a negative ITAT ruling, the Indian CAs will not deviate from that position during bilateral MAP negotiations and, therefore, the taxpayer will continue to face the risk of double taxation, until and unless the other country provides relief to the taxpayer.

It may be possible for a taxpayer to try and avert such a situation by proactively initiating the MAP proceedings, while at the same time, the ITAT proceedings may be taken up slowly such that an ITAT order is not passed until MAP is finalised. While it is not always possible to delay the proceedings before the ITAT as this would depend on the discretion of the concerned members of the ITAT, however, in certain cases[4] the Hon'ble ITAT has accepted such requests of taxpayers.

Updated MAP Guidance recently issued in India

The CBDT has recently issued an Updated MAP Guidance[5] dated June 10, 2022, which makes the following additions to the earlier MAP Guidance:

1. ***Circumstances where India can deny access to MAP – Interplay of MAP with Vivad se Vishwas Scheme ("VsV") explained***

Where resident taxpayer opts for VsV for transfer pricing dispute, which is accepted by the IRA and the CA of other country accepts MAP application from its taxpayer (i.e. NR AE) on same issue.

IRA shall allow access to MAP but charge taxes as per VsV. IRA will request the CA of the other country to provide correlative relief.

CA of India shall not provide access to MAP to a non-resident taxpayer who has opted for the VsV scheme on the same issue because the applicant has given up its legal right to access MAP under VsV.

4 ITAT in Skoda Auto Volkswagen India Private Limited Vs. DCIT – 1(3)2 in ITA No. 1990/Mum/2017 [2021 SCC OnLine ITAT 547] has kept the matter adjourned on request of taxpayer due to ongoing MAP proceedings

5 Vide F No. 500/09/2016-APA-I dated June 10, 2022

Earlier IRA had denied access to MAP in such cases. However, the MAP Peer Review Report on India (Stage 2), issued by the OECD under BEPS Action 14, had stated that India's position of denying MAP access to matters covered under VsV prevented correlative relief in the other country. Therefore, the Updated MAP Guidance was intended to meet this requirement.

2. ***A new Part E added to MAP Guidance to highlight a MAP applicant's responsibilities***

   It was observed that in some cases, taxpayers suppressed information. For instance, not making a disclosure where a treaty partner has also made adjustment for the same transaction. In case an order is passed by the ITAT, a MAP applicant should ideally immediately notify the CAs so that MAP proceedings are closed forthwith with no wastage of efforts of the respective CAs. Therefore, Part E has been added to the MAP Guidance to lay down the following responsibilities of the MAP Applicant:

Responsibilities of MAP Applicant

Making true disclosure - provide all facts that can materially affect the negotiation process, for instance: disclose adjustments made in the other jurisdiction

Provide up-to-date information - Applicant must update CAs on all material events in connection with the MAP application

India's Journey under MAP

The government by its numerous measures has shown serious commitment towards establishing a healthy MAP framework in the country, in line with the OECD's minimum standards under its BEPS project.

The judicial system in India is already overburdened with an avalanche of cases and it takes countless years for a tax dispute to reach a logical conclusion, whereas MAP provides an alternate resolution mechanism, independent from the ordinary legal remedies that is acceptable in both the countries. Therefore, it also relieves the traditional legal machinery of a country from the burden of resolving tax disputes. Given the volume of international transactions in today's times and the complexity of tax laws of various countries, a robust dispute resolution process is vital. Lengthy, tedious and costly tax litigations are not conducive to a healthy business environment and can dissuade potential investors from investing or expanding in any country where the tax litigation process is painful, especially if there is no alternate mechanism to resolve disputes in an effective manner.

Resorting to an alternate dispute resolution mechanism such as MAP could be time and cost effective, both for the taxpayers as well as the tax administrators, especially when both sides are keen to resolve a matter within a limited timeframe in a mutually acceptable manner. It may be appreciated that the officials involved in MAP negotiations on behalf of the taxpayer are experts in the field of taxation and handle the matter on behalf of the taxpayer with great expertise.

Complicated process

The concept of MAP and the overall process is very layered and complex since it involves balancing the vested interests of two different countries, and each country has its own idiosyncrasies. As a result, there may be additional hurdles and bottlenecks every now and then. It requires co-ordination and the meeting of minds between two countries. They need to arrive at a resolution that is acceptable to all concerned parties, while keeping their own interests in mind. Each case needs to be negotiated taking into account the peculiarities and circumstances of the particular case and discussions may need to be carried out with a different treaty partner each time, with very little guidance drawn upon from a previous MAP matter.

Arriving at a MAP resolution is not a smooth and straightforward process and requires utmost dedication from the CAs of both the jurisdictions to conclude the process. The MAP process is fraught with severe practical complexities, as illustrated below and it is only when each of these obstacles can be overcome, a mutual resolution can be reached:

Negotiation takes place between officials of 2 countries, each trying to resolve the matter while also burdened with the responsibility to protect the taxing rights of their own country.

Cas are not bound to reach an agreement. The taxpayer continues to face risk that MAP can be inconclusive and devotes time and efforts in pursuing the domestic appeals as well, simultaneously.

While the MAP process is ongoing, a tax authority may take coercive steps to recover part of the tax demand as per domestic rules, so the burden on taxpayer continues till resolution is reached, except for countries already having MOU with India.

MAP resolutions entered in the past are not available in the public domain and are not known to taxpayers for guidance. Therefore, each MAP takes place in uncharted waters and brings uncertainty in the mind of the taxpayer.

In certain cases, India may already have MOUs in respect of certain procedure(s) or action(s) to prevent unnecessary harassment of taxpayers while the MAP resolution is underway. For instance, India and the UK have signed a MOU[6] for suspension of tax collection during the pendency of MAP, in case of a taxpayer who is an UK resident and whose request under MAP is under consideration of CAs, subject to furnishing of a bank guarantee equivalent to the disputed tax and interest amount accruing thereon under the provisions of Indian tax laws. India and the US also have a similar arrangement.

Penalty proceedings

There are no separate provisions under the respective tax treaties that govern the levy of penalty in a particular case, post entering into a MAP resolution by the respective taxpayer. Even under the Indian tax laws, the penalty provisions constitute a self-contained code and, therefore, penalty proceedings are distinct from assessment proceedings. As per the provisions of the respective domestic tax laws, penalty proceedings do not cease merely due to a MAP agreement since DTAAs are generally silent about them. Consequently, tax authorities may continue to pursue penalty proceedings on any additions surviving post MAP. In this regard, Karnataka HC in the case of ***Toyota Kirloskar Motor (P.) Ltd.,***[7] where a writ petition came to be filed by the taxpayer, challenging the constitutional validity of penalty provisions on amount determined pursuant to a MAP proceeding, observed that penalty provisions under the Indian tax laws shall continue to apply to the adjustment or addition surviving post MAP proceedings despite issues getting resolved and concluded under MAP, unless the DTAA or the MAP specifically waives the penalty. Merely because MAP has been opted for by a taxpayer, it would not invalidate the penalty proceedings. Therefore, in such penalty proceedings, the onus lies on the taxpayer to prove that there is no under-reporting or misreporting of income, which merits the levy of penalty under the Indian tax laws.

Importantly, even as per the MAP Guidance issued by CBDT on August 7, 2020, CAs in India shall not cover levy of penalty within the MAP negotiation as it will continue to be administered under the respective domestic tax laws.

Therefore, penalties that are linked to the quantum of income shall vary based on the variation in the quantum of income determined as per MAP resolution. A taxpayer does not get an opportunity to defend a tax adjustment on its merits during a MAP negotiation and the ultimate MAP agreement entered into in no way constitutes an admission of tax liability of a taxpayer. Therefore, the IRA should take such points into consideration while expecting a taxpayer to justify that there has been no concealment of income in respect of the surviving additions.

MAP performance in the past years

The BEPS Final Report on Action 14 *"Making Dispute Resolution Mechanisms More Effective"* agreed to report MAP statistics under MAP Statistics Reporting Framework. OECD released MAP statistics for 2020 on November 11, 2021, which revealed that MAP outcomes remained generally positive where around 75%[8] of the MAP cases that were concluded in 2020 fully resolved the issues related to both transfer pricing and other cases.

However, it was noticed that reaching MAP resolutions still took considerable time. On an average, MAP cases closed in 2020 took 35 months for transfer pricing cases and approximately 18 months for other cases. Whereas the statistics for India released by OECD revealed that on an average, MAP cases closed in 2020 took 30 months approximately and around 87% of the cases got concluded. However, it was also noticed that each year sees an increase in total inventory of MAP cases since the number of cases closed in a year is no match to the number of new ones.

Therefore, Indian authorities need to keep striving to achieve a balance and have sufficient infrastructure and bandwidth to be able to resolve as many MAP cases as are possible efficiently, especially in light of the fact that it has now also committed that it shall endeavour to resolve MAP cases within 24 months. Since MAP is a bilateral process which needs commensurate support from the other country too, therefore, maintaining cordial relations with other countries and their CAs could go a long way in resolving tax problems efficiently and providing a conducive environment for resolution of international tax related disputes in India.

6 Refer CBDT Instruction No. 3 of 2004, F.No.480/12/2003-FTD-I dated March 19, 2004
7 Toyota Kirloskar Motor (P.) Ltd. Vs. Union of India [W.P. No. 57865/ 2015] (2019)311CTR (Kar) 770
8 https://www.oecd.org/tax/beps/new-mutual-agreement-procedure-statistics-on-the-resolution-of-international-tax-disputes-released-on-oecd-tax-certainty-day.htm and https://www.oecd.org/tax/dispute/2020-map-statistics-india.pdf

Payments towards hosting an advertising banner on a social media platform is not taxable as either FTS or royalty

In ***Play Games 24x7 Pvt. Ltd.,***[9] the Mumbai ITAT held that fees paid to Facebook Ireland for hosting advertising banners on its platform was neither FTS nor royalty and resultantly, the payer had no obligation to withhold taxes on the fees paid.

Facts

Play Games 24x7 Pvt. Ltd. ("**Assessee**") is an Indian resident company engaged in the business of providing a platform for online gaming, more particularly Rummy. During the relevant previous year, the Assessee had paid certain sums to Facebook Ireland ("**Facebook**") towards banner advertisement, but it did not withhold any taxes on the sums paid to it. The Assessee was asked to explain why tax was not withheld and why the said expenditure should not be disallowed under section 40(a)(ia) of the IT Act. Dissatisfied with the Assessee's justification, the AO made a disallowance of this expenditure under section 40(a)(ia) of the IT Act and subsequently passed an assessment order. Later, the AO rectified the disallowance as being under section 40(a)(i) (failure to withhold taxes on payments outside India) instead of under section 40(a)(ia) (failure to withhold taxes on payment to resident), as it was inadvertently done during the original assessment order.

Aggrieved, the Assessee filed an appeal before the CIT(A) who, however, was not convinced with the arguments put forth by the Assessee and sustained the additions made by the AO. The Assessee then approached the Mumbai ITAT, challenging the decision of the CIT(A).

Issue

Was the payment towards banner advertisement made by the Assessee to Facebook in the nature of FTS or 'royalty' and subject to withholding taxes?

Arguments

The Assessee submitted that Facebook had not rendered any 'technical services' to the Assessee. It was contended that the sums were in the nature of 'business profits' and not technical services. It was also argued that Facebook did not act as the Assessee's agent and existing customers and clients were able to access the advertisements placed by the Assessee by only clicking on the banner. In this regard, no technical services were required from Facebook. The Assessee relied on the SC's decision in *Bharti Cellular*[10] to submit that FTS covered within its scope only managerial, technical or consultancy services that require 'human intervention' and in the instant case, there was no human intervention for displaying the advertisement banner.

Further, relying on the SC's decision in *G.E. India Technology Centre Pvt. Ltd.*[11], the Assessee contended that a tax withholding obligation under section 195 of the IT Act arises only when sums are chargeable to tax. Since the extant payments did not fall within the purview of section 9 of the IT Act, there can be no tax withholding obligation under section 195 of the IT Act.

The IRA filed a delayed cross-objection in 2021 (while the appeal was filed in March 2019), contesting that the fees paid are in the nature of 'royalty' and not FTS. Resultantly, sums are to be disallowed under section 40(a)(i) of the IT Act.

[9] Play Games 24x7 Private Limited v. DCIT, ITA No. 1533/ 2019 [TS-233-ITAT-2022(Mum)].
[10] CIT v. Bharti Cellular Ltd. [2008] 319 ITR 139 (Delhi HC).
[11] GE India Technology Pvt. Ltd. v. CIT, (2013) 327 ITR 456 (Karnataka HC).

Judgment

The ITAT decided in favour of the Assessee, holding that the fees paid towards banner advertisements did not amount to FTS under the India-Ireland DTAA.

The ITAT noted that for the purposes of uploading the banner advertisement on its platform, a person is expected to upload the advertisement related information on Facebook in the required format. After due verification, the advertisement is uploaded on Facebook's platform. While uploading the advertisement, the Assessee had no control over the functioning of the interface provided by Facebook. The entire operation and maintenance of the server was under Facebook's control. Additionally, there was no dedicated equipment/ installation provided by Facebook to the Assessee.

The ITAT also found it pertinent that the server through which the advertising banner was uploaded was not located in India. In any case, Facebook Ireland was not a resident of India and did not have a PE in India. Considering these facts, the ITAT concluded that income received by Facebook from the Assessee was not chargeable to tax in India.

The ITAT noted that FTS is determined based on the provision of a service which has a technical aspect, which was absent in the instant case. The Assessee had only taken the privilege of Facebook's platform to display its advertisement, which is not taxable as FTS under the provisions of the DTAA. Further, payment of royalties was not at all involved in the advertisement platform provided by Facebook.

In conclusion, the ITAT held that the sums received by Facebook from the Assessee were neither in the nature of royalty nor FTS and, therefore, such fees were not chargeable to tax in India. Consequently, the Assessee had no obligation to withhold taxes under section 195 of the IT Act and, therefore, the disallowance of the sums by the AO under section 40(a)(i) or section 40(a)(ia) was impermissible.

Significant Takeaways

Payments made to e-commerce companies are facing increasing IRA scrutiny. It may be noted that a few years ago, the Bangalore ITAT had held that payment made by Google India[12] to Google Ireland Ltd., in respect of purchase of advertisement space for resale advertisers in India amounted to royalty because Google India had been granted access to Google Ireland's intellectual property rights, technical know-how, etc. In the instant case, the distinguishing factor was that the payments were directly made by the Indian customers to Facebook Ireland and were not routed through Facebook India and that such Indian customers could not be said to have access to the IPRs of Facebook. It is also relevant to note that the Karnataka HC has remanded this matter back to the Bangalore ITAT for fresh consideration since it was opined that the ITAT had not looked at all the documents placed before it and the order was violative of the principles of natural justice.[13] It is pertinent to note that despite this decision, it is possible that the fees towards such online advertising services payable by Google India to Google Ireland may be subject to EL. Under FA, 2016, EL at the rate of 6% is levied on the consideration received in lieu of 'specified online advertising services' rendered by a non-resident to an Indian resident (subject to the consideration exceeding INR 10 Million).

A non-resident offering services to Indian tax residents may also be taxed under the IT Act if it has a significant economic presence ("**SEP**") in India. As per section 9(1)(a) of the IT Act, if a non-resident generates revenue from Indian customers in excess of INR 20 Million in a FY, then the non-resident shall be deemed to have an SEP (and consequent 'business connection') in India, and the income of the non-resident which is reasonably attributable to India shall be subject to tax in India. Therefore, in jurisdictions that do not have a DTAA with India, it would also be relevant to examine if the non-resident is earning income from advertising services over the prescribed threshold of INR 20 Million.

"Providing platform banner for advertisement does not constitute royalty or FTS under the India-Ireland DTAA."

[12] Google India Private Limited v. JDIT (ITA No. 1190/Bang/2014, dated 11 May 2018) [TS-235-ITAT-2018(Bang)].
[13] Google India Private Limited v. CIT (2021) 320 CTR (Kar) 622.

Incidental income arising from air transport is not exempted under the DTAA

In the case of ***Lufthansa German Airlines***[14], the Delhi ITAT held that the collection charges received by an air transport operator from the Airport Authority of India ("**AAI**") for timely remitting of User Development Fees ("**UDF**") to it did not fall within the exception under Article 8 of the India-Germany DTAA, exempting "Profits from the operation of ships or aircraft" and instead were taxable as business profits of the taxpayer under Article 7 of the DTAA.

Facts

Lufthansa German Airlines ("**Assessee**") is an international air transport operator having its head office in Germany. The Assessee primarily derived income from operation of aircrafts for international traffic, transportation of passengers and cargo. The Assessee would collect UDF from passengers as part of the ticket sale and would remit the same to the AAI. On account of remitting UDF to AAI within the stipulated time, the Assessee received certain collection charges from AAI. The Assessee in its return of income claimed its entire income as exempt from tax under Article 8 of the India-Germany DTAA (under profits from the operation of ships or aircrafts).

Under Article 8 of the India-Germany DTAA, a taxpayer earning income from the operation of ships or aircraft in international traffic is taxable only in the State in which the place of effective management of the enterprise is situated. The Assessee being an airline operator with its place of management situated in Germany, would be exempt from taxation in India on 'profits from operation of aircrafts' by virtue of the aforementioned Article 8.

The AO after examining the return of income filed by the Assessee, found that the income earned from the operation of ships or aircraft in international traffic was exempt from tax in India under Article 8 of the DTAA. However, with respect to collection charges received by the Assessee from the AAI for timely remittances of UDF, the AO was of the view that these collection charges paid by AAI to the Assessee were in the nature of commission earned by the Assessee. Additionally, the AO also found that the collection fee received in lieu of collecting UDF and remitting them to the AAI was a separate activity independent from the business operations of aircrafts in India and, resultantly, could not be exempt under Article 8 of the DTAA. Even if the opportunity to earn income may have accrued due to the operation of airlines by the Assessee, the activities were merely incidental to the operation of the aircraft. Resultantly, the AO passed a draft assessment order by which he proposed to assess the collection charges as business income chargeable to tax under Article 7 of the India-Germany DTAA.

The Assessee filed its objections before the DRP which approved the draft order passed by the AO. The Assessee filed an appeal before the ITAT challenging the decision of the DRP.

Issue

Whether the sums received by the Assessee from AAI as 'collection charges' are exempt under Article 8 of the India-Germany DTAA?

Arguments

The Assessee submitted that the sums paid as collection charges by the AAI to the Assessee were in the nature of 'discounts' and not 'commission', which were subject to the air transport operator remitting the sum collected to AAI within a stipulated time period. Consequently, the Assessee also argued that the discount allowed by the AAI should not be taxable under Article 8 of the DTAA as this income is derived from the operation of aircrafts.

On the other hand, the IRA submitted that discounts were not covered within the exemption under Article 8 of the DTAA since the discount in this case was unrelated to the operation of aircrafts by the Assessee. The IRA also contended that the sums were remitted by AAI to the Assessee for the *services* rendered by the Assessee to AAI in India by timely collecting and passing of UDFs to AAI.

Judgment

The ITAT held in favour of the IRA, holding that the collection fees received by the Assessee were not exempt under Article 8 of the DTAA.

The ITAT discussed the concept and rationale behind the collection of UDF. UDF is levied at airports to increase the revenues of airport operators. The quantum of UDF is determined by the Airports Economic Regulatory Authority of India for major airports and the Ministry of Civil Aviation for non-major airports. Presently, the UDF collection charge is at a flat rate of INR 5 per passenger, subject to payment of UDF to AAI within 15 days of receipt of a bill. The airline is expected to make full payment of UDF to AAI and raise a separate invoice for the collection charges on UDF.

[14] Lufthansa German Airlines v. DCIT, ITA No. 6012/Del/2017 (dated March 24, 2022) [TS-218-ITAT-2022(DEL)].

Considering this, the ITAT concluded that the collection charges paid by AAI to the Assessee is a 'service charge' paid to the Assessee in lieu of collecting UDF and passing it on to AAI. This service charge cannot be said to be income derived from the operation of the aircraft.

Significant Takeaways

Through this decision, the ITAT has held that the collection fees received by airline companies from the AAI is not exempt under Article 8 of the DTAA. The ITAT has significantly restricted the scope of "profits from the operation of ships or aircraft" under Article 8 of the DTAA.

This position, however, is inconsistent with the otherwise settled position in law that the scope of exemption to profits from operation of ships and aircrafts is to be read broadly. The Commentary to the OECD Model Clauses[15] provides that profits earned from activities ancillary to the operation of ships and aircrafts shall also be covered under the exemption. The Commentary states: *"profits from activities directly connected with such operations as well as profits from activities which are not directly connected with the operation of the enterprise's ships or aircraft in international traffic as long as they are ancillary to such operation."* Earlier decisions of the Bombay HC have also favoured an interpretation which includes ancillary activities within the scope of profits from operation of ships and aircrafts for the purposes of Article 8 of the DTAA.

The ITAT's decision does not discuss the possibility of profits arising from activities ancillary to the operation of aircrafts and ships as falling within the exemption under Article 8. Considering this, the ITAT-Delhi's approach seems to be restrictive in interpreting the scope of the exemption available under Article 8 of the DTAA to international airline operators and is consequently unfair to them.[16]

> **"The collection charges paid by AAI to an international airline operator is not exempt under Article 8 of the DTAA."**

[15] OECD Model Commentary 2017.
[16] Hapag –Llyod AG v. ADIT, [2013] 31 taxmann.com 64 (Bombay); DIT v. Balaji Shipping UK Ltd. [2012] 211 Taxman 535/24 taxmann.com 229 (Bom.).

ITAT holds out-of-pocket expenses incurred by Indian AE not eligible for TP adjustment

In the case of ***Capgemini India Pvt. Ltd.,***[17] the Mumbai ITAT held that out-of-pocket expenditure incurred by an Indian service provider, which was reimbursed by its group entities on a cost-to-cost basis, was in the nature of pass-through cost, and hence, did not require a mark-up.

Facts

Capgemini India Pvt. Ltd. ("**Assessee**") is an Indian company engaged in the business of providing information technology enabled support services. During the relevant FY, the Assessee, *inter alia,* provided these services ("**the Services**") to various AEs under the terms of a Master Service agreement ("**MSA**"). As per the MSA, the Assessee was entitled to recover its total cost, along with a mark-up of 12%. However, this excluded any pass-through costs incurred by the Assessee. While rendering the Services to its AEs, the Assessee incurred several costs related to software licences, communications and travel and conveyance, boarding and lodging expenses, etc. The Assessee got the same reimbursed from its AEs as out-of-pocket expenditure ("**OPEs**"). These OPEs were not included by the Assessee while calculating its total cost on which mark-up was charged.

The TPO in the transfer pricing proceedings held that these were not pass-through costs since they were incurred in connection with the execution of projects and pertained to employees of the Assessee who travelled abroad. Accordingly, the TPO held that the Assessee should have earned a mark-up on these expenses and made an adjustment with respect to 12% of the total reimbursements of OPEs. Against the draft assessment order passed by the AO, the Assessee did not file any objections before the DRP and the final assessment order was passed by the AO, which was similar to the draft assessment order. The Assessee appealed before the CIT(A) on certain issues, including this issue, but did not get relief from the CIT(A). Aggrieved, the Assessee appealed before the Mumbai ITAT.

Issue

Whether the Assessee was required to charge a mark-up on the OPEs incurred by it?

Arguments

The Assessee argued that for the past AYs, such OPEs incurred on behalf of AEs had been routinely claimed by the Assessee at cost without any mark-up and the same had been allowed by the IRA. Thus, the TPO's adjustment was unwarranted on the principle of consistency. The OPEs were incurred only for administrative convenience and not for providing any services. At the time of implementation and testing of the software, the Assessee's employees travelled on site to provide support services and hence, travel expenses were incurred on behalf of its AEs and not on its own account. Thus, they could not be added to the cost base for charging mark-up. The Assessee also submitted that the recovery of such expenses on a cost to cost basis was standard across the information technology industry. Under the MSA, only those costs were to be marked up which were consumed in the value-added services provided by the Assessee. Since the OPEs were incidental to such services and did not include any service element on part of the Assessee, they could not be considered for charging mark-up.

The Assessee further argued that even if such expenses were treated as part of its cost base, even then the operating margin earned from software development activity was 19.45% whereas the arithmetic mean of margins of comparable companies was only 8.69%. Thus, even otherwise the adjustment was not warranted.

The IRA submitted that there was no difference between the cost incurred by the Assessee for its AEs and the cost incurred on its own. There was no requirement of any value-added cost to be included under the terms of the MSA. Further, the principle of *res-judicata* was not applicable to income-tax proceedings and thus the principle of consistency could not be relied upon.

Judgment

The ITAT noted that it had been a continuing practice of the Assesseee for the last several years to seek reimbursement of such OPEs on a cost-to-cost basis and no mark-up was required to be charged on the same. The TPO's orders from FY 2001-02 to FY 2008-09 reflected that no addition in lieu of such expenses had previously been sought by the TPO. The nature of the Services provided by the Assessee under the MSA required its employees to travel on-site. Thus, the expenditure in the nature of travelling, etc., needed to be incurred by the Assessee on behalf of its AEs. Accordingly, no mark-up on such expenditure was required.

Further, while the MSA did not explicitly clarify what cost is to be considered in the cost base and the Assessee submitted that its operating margin from software development services was 19.45%, while the mean of margins of comparable companies

[17] Capgemini India Private Limited v. DCIT [TS-287-ITAT-2022(Mum)-TP].

was only 8.69%. The TPO had not disputed any of the comparables selected by the Assessee for computation of arm's length price ("**ALP**"). Thus, the ITAT held that such mark-up was final and the relevant addition made by the AO could not be sustained.

Significant Takeaways

Transfer pricing ("**TP**") provisions under the IT Act are specific anti-avoidance provisions which require transactions between AEs to be on an arm's length basis. Typically, expenses payable on a cost-to-cost basis, i.e., in the nature of pure reimbursement are neither an 'income' nor an 'expense' in the hands of the recipient. However, due to huge sums of money involved in such reimbursements, such transactions, most of the times, face intense scrutiny from the IRA. Courts have previously held that any amount received by the taxpayer by way of pure reimbursement cannot be regarded as income of such taxpayer.[18] However, if a service element is involved or if any significant risk is assumed by the service provider, then such reimbursement may be liable to tax in India.[19] Further, if the reimbursement received from an AE is shown as revenue under the books of accounts, it may be treated as income of the taxpayer, and corresponding expense incurred in its respect can consequently lead to a TP adjustment by the TPO.[20]

The decision in the Assessee's case is supported by an earlier ruling of the Delhi HC,[21] wherein it was held that those reimbursement costs received by an Indian company from its subsidiary, which did not have any profit purpose, should be excluded while working out the ALP. Interestingly, this situation might be slightly different if costs were being reimbursed by the Indian company to its foreign AE. In such a scenario, previously, the Delhi HC,[22] in another ruling had held that even with respect to reimbursement costs, when such a transaction occurs between two AEs, it is necessary to test whether the cost itself is not inflated by carrying out comprehensive TP analysis. It was also held that it is critical to demonstrate that the reimbursement arose out of a business need and was 'wholly and exclusively' connected with the taxpayer's business. The latter was distinguished from the former since the former involved (i) reimbursement from an Indian company to its foreign AE; and (ii) the agreement under the latter did not categorize the reimbursement costs while the agreement under the former specifically clarified which costs were subject to mark-up and which were pure reimbursements.

While these judgments were not relied upon by the Mumbai ITAT in the Assessee's case, the MSA in the instant case was silent about the nature of expenses which should be regarded as costs incurred by the Assessee and those which are in the nature of pure reimbursements. The ITAT accordingly relied on the ALP determined by the TPO and confirmed its understanding that the reimbursements did not take place at a price lower than the ALP. Based on the precedents discussed here, it is important for taxpayers to explicitly clarify what constitutes as 'cost' or fees under the service agreement and the scope of reimbursements available to it (which do not need to be included in the cost base), to ensure that there are no TP concerns with respect to reimbursement cost. In addition to such explicit clarification in the definitive documentation, it will also have to be justified on the basis of relevant facts that such reimbursements should not form a part of costs, while ascertaining the costs of operations for the purposes of claiming a mark-up.

> **"The assessee is justified in not charging any mark-up on out-of-pocket expenditure."**

[18] See e.g., CIT v. Siemens Aktiongesellschaft (2009) 310 ITR 320 (Bom); CIT v. IDFC Investment Advisors Limited, MANU/MH/2764/2016; DIT v. WNS Global Services (UK) Ltd, [2013] 214 Taxman 317 (Bom); DCIT v. UPS Jetair Express, MANU/IU/0327/2015; Aricent Technologies (Holding) Limited v. ACIT [TS-9-ITAT-2011(DEL)]; WM India Technical and Consulting Services Private Limited [TS-487-ITAT-2020(DEL)-TP].

[19] See e.g., C.U. Inspection (I) P Ltd v. DCIT, ITA No. 577/Mum/2011; DCIT (TDS) v. Kodak India Private Ltd. [TS-31-ITAT-2015(Mum)]; Tata Coffee Limited v. DCIT [TS-138-ITAT-2021(Bang)-TP].

[20] Seagram Manufacturing Private Limited [TS-157-ITAT-2016(Del)-TP].

[21] CPA Global Services Private Limited [TS-329-HC-2017(DEL)-TP].

[22] Cushman and Wakefield (India) Private Limited, [TS-150-HC-2014(DEL)-TP].

ITAT confirms payments made for purchase of advertisement space not royalty

In ***ESPN Digital Media (India) Pvt. Ltd.,***[23] the Chennai ITAT held that payments made by an Indian company to its foreign group company for purchase of advertisement space did not constitute 'royalty' under the IT Act or the India-UK DTAA.

Facts

ESPN Digital Media (India) Pvt. Ltd. ("**Assessee**") is an Indian company which had entered into an agreement with its foreign group company ("**UK Co**") for resale of advertisement space on websites owned by the UK Co ("**Reseller Agreement**"). Under the Reseller Agreement, the Assessee purchased advertisement spaces on website owned and hosted by UK Co on servers outside India, and sold the same to third-party advertisers in India. EL on these purchases were also deposited with the IRA. The AO, on assessment, held that payments made by the Assessee to the UK Co under the Reseller Agreement were in the nature of 'royalty' and the Assessee was liable to withhold taxes under the provisions of section 195 of the IT Act. Accordingly, the Assessee was declared as an assessee-in-default under the provisions of the IT Act.

On appeal, the CIT(A) agreed with the position taken by the AO. Aggrieved, the Assessee filed an appeal before the Chennai ITAT.

Issue

Whether payments made by the Assessee to UK Co for purchase of advertisement space was taxable as 'royalty' under the IT Act, read with the India-UK DTAA?

Arguments

The IRA relied on the definition of 'royalty' as given under clause (via) of explanation 2 to section 9(1)(vi) of the IT Act, which defines royalty as 'consideration received for the use or right to use any industrial, commercial or scientific equipment'. The IRA submitted that the words "use" and "right to use" followed by the word "equipment" have to be understood in a broad sense in the digital era, i.e., there must be a positive act of utilisation, application and employment of equipment for the desired purpose. Accordingly, the IRA argued that since under the Reseller Agreement, the Assessee collects advertisements from Indian advertisers and uploads them on the web server, this implies that there is a positive utilisation of the web server, which is squarely covered within the purview of clause (via) of explanation 2 to section 9(1)(vi) of the IT Act.

Furthermore, the definition of royalty under the India-UK DTAA, *inter alia,* also includes payment of any kind received as consideration for the use of, or the right to use, any industrial, commercial, or scientific equipment. In the instant case, the Assessee provided a comprehensive service to UK Co whereby it was able to use the web servers of the UK Co to upload Indian-sourced advertisements, i.e., the payment was made for use of equipment/ process provided by UK Co. Thus, this was also covered under the definition of royalty as given under the India-UK DTAA.

The Assessee argued that under the Reseller Agreement, there was merely a sale of advertisement space on a principal to principal basis. The Assessee did not obtain any right to use/ exploit the websites or gain any direct access to the servers for the purpose of uploading advertisements. The Assessee was merely responsible for providing advertisement content in accordance with the guidelines of UK Co and the actual uploading was handled by a third-party service provider. Majority of the advertisements were uploaded on third-party websites. There was no transfer of right, property, or information under the Reseller Agreement. Additionally, the Assessee submitted that the word "use" must be read in conjunction with the provision of industrial, commercial, or scientific experience and no such experience or know-how was transferred by UK Co to the Assessee. The Assessee relied on numerous precedents[24] in support of these contentions. On the basis of these submissions, it was contended that the payments made by the Assessee were not 'royalty' under the provisions of the IT Act or under the India-UK DTAA.

It was also submitted by the Assessee that EL was introduced to tax certain income generated from digital advertisements by non-residents in India which was otherwise not taxable under the IT Act. As the Assessee had already deposited EL, if the payment made by the Assessee was to be considered as 'royalty', it would be contrary to the legislative intent and lead to double taxation of the same income.

Judgment

After analysing the Reseller Agreement, the Chennai ITAT found that it, *inter alia*, provided that all digital media websites were owned and controlled by UK Co and no right had been transferred to the Assessee. Thus, the Chennai ITAT held that under the terms of the Reseller Agreement, no "right to use" any industrial, commercial, or scientific equipment had been provided nor was the web server placed under the control of the Assessee. There had been no transfer of right, property, information, or scientific experience in any manner whatsoever.

[23] M/s. ESPN Digital Media (India) Pvt. Ltd. v. DCIT, [TS-360-ITAT-2022(CHNY)].
[24] Urban Ladder Home Décor Solutions Pvt. Ltd., v. ACIT, ITA No.615/Bang/ 2020 (Bangalore ITAT); Myntra Designs Private Limited v. DCIT, ITA No.598/Bang/2020 (Bangalore ITAT).

It was further held that the IRA's reliance on section 9(1)(vi) of the IT Act was misplaced since it is a settled position of law that unilateral amendments under domestic law could not expand the definition of royalty under DTAAs, as has been previously held by the SC.[25] This is because non-residents, who are eligible to benefits under a DTAA, stand on a better footing than residents. The provisions of the IT Act cannot be used to restrict the scope of the benefit available under a DTAA. Furthermore, the provisions relied on by the IRA were inserted in a period subsequent to the FY to which the Assessee's case pertained to and could not be retrospectively applied in any case.

The ITAT also took note of the EL payments made by UK Co and agreed with the Assessee's contention that including the payments made to UK Co under 'royalty' would be contrary to the legislative intent of introducing EL provisions. Thus, the appeal filed by the Assessee was allowed.

Significant Takeaways

Advertising services have become a major source of revenue for major global digital players, who may otherwise not charge their 'users' for use of their platforms. The taxability of advertising services has thus been a matter of litigation in several recent cases. Recently, the Delhi ITAT had held that payment to Facebook Ireland Inc. for advertisement services is not chargeable to tax under the India-Ireland DTAA, in the absence of a PE in India.[26] Similarly, a Mumbai ITAT ruling held that payment made to Facebook Ireland Inc. for uploading an advertisement banner on Facebook is not taxable as royalty/ FTS.[27] Interestingly, the Bangalore ITAT, in another case, has held that payments made by an Indian company to its foreign group company for purchase of advertisement space were in the nature of royalty, since as per the facts of the case, the Indian company had, *inter alia*, gained access to the intellectual property of the foreign company.[28] It is relevant to note that the Karnataka HC has recently opined that this decision of the Bangalore ITAT was given mechanically and has remanded the same back to the ITAT since it was considered being violative of the principles of natural justice.[29] It will be interesting to see the final position that the Bangalore ITAT will take in this context.

An analysis of *ESPN Digital Media (India) Pvt. Ltd.* and the aforementioned cases suggests that agreements for a simple purchase of advertisement space may not be taxable as royalty/ FTS under the IT Act. However, it would be important to undertake this analysis after analysing the overall factual matrix and the specific terms of the agreements entered into. Consideration paid under an agreement for acquisition of advertising space may be brought to tax as royalty, if there is any material/ evidence on record to suggest that the consideration paid under the aforementioned agreement was towards use of licences/ other intellectual property. It is thus crucial for taxpayers to carry out a comprehensive analysis and consult their tax advisors in light of these judgments and ascertain whether reliefs are available under the relevant DTAAs prior to finalising any such agreements.

“ Any payment made for mere purchase of digital advertisement space cannot be characterised as royalty. ”

[25] Engineering Analysis Centre of Excellence Pvt. Ltd. v. CIT, 432 ITR 471 (SC).
[26] ACIT v. Lenskart Solutions [TS-236-ITAT-2022(DEL)].
[27] Play Games 24x7 (supra).
[28] Google India (supra).
[29] Google India (supra).

SC upholds validity of assessment order passed in the name of amalgamating company after amalgamation

In the case of ***Mahagun Realtors Pvt. Ltd.***[30]**,** the SC has held that the assessment order passed in the name of amalgamating company after amalgamation cannot be rejected, having regard to the conduct of the companies involved.

Facts

Mahagun Realtors Pvt. Ltd. ("**Assessee**" or "**MRPL**") was engaged in real estate development and had executed one residential project. MRPL amalgamated with Mahagun India Pvt. Ltd. ("**MIPL**") by virtue of a September 2007 HC order. The amalgamation was effective from April 1, 2006.

A search and seizure operation was carried out in the Mahagun group of companies, including MRPL and MIPL, whereby the directors of both the entities gave a combined statement in August 2008. Post the said operation, a notice was issued to the Assessee to file a return of income for AY 2006-07, which was filed in May 2010 in the name of the Assessee, giving its PAN and without providing any information regarding the amalgamation. It is relevant to note that in July 2010, two letters were filed on behalf of MRPL, intimating the IRA about the amalgamation, but it was for AY 2007-08 (for which separate proceedings were initiated under section 153A of the IT Act) and not for the subject year, i.e., AY 2006-07. The AO then proceeded to pass an assessment order under the name 'MRPL, represented by MIPL'.

The Assessee filed an appeal before the CIT(A) in the name of 'Mahagun Realtors (Represented by MIPL, after amalgamation)'. The CIT(A) partly allowed the Assessee's appeal. Aggrieved, the IRA filed an appeal before the ITAT against which the Assessee filed cross objections. While the IRA's appeal was dismissed, the ITAT allowed the Assessee's cross objection on the ground that owing to the amalgamation, the Assessee was not in existence when the assessment order was passed. Thus, the ITAT held that the AO's order was unsustainable.

The IRA appealed before the HC, but the appeal was dismissed, relying on SC's order in the case of *Maruti Suzuki India Ltd.*[31] ("**Maruti Suzuki**"). Aggrieved, the IRA filed an appeal before the SC.

Issue

Whether the assessment order passed by the AO in the name of the amalgamating company, after amalgamation should be considered valid?

Arguments

The IRA submitted that the names of both the amalgamating company as well as the amalgamated company were mentioned in the assessment order and the former was duly represented by the latter and hence, the assessment was in substance in conformity with the other provisions and processes involved. The name of the amalgamating company in the assessment order was a mistake or omission curable under section 292B of the IT Act. The IRA submitted that the case of the Assessee can be distinguished from *Maruti Suzuki* since the name of the amalgamated company was not mentioned in it, while in the instant case, names of both the amalgamating and the amalgamated company were mentioned. The IRA also claimed

[30] Principal Commissioner of Income-tax v. Mahagun Realtors (P.) Ltd. [2022] 137 taxmann.com 91 (SC)
[31] CIT v. Maruti Suzuki India Ltd. [2019] 107 taxmann.com 375/265 Taxman 515/416 ITR 613 (SC).

that in *Maruti Suzuki*, the fact of amalgamation was duly informed to the IRA, whereas in the instant case, the Assessee did not inform the IRA about amalgamation during the search proceedings or anytime thereafter. During the search proceedings, post-dated cheques were issued in the name of the Assessee. In fact, the return of income was filed in the Assessee's name post the search proceedings.

When the AO was informed during the assessment proceedings about the amalgamation, the AO mentioned the description of the name in the assessment order as 'MRPL, represented by MIPL'. In fact, the Assessee itself had filed the appeal before CIT(A) as well as cross objections before the ITAT in a similar way, thereby acknowledging that the assessment order was passed in relation to the amalgamated company i.e., MIPL.

The Assessee argued that upon amalgamation, the amalgamating company got wound up under the provisions of the Companies Act, 1956, and it cannot be considered as a person under section 2(31) of the IT Act. The Assessee also submitted that the fact of amalgamation was brought to the notice of the AO on May 30, 2008, and the director had also stated the same at the time of search proceedings. Hence, the notice under section 153A of the IT Act issued in the name of MRPL, a non-existing entity, was invalid and the proceedings were void-ab-initio. The Assessee also submitted that after amalgamation, the notice should be issued in the name of the amalgamated company as per section 170(2) of the IT Act. The Assessee relied on the judgment of Delhi HC in the case of *Spice Infotainment Ltd.*[32] ("**Spice**"), wherein the assessment framed in the name of the amalgamating company, which ceased to exist in law, was held invalid and untenable and such defect could not be cured in terms of section 292B of the IT Act. Further, it was also held that the fact that the amalgamated company had participated in the assessment proceedings would not operate as estoppel. The Assessee submitted that its case was similar to *Maruti Suzuki*.

Judgment

The SC observed that an amalgamation is unlike winding up. In amalgamation, the outer shell of the company is destroyed, but the corporate venture continues in the name of the transferee entity. The SC also stated that under civil law, upon amalgamation, the complaint against the predecessor does not cease, but a successor or representative is located, who is made responsible for liabilities arising from the complaint. Under section 394 of the Companies Act, 1956, read with section 2(1A) of the IT Act and other related sections, despite amalgamation, the business of the amalgamating entity continues and any benefits (e.g. depreciation and losses) are transferred to the amalgamated entity.

The SC held that the Assessee's case may be distinguished from Maruti Suzuki and Spice, as under:

(i) The assessees in those cases had duly informed the AO about the amalgamation and yet, the order was passed in the name of the amalgamating company. In the instant case, for AY

32 [2012] 247 CTR 500 dismissed by SC in Spice Enfotainment Ltd. [TS-504-SC-2017].

2006-07, there was no intimation by the Assessee regarding the amalgamation.

(ii) Post the search proceedings, the return of income was filed by the Assessee in 2010 in MRPL's name, using MRPL's PAN and the representative from MRPL corresponded with the IRA in the name of MRPL. The SC noted that the letter filed by the Assessee informing of the amalgamation was for AY 2007-08 and not AY 2006-07.

(iii) It was not stated by the Assessee at any time during the proceedings that MRPL was not in existence, and its business assets and liabilities had been taken over by MIPL.

(iv) The counter affidavit filed by the Assessee in 2020 before the SC was affirmed by a director of MRPL (and not MIPL).

(v) The SC questioned the conduct of the Assessee throughout the proceedings i.e., right from the conduct of search till the proceedings before the SC. At each and every stage, the Assessee itself presented that the submissions are being filed by MRPL (represented by MIPL).

(vi) The SC also noted that the AO could have decided to pass a common assessment order for MRPL, MIPL and other group entities. But if he chose to pass separate order for different amalgamating companies, including MRPL, the same cannot be nullified given the circumstances at hand.

(vii) The SC also made a comment for MIPL that in case a refund is due to MRPL, whether MIPL will claim the same because it will be issued in favour of a non-existent entity i.e. MRPL.

Basis the above contentions, the SC concluded that the Assessee has consistently held itself out as the assessee and hence, the order of HC cannot be sustained and should be set aside. The assessment order was held to be valid. However, the matter was restored to the ITAT to hear the same on merits.

Significant Takeaways

The SC has appreciated the difference between winding up and amalgamation. It also took a firm stance regarding the conduct of the Assessee when it failed to inform the IRA of the amalgamation at any time during the assessment proceedings and later on raised the same only in the cross objections for dismissal of appeal. Rather than straightaway relying on *Maruti Suzuki* and giving a decision in favour of the Assessee, the SC decided to dig deeper on the facts, placing high importance towards the actual conduct of the Assessee. Thus, to expect a just and fair treatment, it is important that true disclosure should be made by the taxpayers before the IRA as well as before the Courts.

Thus, as far as the current issue is concerned, it is relevant to mention that the controversy regarding the validity of the assessment order in case of succession has already been amended by FA 2022. Section 170(2A) has been inserted in the IT Act to mention that in case of succession, any proceedings made or initiated on the predecessor during the course of pendency of such succession shall be deemed to be made on the successor. Thus, the SC judgment is also in accordance with the spirit of the law.

> **"SC rules that the assessment order issued on amalgamating company is valid especially when the assessee had been duly represented during the assessment and appellate proceedings."**

Bombay HC holds amount kept in escrow to be excluded while computing capital gains

In the case of ***Dinesh Vazirani,***[33] the Bombay HC has held that the consideration for sale of shares which was deposited in an escrow account and was subsequently withdrawn by the purchaser towards the liabilities contemplated under the share purchase agreement, could not be brought to tax in the hands of the taxpayer (i.e., the seller).

Facts

Dinesh Vazirani ("**Assessee**") is an Indian resident individual. The Assessee entered into a share purchase agreement ("**SPA**") with an Indian company ("**I Co**") to sell certain equity shares held by him in an Indian company. Under the terms of the SPA, part of the purchase consideration was to be kept in an escrow account (for a period of two years) and its transfer to the Assessee was made subject to certain specified conditions. The Assessee computed capital gains on the sale of the said equity shares, taking into account the entire purchase, including the amount kept in escrow, and offered the same to tax in the year of sale.

Subsequently, certain statutory and other liabilities arose in I Co for a period prior to the sale of shares. The amount due towards these liabilities was recovered from the escrow account by I Co, in accordance with the terms of the SPA, and the net amount from the escrow amount was paid to the Assessee. Since the assessment proceedings in respect of the return of income filed by the Assessee offering to tax capital gains arising to him under the SPA had already been completed, the Assessee filed a revision application before the PCIT under section 264 of the IT Act and prayed for a refund of the excess tax paid on the amount that was not received by the Assessee.

The PCIT, however, rejected the application made by the Assessee. Aggrieved, the Assessee filed a writ petition before the Bombay HC.

Issue

Whether the portion of consideration for sale of shares of I Co, kept in an escrow account for meeting contingent liabilities, could be reduced from the total taxable income while computing capital gains, if such amounts were actually utilised towards such liabilities?

Arguments

The Assessee argued that since certain liabilities arose in I Co, which were paid out of the escrow account, the Assessee received a reduced amount compared to the sale consideration disclosed in the Assessee's return of income. Therefore, the capital gains amount had to be recomputed by reducing the appropriate amount from the sale consideration and the excess tax paid should be refunded. It was also contended that the amount was diverted towards meeting the liabilities and was neither received nor accrued to the Assessee. The Assessee asserted that it was the obligation of the IRA to tax only such income as is chargeable under the IT Act and if higher income was offered to tax, then it was their duty to compute the correct income and grant refund of excess taxes erroneously paid by a taxpayer.

The PCIT relied on the manner of computation of capital gains under the IT Act and stated that only specified costs could be reduced under section 48 of the IT Act while computing capital gains, i.e., cost of acquisition, cost of improvement or expenditure incurred exclusively in connection with the transfer. Accordingly, amount paid for meeting contingent liability could not be reduced from the consideration while computing capital gains. The PCIT further stated that in the absence of a specific provision, under the scheme of the IT Act, any *suo moto* tax paid by a taxpayer on any returned income was sacrosanct and could not be refunded.

Judgment

The Bombay HC held that the PCIT had erred in holding that the amount held in escrow was 'income' in the hands of the Assessee. The amount had neither been received, nor accrued to the Assessee, and accordingly, could not have been included within the total sale consideration while computing capital gains to the Assessee. The HC noted that under the terms of the SPA, the amount kept in escrow was not an absolute amount, but subject to certain liabilities, which may have to be borne by the Assessee due to subsequent events. The Bombay HC relied on a decision of the SC,[34] wherein it was held that where income has not resulted to an Assessee, i.e., neither receipt nor accrual of income has happened, there could not be any tax, even though an entry may have been made in the books of account. Accordingly, the HC held that the amount which had been diverted towards fulfilling the liabilities which had arisen subsequently, had neither been received nor accrued to the Assessee and had to be reduced from the purchase consideration while determining capital gains in the hands of the Assessee.

The Bombay HC further held that the PCIT had powers to refund the excess taxes paid by the taxpayer in situations where any error was made by the Assessee or where the income was not

[33] Dinesh Vazirani v. Principal Commissioner of Income Tax, W.P. No. 2475 of 2015.
[34] CIT v. Shoorji Vallabhdas and Co., (1962) 46 ITR 144 (SC).

taxable under the IT Act. It is the duty of the tax authorities to compute the correct income and grant refund of higher taxes, if any, paid erroneously by a taxpayer. Accordingly, the Bombay HC ruled in favour of the Assessee and quashed the order of the PCIT.

Significant Takeaway

This ruling of the Bombay HC is extremely relevant from an M&A perspective as it reasserts the fact that only such income can be brought to tax which is genuinely taxable under the IT Act. It reaffirms that for any income to be taxable, it must have been received or a right to receive must have been created in favour of the taxpayer. As a corollary, there must be a liability to pay the other party. Section 5 of the IT Act is the charging section, which necessitates the income to have been received or accrued or arisen or deemed to have been received or accrued or arisen, to be taxable. Both 'accrue' and 'arise' have been used in contradistinction to the word 'receive' and indicate a 'right to receive'.[35] In this context, it is crucial to understand the meaning of the term, "accrued" under the IT Act. The SC has clarified that income is said to accrue when it 'becomes due' and mere deferral of payment of income would not affect the accrual of income.[36] The test to see if a right to receive income has been acquired and income has consequently accrued to the taxpayer is to determine whether a debt due by somebody, in favour of the taxpayer, has been created.[37] Thus, it becomes crucial to review the terms of the definitive documents between the parties to determine whether a right to receive income has been acquired by the taxpayer.

A Madras HC ("**Caborandum**")[38] decision is relevant in this regard. In *Caborandum*, the taxpayer had entered into a business sale agreement ("**BSA**") and kept a part of the consideration in an escrow account to meet any contingent liabilities. However, a review of the terms of the BSA showed that the entire sale consideration (including the amount kept in escrow) had accrued to the taxpayer in the relevant FY. This was evidenced by the fact that the taxpayer had, *inter alia*, (i) acquired a right to receive interest income on the sum retained in the escrow account; and (ii) all liabilities, including contingent liabilities, were to be solely borne by the taxpayer. Thus, the amount retained in the escrow account was an 'application of income' which had already accrued to the taxpayer.

From an analysis of *Dinesh Varizani* and *Caborandum,* it becomes clear that taxpayers need to be extremely mindful while entering into an asset purchase agreement. It is important to pay attention to the language of the definitive documents while negotiating them. *Dinesh Vazirani* is a welcome ruling and has the potential to provide guidance on the taxability of not just escrow accounts but also other similar contingency-linked payment structures such as holdback agreements or earn-outs. Nonetheless, the impact of this ruling would need to be determined on a fact-to-fact basis and may differ across transactions. It may further be noted that this ruling was specific to that part of the escrow amount which had been used towards meeting of contingencies and does not comment about taxability of the entire amount kept in escrow.

> **" Adjustment of the amounts held in escrow towards meeting contingent liabilities should be allowed as a deduction. "**

[35] Seth Pushalal Mansinghka (P.) Ltd. v. Commissioner of Income-tax, [1967] 66 ITR 159 (SC).
[36] Morvi Industries Limited v. Commissioner of Income-tax, [1971] 82 ITR 835 (SC).
[37] E.D. Sassoon v. Commissioner of Income-tax, [1954] 26 ITR 27 (SC).
[38] Caborandum Universal Limited v. Assistant Commissioner of Income-tax, [2021] 130 taxmann.com 133 (Madras).

NCLT disregards IRA's objections on GAAR and approves amalgamation

NCLT approved the Scheme of Amalgamation ("**Scheme**") between Panasonic India Pvt. Ltd. ("**Transferor**") and Panasonic Life Solutions India Pvt. Ltd. ("**Transferee**").[39] In the process, it rejected the IRA's contention that the main objective of the Scheme was to benefit from the carry forward losses of the Transferor and that provisions of GAAR should be invoked.

Facts

The Transferor and the Transferee filed an application praying for sanctioning of the Scheme before the NCLT. As per provisions of the Companies Act, 2013, and directions of the NCLT, notice of hearing was served upon (a) Ministry of Corporate Affairs, (b) Competition Commission of India, (c) Registrar of Companies, (d) Official Liquidator and (e) IRA.

Out of the aforementioned authorities, only the IRA made certain adverse observations and objected to the Scheme.

Issue

Whether the Scheme should be approved despite the IRA's objection?

Arguments

The IRA contended that the Scheme was not at arm's length as the Transferor and Transferee are ultimately held by Panasonic Corporation Japan. The main objective of the Scheme was to set off the profits of the Transferee with the accumulated losses of INR 14,375 Million lying in the books of the Transferor, which would result in huge tax losses to the IRA. In this regard, the IRA placed reliance on NCLT Mumbai's decision in the case of *Gabs Investment and Ajanta Pharma*[40] and NCLAT's decision in the case of *Wiki Kids*[41], wherein the amalgamation schemes were not sanctioned primarily based on the objection from the IRA that huge tax liability was avoided and the scheme was not in public interest.

The IRA also alleged that there will be a loss of tax revenue on account of possible non-payment of capital gains realizable by the shareholders of the Transferor while selling shares of the Transferee, as these shareholders are residents of Singapore and the Netherlands, and will enjoy the benefit of the respective DTAAs. The Scheme was a vehicle to achieve a tax benefit in the form of transfer of accumulated losses of Transferor to Transferee and hence, GAAR provisions could be invoked which would deny the tax benefits proposed to be claimed by the shareholders from Singapore and Netherlands.

The Transferor and Transferee (i.e. Parties to the Scheme) contended that it was executed for various commercial reasons, including reduction in operating and marketing costs, economies in procurement, increased value to customers, offering holistic customer solutions, and enhancing shareholder's value. Section 47 of the IT Act provides tax neutrality of amalgamation in the hands of the transferor company and its shareholders. Hence, if the conditions for tax neutrality provided in the IT Act are fulfilled, the IRA cannot argue that the Scheme will be prejudicial to the interest of IRA.

The Parties contended that set-off of accumulated losses would be available only when the conditions laid down in Section 72A of the IT Act, read with Rule 9(c) of the IT Rules and that the AO can verify the same at the time of completion of the assessment for the relevant year.

The Parties also contended that the non-resident shareholders of the Transferor would anyways not have any obligation to pay capital gains tax on the transfer of shares of the Transferor if the amalgamation did not take place, as they would be eligible for relief under the DTAAs with the Netherlands and Singapore. It was also argued that GAAR cannot be invoked since the amalgamation is not an 'impermissible avoidance arrangement' ("**IAA**") and its main purpose is not to obtain tax benefits. Further, reliance was also placed on the SC decision in case of *Vodafone International Holdings Bv*[42] wherein it was held that the IRA cannot disregard a transaction which otherwise does not lack business/ commercial substance unless its sole motive is to avoid tax,.

The Parties also objected to reliance by IRA on Mumbai NCLT's ruling in *Gabs Investment and Ajanta Pharma (supra)* and in the NCLAT's decision in *Wiki Kids (supra)*, as the facts of these cases are distinguishable. In both the cases, the transferor companies did not have any business activity and were merely holding shares of the transferee companies which were listed entities. The rationale for amalgamation in both cases was merely simplification of shareholding which was beneficial only to a few promoters, and there was no benefit to the public shareholders at large.

39 In the matter of scheme of amalgamation of Panasonic India Private Limited and Panasonic Life Solutions India Private Limited, CP (CAA) No. 8. Chd/Hry/2021 (NCLT).
40 CSP No.995 and 996 of 2017 and CSA No.791 and 792 of 2017.
41 Wiki Kids Ltd. and Ors. v. Regional Director, South East Region and Ors. in Company Appeal (AT) No.285 of 2017 decided on 21.12.2017.
42 Vodafone International Holdings BV v. UOI (2009) 41 ITR 1 (SC).

Order

The NCLT distinguished the facts of the instant case from the facts of *Gabs Investment and Ajanta Pharma (supra)* and *Wiki Leaks Ltd (supra)*. It held that the parties to this Scheme have spelt out the operational synergies, which justify the claim that it was for business consolidation and tax benefits were merely consequential. It held that IRA was unable to point out any adverse issue concerning the valuation of shares after the copy of valuation report and the exchange ratio was reported to it.

The treatment of carry forward and set off of a loss in amalgamation or demerger is provided under the IT Act with additional conditions regarding a change in the shareholding pattern i.e., section 79 of the IT Act provides that the accumulated business losses of a company may not be carried forward and set off, if on the last day of the previous year, pursuant to a change in shareholding, shares representing at least 51% of the voting power of the company are no longer beneficially held by persons who beneficially held shares representing 51% of the voting power of the company on the last day of the year in which the losses were incurred. The NCLT opined that these conditions were sufficient to protect the interest of the IRA in any case of amalgamation or demerger.

Further, even if the Scheme is approved by the NCLT, it does not override the provisions under the IT Act. Hence, the issues concerning carry forward of losses, and invocation of GAAR may come up for consideration at the time of assessment, and the IRA may deny any benefit as per the provisions of the IT Act. However, GAAR provisions should be invoked as per the procedure provided in the IT Act.

Significant Takeaways

This is a welcome decision of the NCLT as it had explicitly held that as long as the conditions specified under IT Act for tax neutrality and carry forward and set off of losses are satisfied, the interest of the IRA can be considered to have been protected.

GAAR provisions are more severe in nature as it provides broad powers to the IRA to determine tax consequences by disregarding any structure, reallocating or recharacterizing income, denying treaty benefits, etc. However, GAAR provisions have not been invoked by the IRA till now. The CBDT in its Circular No. 7 of 2017 had stated that where NCLT has explicitly and adequately considered the tax implications while sanctioning an arrangement, GAAR will not apply to such arrangement. In the instant case, the NCLT held that IRA can invoke GAAR provisions at the time of scrutiny assessment of the parties. It is worthwhile to highlight that GAAR cannot be invoked merely on the allegation that there is a tax benefit to the tax payer, the transaction needs to satisfy any of four tainted conditions viz. misuse/ abuse of provisions of the IT Act, lacks commercial substance, not employed for *bonafide* purposes or creates rights which are not at arm's length. Therefore, it is essential for parties who are undertaking an amalgamation to cull out the commercial substance in a comprehensive manner in the scheme itself and also to keep their arguments and contentions together to give more weight to its arguments in case the case is picked by the IRA in future.

> **“ A Scheme of Amalgamation should be permissible if the Parties are able to identify the operational synergies, which justify the claim for business consolidation. ”**

ITAT holds amended proviso under section 201(1) has retrospective effect

In ***Shree Balaji Concepts***,[43] the Panaji ITAT has held that the proviso under section 201(1) of the IT Act, which was amended *vide* FA 2019 to provide that no tax may be recovered from a taxpayer who has failed to deduct tax on payments made to a non-resident if such non-resident payee reports such income in their return and pays tax on the same, has retrospective effect since it corrected an anomaly under the IT Act.

Facts

Shree Balaji Concepts ("**Assessee**"), an Indian resident partnership firm, purchased immovable property in India from two UK based non-residents. However, the Assessee did not deduct any tax under section 195 of the IT Act while making payment to the non-residents. The AO deemed the Assessee to be an assessee in default under section 201(1) the IT Act and sought to recover the impugned tax amount along with interest from the Assessee.

On appeal, the CIT(A) confirmed the order passed by the AO. Aggrieved, the Assessee further appealed before the Panaji ITAT.

Issue

Whether the amendments to section 201(1) of the IT Act, which extended certain relief on non-deduction of tax to non-residents, would be applicable retrospectively?

Arguments

The Assessee argued that since the non-resident sellers had declared the income from sale of property in their return of income, the Assessee could not be considered an assessee in default as per the first proviso to section 201(1) of the IT Act. The Assessee argued that although the said amendment was effective from September 1, 2019, it should be given retrospective effect since it was only brought about to remove an anomaly under the IT Act. The Assessee drew support from the Memorandum to Finance [No. 2] Bill of 2019, which clarified that the amendment to the first proviso of section 201(1) of the IT Act was made to remove the anomaly where benefit was not available in case of non-resident payees. The Assessee also placed reliance on Article 26 of the India-UK DTAA, which provides for a non-discrimination clause, wherein a country is prohibited from treating residents and non-residents unequally.

The IRA contended that the benefit under the proviso to section 201(1) of the IT Act cannot be extended to non-residents and thus, had no application in the instant case. Further, since the Assessee was a resident, it could not avail the benefit of the non-discrimination clause under the India-UK DTAA, which was only available to non-residents.

Judgment

Panaji ITAT agreed with the Assessee and held that the amended proviso to section 201(1) of the IT Act, wherein benefits have been extended to non-resident payees, needs to be given retrospective effect since it is meant to remove an anomaly under the IT Act. On reaching this conclusion, the ITAT relied on several judicial precedents wherein curative amendments, which removed an anomaly under the IT Act, have been given retrospective application.[44] Even though the Assessee's case pertained to FY 2011-12, i.e., prior to the amendment to the first proviso to section 201(1) of the IT Act, the ITAT was of the view that the beneficial relaxations should be allowed to the resident payees under section 201(1) of the IT Act as well. The legislature had thought about this discrimination and sought to correct this anomaly by introducing the amendment *vide* the FA 2019, as evidenced by the Memorandum to Finance [No. 2] Bill of 2019. As the amendment was brought only to remove the said anomaly, it had to be given retrospective effect.

Accordingly, the ITAT decided that the Assessee could not be considered to be an assessee in default. The interest liability of the Assessee was to be accordingly recomputed and reduced.

Significant Takeways

The first proviso to section 201(1) of the IT Act provides that if a taxpayer will not be treated as an assessee in default for its failure to deduct tax if the payee declares such income in its return of income and duly pays the total tax payable thereon. Earlier, the proviso only covered 'residents' and not all 'payees.' It was amended *vide* the FA 2019 to cover non-residents as well.

Mumbai ITAT,[45] in the context of section 40(a)(i) of the IT Act, had similarly held that the extension of benefit to non-residents under the said section is applicable retrospectively. Further, the Memorandum to Finance [No. 2] Bill, 2019, also noted that the amendments to section 40 and section 201 were made to remove the anomaly under the IT Act, wherein certain reliefs

[43] M/s. Shree Balaji Concepts v. ITO (International Taxation), [TS-393-ITAT-2022(PAN)].

[44] Celltick Mobile Media Pvt. Ltd. v. DCIT (2021) 127 taxmann.com 598 (Mumbai ITAT.); CIT v. Ansal Land Mark Township Pvt. Ltd. (2015) 61 taxmann.com 45 (Delhi); CIT v. Calcutta Export Company [2018] 93 taxmann.com 51 (SC); DCIT v. Ananda Marakala (2014) 48 taxmann.com 402 (Bangalore ITAT).

[45] Celltick (supra).

were available to a resident but similar reliefs were not available to a non-resident. Thus, these amendments were curative in nature and were to be given retrospective effect. The instant case brings respite to resident purchasers who enter similar transactions with non-residents and fail to deduct tax on the same.

The Panaji ITAT, in this case, based its ruling on the intent of the legislature, as evidenced by the Memorandum to Finance [No. 2] Bill, 2019. It did not discuss the applicability of the non-discrimination clause under the India-UK DTAA.

“ Amendments to the proviso to section 201(1) should be provided a retrospective effect. ”

CASE LAW UPDATES- DIRECT TAX ROUTINE

Delhi HC differentiates between under-reporting and misreporting of income for levying penalty and directs the AO to grant immunity

In the case of ***Prem Brothers Infrastructure LLP***,[46] the Delhi HC has quashed a penalty order passed by the AO by differentiating between under-reporting and misreporting of income due to disallowance under section 14A of the IT Act and ordered the AO to grant immunity from penalty and prosecution.

Facts

Prem Brothers Infrastructure LLP ("**Assessee**") had made a disallowance under section 14A of the IT Act amounting to INR 32 Million while filing return of income for AY 2018-19. It had earned exempt income amounting to INR 4.5 Million (approx.). The assessment proceedings were initiated for the relevant AY and while passing the assessment order dated April 30, 2021, the AO enhanced the disallowance under section 14A of the IT Act to INR 68.2 Million.

Subsequently, penalty proceedings were initiated, and the AO proceeded to pass a penalty order under section 270A of the IT Act on March 28, 2022, against the Assessee, for misreporting the amount of disallowance under section 14A of the IT Act. The application filed by the Assessee under section 270AA of the IT Act, requesting immunity from penalty and prosecution proceedings, was also rejected in the said penalty order.

Aggrieved, the Assessee filed a writ petition before the Delhi HC.

Issues

Whether the action of the AO of levying penalty for misreporting of income and rejecting the application for immunity were valid?

Arguments

The Assessee had filed an application under section 270AA of the IT Act, seeking immunity from penalty and prosecution proceedings. However, the IRA did not pass a separate order under section 270AA(4) of the IT Act. Instead, the IRA simply rejected the application in the subject penalty order. The Assessee submitted that the time limit for passing order under section 270AA(4) of the IT Act is one month from the end of the month in which application seeking immunity is received by the AO and the same had expired by the time the subject penalty order was passed in March 2022. Thus, rejection of the application filed under section 270AA of the IT Act by the IRA was time barred.

The Assessee submitted that during the subject AY, it had earned exempt income of INR 4.5 Million (approx.), whereas the disallowance made by it under section 14A of the IT Act was around INR 32 Million. Relying on the order of Delhi HC in the case of *Joint Investments Pvt. Ltd.*[47], the Assessee submitted that the disallowance under section 14A of the IT Act cannot exceed exempt income. Thus, as the disallowance made by the Assessee exceeded the exempt income earned by it, no further disallowance was required to be made and accordingly, no penalty could be levied on the same.

The Assessee further submitted that the issue was related to the estimation of disallowance under section 14A of the IT Act. Referring to the provisions of section 270A(6)(c) of the IT Act, the Assessee submitted that the under-reported income shall not include a case where the disallowance has been made on the basis of an estimate and the Assessee has estimated a lower amount of disallowance, but has disclosed all the relevant material facts, information and had furnished the documents during the assessment. As all the facts were disclosed and were

[46] Prem Brothers Infrastructure LLP v. National Faceless Assessment Centre & Anr. [TS-445-HC-2022 (Del)].
[47] Joint Investments Pvt. Ltd. v. CIT, [2015] 372 ITR 694 (Del).

correctly recorded in the books of accounts maintained by the Assessee, there was no under-reporting of income and hence, penalty should not be levied under section 270A of the IT Act.

In addition, the Assessee also submitted that the issue of disallowance under section 14A of the IT Act does not fall in any of the cases mentioned for misreporting of income under section 270A(9) of the IT Act and the penalty order is also silent about the same.

On the other hand, the IRA submitted that the Assessee did not make the correct disallowance under section 14A of the IT Act and had not only under-reported income, but had also misreported income. Thus, the IRA submitted that its action of levying penalty and rejecting immunity under section 270A and section 270AA of the IT Act respectively, were right and valid.

Judgment

The Delhi HC referred to its recent judgment in *Schneider Electric South East Asia (HQ) Pte. Ltd.*[48], wherein the AO did not mention whether the penalty was getting initiated for under-reporting or misreporting of income. In the absence of clear specification of the limb in which penalty proceedings were getting initiated, the action of the IRA rejecting immunity from penalty and prosecution proceedings was held by the Delhi HC to be arbitrary and invalid.

In the instant case, only disallowance related to section 14A of the IT Act was enhanced by the AO, even though disallowance made by the Assessee was already much more than the exempt income earned during the subject AY. The Delhi HC noted that the instant case related to under-reporting of income, consequent to an increase in disallowance, which was voluntarily estimated by the Assessee.

The HC noted that the Assessee had furnished all the details of transactions relating to disallowance under section 14A of the IT Act and the AO as well as the Assessee had used the same details to arrive at different conclusions, i.e., quantum of disallowance. While there may be cases wherein under-reporting of income may lead to misreporting of income, the HC held that the same cannot be said for the facts of the instant case.

The HC also noted that the AO had not mentioned in the order how the instant case was covered under section 270A(9) of the IT Act, which exhaustively provides the ambit of misreporting of income. Thus, in the absence of providing the above details, by just referring to the word 'misreporting' makes the penalty order arbitrary, which should be quashed. Further, such an order cannot deny immunity from penalty and prosecution under section 270AA of the IT Act.

Basis the above, the HC quashed the penalty order and directed the AO to grant immunity to the Assessee under section 270AA of the IT Act from levying penalty under section 270A of the IT Act.

Significant Takeways

The penalty regime under the IT Act witnessed a revamp in FA, 2016, whereby the earlier provisions of section 271(1)(c) of the IT Act levying penalty in case of concealment or reporting inaccurate particulars of income was replaced with section 270A of the IT Act. The earlier regime gave a discretion to the AO to decide the quantum of penalty (i.e., between 100-300% of tax sought to be evaded), depending upon the circumstances and the gravity of the issue. However, the new regime provided a more structured approach wherein the penalty for under-reporting of income is 50%, whereas in case of specified situations of misreporting of income, the penalty is levied at 200% of tax payable on under-reported income.

Further, the new regime also provided an opportunity under section 270AA of the IT Act for applying for immunity from penalty and prosecution proceedings, provided the case does not fall within the ambit of misreporting of income and certain other conditions like payment of tax and interest are satisfied. This section has been brought to encourage and incentivise a taxpayer to (i) fast-track settlement of the issue; (ii) recover tax demand; and (iii) reduce protracted litigation.

Hence, it is of utmost importance that while initiating penalty proceedings, the AO should specify the limb under which the case is being classified i.e. under-reporting or misreporting. Even under the previous regime, it had been held by the Courts in a number of judicial precedents[49] that a notice initiating penalty, wherein the classification between concealment of income or for furnishing inaccurate particulars of income is not specified, is arbitrary and against the principles of natural justice.

The Delhi HC has similarly upheld that the burden of proof lies on the IRA and by not specifying the limb, the whole proceeding may be held to be arbitrary and invalid. Thus, it is clear that there is no room for ambiguities and vagueness and since penalty proceedings are separate from assessment proceedings, the notice initiating penalty should be clear in terms of the charge which the AO proposes to make.

> **“Calculation of quantum of disallowance in a specific manner is not misreporting of income.”**

[48] Schneider Electric South East Asia (HQ) Pte Ltd. v. ACIT, International Taxation Circle 3(1)(2), New Delhi and Ors. W.P.(C) No. 5111/2022 [TS-226-HC-2022(DEL)].

[49] Dilip N. Shroff v. Joint Commissioner of Income-tax, Special Range, Mumbai [2007] 161 Taxman 218 (SC); Ganga Iron & Steel Trading Co. v. Commissioner of Income-tax [2022] 135 taxmann.com 244 (Bombay); Mohd. Farhan A. Shaikh v. Deputy Commissioner of Income Tax, Central Circle 1, Belgaum [2021] 125 taxmann.com 253 (Bombay).

ITAT confirms expenditure on software development is not an intangible asset

In ***Wipro Ltd.,***[50] the Bangalore ITAT has held that expenditure incurred by a software development company to develop an 'artificial intelligence' software for internal use was allowable as revenue expenditure. The ITAT held that internal technologies and software platforms developed by the taxpayer would not constitute an intangible asset and rejected the IRA's contention that the expenses incurred in this regard ought to have been capitalised by the taxpayer.

Facts

Wipro Ltd. ("**Assessee**") is an Indian company engaged in the business of providing software services and information technology enabled services, including software development. It developed certain technologies and software platforms based on artificial intelligence and machine learning, for internal use and incurred certain expenses towards such development. A major part of this expenditure included salary costs of employees paid by the Assessee. This expenditure was claimed to be revenue in nature by the Assessee, which is deductible as business expenditure under section 37 of the IT Act. On assessment, the AO was of the view that the technologies and software platforms developed by the Assessee were 'capital assets' of intangible nature, in the hands of the Assessee. Accordingly, expenditure incurred for developing the same would be capital expenditure, which could not be claimed as deduction under section 37 of the IT Act. The DRP, *inter alia*, agreed with the view taken by the AO. Aggrieved, the Assessee preferred an appeal before the Bangalore ITAT.[51]

Issue

Whether expenditure incurred for the development of internal technologies and software platforms by the Assessee was revenue or capital in nature?

Arguments

The Assessee argued that it was engaged in the business of providing software services, wherein the employee cost is the major portion of its expenditure. Salaries paid to employees have been claimed as revenue expenditure by the Assessee routinely and the same had also been accepted by the AO year after year. There is no requirement to capitalise salary expenses. Even if salary expenses were to be capitalised, deduction should still be allowed as depreciation or as expenditure on scientific research and development. Further, the software and technology platforms developed were part of its regular business operations, meant for internal use. They were not meant to be exploited commercially but only to enhance the Assessee's in-house capabilities. They also had a short life due to fast technological obsolescence and could not be expected to give enduring benefits to the Assessee.

The IRA submitted that the Assessee had developed new applications, which were in the nature of intangible assets. This reasoning was supported by the fact that the Assessee had received a trademark for some of the technology platforms. Hence, the expenses incurred for their development, including salary paid to employees, were correctly held to be capitalised by the AO.

Judgment

Firstly, the ITAT noted that the core business of the Assessee was to develop software and generate revenue through sale/ licencing. Thus, the expenditure incurred on development of relevant software constituted revenue expenditure for the Assessee under the revenue-cost matching principle. Secondly, according to certain precedents,[52] the 'enduring benefit' test is not the most appropriate test to determine whether software constitutes 'capital assets' for technology companies and the same had to be done only by a case-by-case determination. For instance, where the software merely enhances the productive operations of a company or is held as stock-in-trade, it would not result in the acquisition of a capital asset. Lastly, since the software industry is prone to fast technological obsolescence, such softwares typically have a short life. Thus, it did not have the requisite degree of durability to fulfill the requirements of an enduring capital asset.[53]

Thus, the ITAT held that keeping in mind the business operations of the Assessee and the constantly evolving nature of the industry it operated in, the development expenditure (including salaries paid to its personnel) could only be treated as revenue expenditure.

[50] M/s. Wipro Limited v. DCIT, [TS-402-ITAT-2022 (Bang)].
[51] It may be noted that this was not the sole issue for consideration before the Bangalore ITAT.
[52] CIT v. IBM India Ltd [2013] 357 ITR 88 (Karn); Sasken Technologies Ltd. v. JCIT, ITA No. 2546/Bang/2019, MANU/IL/0210/2022 (Bangalore ITAT).
[53] Alembic Chemical Works Co. Ltd. v. CIT, 1989 SCR (2) 302; Indian Aluminium Company Ltd v. CIT, (2017) 291 CTR (Cal) 196.

Significant Takeaways

Courts have in the past, *inter alia*, applied the enduring benefit test to check whether an expenditure is capital or revenue in nature, which requires that the expense should benefit the business not just in the year in which it is incurred, but also in the years that follow. While the ITAT in the instant case initially rejected the test of enduring benefits, it finally stated that this test was not fulfilled due to technology requiring constant improvements/ further development to remain commercially viable in the market, in the absence of which, it would cease to remain useful to the Assessee. A similar reasoning has been given by the Delhi HC, when dealing with a matter which involved use of software which required constant upgradation.[54] It was held that the expression capital or revenue expenditure must be construed in business sense and by applying sound accountancy principles, unless there is a statutory mandate to the contrary. Accordingly, such software failed the test of enduring benefits and could not be treated as a capital asset.

This judgment is relevant not just for companies engaged purely in the creation or sale of technology, but also for other businesses, which use internal technology processes and continuously upgrade the same in order to stay competitive in the market. Since the COVID-19 pandemic, many businesses have moved online and/ or incorporated technological processes within their operations. If this technology is developed or acquired for the purpose of enhancing in-house capabilities such that it constitutes normal research expenses, necessary in their line of business, and does not provide any enduring benefit, expenses incurred for the same may be claimed as revenue expenditure. While it can be easier to prove the ephemerality of technological processes/ software in the technology sector, this may prove a challenge in more traditional sectors, which have recently started adopting technological processes to remain competitive in the changing market. However, keeping in mind the commercial exigencies of every business, it may be possible to claim such deductions.

> **“ Expenses incurred by a software developer for in-house use should be considered as revenue expenditure. ”**

[54] Oracle India (P.) Ltd. v. CIT [2013] 39 taxmann.com 150 (Delhi).

Secondment of employees may be in the nature of manpower service and attract service tax

In the case of ***Northern Operating Systems Pvt. Ltd.***[55]**,** the SC has held that operational or functional control over seconded employees was not the determining factor to identify the existence of an employee-employer relationship.

Facts

Northern Operating Systems Pvt. Ltd. ("**Assesseee**") is engaged in providing back office and operational support to group companies located in various countries such as the US, UK, Singapore, etc. The Assessee had also entered into secondment agreements with them for deputation of employees. The agreements provided that, *inter alia*, (i) employee shall work as per instruction of Assessee; (ii) the seconded employees would remain on the payroll of the group firm (foreign entity) for the purpose of continuing to receive social security/ retirement benefits; (iii) Assessee would be the employer for all practical purposes. The Assessee was required to issue a letter of employment to the seconded personnel outlining the employment requirements. However, the salary, bonus, benefits, etc., were to be received from group companies. The group companies charged for these amounts from the Assessee. The seconded employees were also required to file return of income in India and contribute to provident fund.

The IRA issued multiple show cause notices pertaining to different periods to the Assessee alleging that it had failed to discharge service tax on import of "manpower recruitment or supply agency service" with regard to certain seconded employees. While the Assessee replied to such allegations, the IRA confirmed the demand for the period prior to April 2012. Aggrieved, the Assessee filed an appeal before CESTAT. However, the IRA also appealed before CESTAT for the same issue for two other years. The CESTAT agreed with the Assessee's submission and allowed its appeal. Aggrieved, the IRA filed an appeal before the SC.

Issue

Whether secondment of employees can be treated as manpower recruitment or supply agency service exigible to service tax?

Arguments

The IRA asserted that the Assessee, as per terms of contractual arrangement, was providing back office and operational support to group companies who were supplying employees on secondment. The agreement with the employees demonstrated that the overseas employer provided the Assessee with the services of its employees for the completion of tasks provided by the overseas group company. The seconded employees were only operationally under the Assessee's authority for a limited time. Thus, there was no complete control over how the tasks assigned to the employees were performed.

This arrangement was necessary because the Assessee would not have been able to ensure the fulfilment of tasks it was required to undertake as per the main contract of back office services without involving seconded employees. Nonetheless, once the assignment was over, the personnel returned to their former positions in the overseas companies to work there or be deployed elsewhere in accordance with the global policy. The fact that the overseas company had temporary control over the manner in which the seconded employees performed their jobs did not change or reduce the fact that their true employer was the overseas company. The foreign employer determined the salary, allowances, and duration of the secondment and not the

[55] CC, CCE & ST Bangalore v. Northern Operating Systems Pvt. Ltd., 2022 (5) TMI 967 SC.

Assessee. Such secondment was necessary in order to ensure the quality demanded by the overseas employer. The tasks they completed were in support of the Assessee's work, which it was doing as part of a service agreement with an overseas company. Therefore, a combined reading of the contracts established that the arrangement between the Assessee and its foreign group companies was one of a 'contract for service'.

On the other hand, the Assessee asserted that the employee-employer relationship was not covered under the definition of service and was outside the ambit for levy of service tax. The category of manpower supply refers to situations in which the manpower was directed and controlled by the recipient without being employed contractually. The seconded employees were hired as the Assessee's employees on a contractual basis. The Assessee exercised control over them, and such employees gave all of their time and effort to Assessee. The employees also reported to the designated office of the Assessee. They were accountable to the Assessee for their performance; the method of dispersing pay and allowances was exclusively for the convenience of the expat's home country's social security benefits.

The Assessee also argued that the service tax demand was calculated based on the salary and allowances paid to the employees. Any reimbursement of a cost or expense does not represent the total value of a taxable service and so cannot be used to justify the charge of service tax. The Assessee also urged that it had genuine impression that the seconded personnel were its own employees, and hence were not covered under the scope of manpower supply services. Finally, it was also argued that it is a revenue neutral situation as foreign services received by the Assessee would qualify as input services, and credit for service tax paid on such input services could have been availed. Thus, there was no loss to the exchequer.

Judgment

The SC held that the Assessee was a recipient of manpower supply service from the foreign company. The court heavily relied on the terms of agreement and observed that the total compensation package, including allowances and other benefits, was expressed in foreign currency. The seconded employees enjoyed benefits such as special hardship stipend for working in India, a monthly housing allowance, and an annual utility allowance. These benefits could only have been obtained by relying on the overseas employer's standardised policy. It also observed that the foreign company employs a pool of highly skilled workers who were entitled to a set of pay and perks, as well as social security benefits. They were assigned to the Assessee for the purpose of putting their expertise to practise. The seconded employees either returned to their overseas job or were deployed on another secondment after their period of secondment ended. Hence, it concluded that there was a lien between the foreign company and the seconded employees. Thus, the seconded employees were not employees of the Assessee.

However, the SC agreed that it was an interpretation issue and there was no suppression of facts by the Assessee. Hence, the extended period of limitation was not invocable.

Significant Takeaways

The aforementioned decision is a breakthrough one as the SC has held that secondment arrangement can be treated as manpower supply service agreement. The decision would have far-reaching implications for various industries. Even though a taxpayer retains authority and the capacity to dismiss personnel in India, seconded employees retain a lien on their employment in the group company and hence cannot be regarded as the taxpayer's employees. The operational and functional control would not automatically qualify a seconded employee to be treated as an employee of the company where he would work for a temporary period. The reimbursements were also viewed as a form of consideration for calculating the taxpayer's total benefit from the transaction.

The taxpayers in India receiving employees on secondment from foreign entities would now have to be more careful while discharging GST, as the IRA may treat it as import of service. The decision may also impact the responsibilities under the IT Act, as the taxpayers would have to identify if the obligation to deduct TDS towards salary paid to seconded employees and if the services provided by the foreign entity can constitute FTS.

> **“ Applicability of policies of company seconding its employee to determine applicability of service tax. ”**

Advertisement Tax can be levied separately from GST

In the case of ***Hubbali Dharwad Advertisers Association***[56], the Karnataka HC has held that there was no clash between levy of advertisement tax by municipal corporation and levy of GST by the State and Centre, post implementation of GST.

Facts

Hubbali Dharwad Advertisers Association is an association representing various advertising agencies ("**Petitioner(s)**") engaged in the business of advertisement on hoardings licenced by Mahanagar Palika ("**Assessee**"). The Petitioners had been depositing advertisement tax to the Assessee. As GST was introduced w.e.f. July 1, 2017, the Petitioners were of the view that henceforth, the Assessee had no authority to collect advertisement tax.

Basis the above, the Petitioner filed a writ petition challenging the levy of advertisement tax.

Issue

Whether advertisement tax can be levied post implementation of GST?

Arguments

The Petitioner contended that Entry 55 of list II of Schedule VII of the Constitution, which deals with the levy of advertisement tax, was deleted by a constitutional amendment. Thus, the Assessee had no power under section 154 of the Karnataka Municipal Corporations Act, 1976 ("**KMC Act**"), to collect advertisement tax post July 1, 2017. They relied upon the decision of Allahabad HC in the case of *Selvel Media*,[57] wherein the HC had held that in terms of section 173 of the Uttar Pradesh GST Act, 2017, the power of legislature to collect advertisement tax on advertisement hoardings was deleted from the Uttar Pradesh Municipal Corporation Act, 1959. The Petitioners also argued that the levy of GST and advertisement tax amounts to double taxation on the same activity, which was not permissible.

On the other hand, the Assessee urged that the power to collect advertisement tax on advertisement hoardings had not been deleted from the KMC Act. Thus, the reliance placed upon by the Petitioner on the Allahabad HC's decision was incorrect. The Assessee argued that the advertisement tax was not a tax, but a fee imposed for allowing exhibition of advertisement on hoardings located on the land of the Assessee or private parties. Without payment of such fee, no person was allowed to use advertisement hoardings. This fee had no relationship with the GST charged by the Government. In this regard, it also relied on the Gujarat HC decision, which had decided that advertisement tax was a fee. [58]

Judgment

The Karnataka HC reviewed the constitutional provision implementing GST and stated that GST was levied on supply of goods or services. In the present case, the levy of GST was on services rendered to clients and was not in relation to permission granted by the Assessee. The Assessee was providing license/ permission to the Petitioner to use hoardings located on the Assessee's land or private party's land. Thus, the levy of advertisement tax was on licence granted by them. Hence, there are two different independent transactions on which tax is being levied, i.e. under GST (use of hoarding for advertisement on behalf of clients) and KMC Act (permission to use hoarding for advertisement). Hence, there was no double taxation on the same transaction.

The HC also observed that while Entry 55 of list II of Schedule VII of the Constitution has been deleted, Article 243-X of the Constitution provides the power to state legislature to allow imposition and collection of tax. The Municipal authority has the power to collect tax as per procedure laid down under the State Act. Hence, the KMC Act provided to the Assessee the power to collect advertisement tax.

Hence, it held that there was no clash between GST and advertisement tax levied by the Assessee.

Significant Takeaways

While the aforementioned decision goes against the spirit of one nation one tax, the decision highlights a relevant point that all state GST legislations have not repealed their individual state specific levies like advertisement tax. It also raises a concern regarding compensation cess, which was introduced to counter the effect of subsuming multiple taxes, including the levy of advertisement tax. This decision also questions the very omission of Entry 55 of list II of Schedule VII of the Constitution by the 101st Constitutional amendment.

[56] Hubbali Dharwad Advertisers Association v. State of Karnataka, TS(DB)-GST-HC(KAR)-2022-254, (Karnataka HC).
[57] Selvel Media Services Pvt. Ltd. v. State of UP, 2019 (5) TMI 728 (Allahabad HC).
[58] Selvel Media Services Pvt. Ltd. v. State of Gujarat, 2020 (10) TMI 1219 (Gujarat HC).

It can only be hoped that the SC takes cognizance of this issue and adjudicates on this issue conclusively as many States may take this as an opportunity to reintroduce advertisement tax or other levies, relying on the wide power granted under Article 243X of the Constitution and treat that deletion of Entry 55 as redundant. However, till that time, taxpayers would have to bear GST as well as state advertisement tax.

> **“ Advertisement tax can continue to be collected since it is independent of GST levy. ”**

Adjusted total turnover for refund computation excludes domestic supplies attracting Nil duty

In the case of ***Electrosteel Castings Ltd.***[59]***,*** the Calcutta HC has ruled that domestic supplies of finished goods attracting a Nil rate of compensation cess ("**Cess**") were to be counted as exempt supplies for the purposes of refund calculation, and thus deserved to be excluded from the calculation of adjusted total turnover.

Facts

Electrosteel Castings Ltd. ("**Petitioner**") is engaged in the business of manufacturing ductile iron spun pipes and fittings. The Petitioner utilised coal as an input which attracted cess. The Petitioner availed ITC on the Cess paid. Some of its domestic supplies did not attract Cess, accordingly the Petitioner treated them as exempt supplies and reversed a proportion of ITC (amounting to ~ INR 70 Million) on account of the same. The Petitioner claimed refund of unutilised ITC, amounting to INR 37.5 Million (approx.) for undertaking export of goods. The refund computation excluded the value of exempt supply for the purposes of adjusted total turnover. The Petitioner accordingly excluded turnover of domestic supplies that did not attract Cess for the purpose of adjusted total turnover. The Petitioner obtained a favourable order at the appellate stage in this regard. However, the IRA did not disburse the refund even after repeated requests.

Aggrieved, the Petitioner approached the Calcutta HC by filing a writ petition. The IRA also filed a writ challenging the order on the ground that it was perverse and the order incorrectly interprets the GST legislation.

Issue

i. Whether goods which are subject to nil rate of Cess can be construed as exempt supplies?

ii. If yes, whether the turnover of such goods can be excluded from the calculation of adjusted total turnover for computation of refund?

Arguments

The Petitioner objected to the writ petition filed by the IRA on the ground that the HC should not interfere with the order of the Appellate authority by exercising its constitutional writ jurisdiction as an appellate mechanism against the order, as is prescribed under law. There was no jurisdictional excess or error in passing the order by the Appellate authority.

On merits, the Petitioner argued that when calculating adjusted total turnover, the formula established under Rule 89 (4) of the CGST Rules categorically excludes the value of exempt goods other than zero rated supplies. While "exempt supply" was not defined in the GST (Compensation to States) Act, 2017 ("**Cess Act**"), the same was defined in CGST Act, which applies mutatis mutandis to the Cess Act. The Petitioner urged that the IRA has ignored the phrase *"mutatis mutandis"* found in the Cess Act and has failed to explain why domestic deliveries of completed goods, subject to a nil rate of Cess, cannot be understood as exempted supplies. Refund of unutilised ITC could be obtained using the formula prescribed under rules. The Petitioner contended that the IRA was taking two contrary positions at the same time.

The Petitioner also claimed that the net ITC in the computation of refund has been proportionally reversed due to the supply of finished goods that were not subject to the Cess. The reversal was made on the premise that it was an exempt supply for the purposes of the Cess Act, which has not been challenged by the IRA. While the formula for determining the refund amount explicitly excludes the value of exempt supplies in the adjusted total turnover, the IRA is including the same by not treating it as exempt supply.

On the other hand, the IRA asserted that the adjusted total turnover would include the domestic supplies even when no Cess was paid as GST was payable on them. It also contended that the order passed by appellate authority was perverse as it failed to consider the definition of non-taxable supply, which deals only with GST and not Cess.

Judgment

The HC observed that the GST law governs the refund of ITC of Cess where zero-rated supply of goods is concerned. When calculating adjusted total turnover, the formula explicitly excludes the value of exempt supply. The definition of "exempt supply" under the CGST Act would apply *mutatis mutandis* to the computation of Cess ITC refunds.

According to the legislative framework of the Cess Act, Cess was an impost to compensate states for revenue lost due to the subsumption of various taxes with the implementation of the

[59] The Principle Commissioner, CGST & Ors. v. Electrosteel Castings Ltd., TS-298-HC(CAL)-2022-GST (Calcutta HC).

GST regime. As a result, Cess was a levy that combined the characteristics of all the levies that are now incorporated within the GST. Provisions of the CGST and IGST Acts would be clearly applicable to the Cess Act, given the deliberate use of the word "*mutatis mutandis*". Thus, for the purposes of the Cess Act, the terms tax and Cess must be used interchangeably. Non-taxable supply is included in the definition of "exempt supply", which is defined as a supply that attracts a nil rate of tax or is fully exempt from tax.

The HC ruled that domestic deliveries of completed goods that are not subject to Cess should be counted as exempt supplies and should be excluded from adjusted total turnover for the purpose of computing ITC refund arising on account of Cess. As a result, the HC ordered the IRA to refund the money in accordance with the appellate authority's decision.

The HC also held that it did not want to act as an appellate authority where the appellate authority had provided convincing reasons with all the details for its decision.

Significant Takeaways

The aforementioned decision will provide a much-needed boost to the working capital of a business, which was disbursed lower amount of refund on account of incorrect interpretation by the IRA. This judgment re-instils the fundamental objective of the GST legislation that is to promote business friendly landscape and to not export taxes out of India. The legislation must not differentiate between ITC of GST and ITC of Cess as both are taxes under the GST legislation.

"CGST Act applies mutatis-mutandis to Cess Act."

CENVAT credit is unavailable for CSR expenses

In the case of ***M/s. Power Finance Corporation Ltd.***[60], the CESTAT has held that corporate social responsibility ("**CSR**") activities undertaken to comply with the Companies Act, 2013 ("**Companies Act**"), did not qualify as being incurred in the course of business and the company was not eligible for CENVAT credit under service tax legislations.

Facts

M/s. Power Finance Corporation Ltd. ("**Appellant**") is a non-banking finance company that finances projects and has been paying service tax on banking and other financial services. The Appellant had been procuring a variety of inputs and input services that were used in providing services. The Appellant had also taken CENVAT Credit on service tax paid for services used for activities related to its CSR. A show cause notice was issued, asking the Appellant to show cause why CENVAT Credit for the period between April 1, 2011, and December 31, 2015, should be allowed on the ground that it did not qualify as input service for its output services. The same was upheld by the adjudicating authority.

Aggrieved, the Appellant filed an appeal before CESTAT.

Issue

Whether expenses incurred by the Appellant for its CSR activities qualify as being incurred in the course of business and are eligible for credit?

Arguments

The Appellant contended that CSR activities undertaken by it were to comply with the requirements of the Companies Act and were compulsory to run its business. Non-compliance would expose the Appellant to penal consequences. The definition of "input service" includes all activities that were used for rendering output services. Hence, as CSR activities were an essential part of the business process, they were to be treated as input services. In this regard, it relied upon a previous CESTAT ruling where the CESTAT had allowed availment of credit for CSR activities. [61]

IRA, on the other hand, asserted that to ascertain whether a service was "input service", as defined under Rule 2(l) of CCR, the service must be used by a provider of output service for providing an output service. Unquestionably, the Appellant had a duty to undertake CSR related activities in accordance with the Companies Act, but that duty had nothing to do with the services offered. Nexus with service rendered was an essential condition for availing credit. If the Appellant makes a profit after rendering the services or otherwise satisfies other requirements outlined in the Companies Act, it was required by law to contribute money to CSR. These duties by themselves do not qualify as input services for the Appellant's output services. The output service in this situation was "banking and other financial service", and the CENVAT Credit used for CSR expenses had absolutely nothing to do with it.

Judgment

CESTAT observed that most of the companies earning profit would have obligations to its stakeholders, including the payment of bonuses, incentives connected to productivity, and a mandated financial contribution to CSR initiatives. All these obligations arise because the Appellant is working in India. According to a plain reading of relevant provisions, only services used by an output service provider for the provision of output services qualify as "input services", not any services used by the provider of output services in operating its business. If the legislative goal had been to allow CENVAT Credit to be claimed for all services, the rules would have stated "any service used by the provider of output". CSR activities have no nexus to providing any services.

CESTAT also observed that the definition of input service has an inclusion and exclusion clause. CSR activity has not been mentioned under either of them. CESTAT also provided its reason for not relying on the earlier decision. CESTAT differentiated its view from the decision of Karnataka HC in *Millipore India Pvt. Ltd.*[62] case, by stating that it was in relation to other input services such as landscaping of garden, insurance, etc., and the HC in that case had just made a passing reference to CSR activities (as it was not in dispute).

In relation to *Essel Propack Ltd.*[63], CESTAT was of the view that Rule 2(l) does not list "activities relating to business" as an input service and the decision was not in consonance with established proper legislation. CESTAT was not authorised to change or broaden the application of this rule because that was a legislative or quasi-legislative function. Thus, CESTAT held that the definition of input services cannot be understood to include the phrase activities pertaining to business. The Appellant was not entitled to CENVAT Credit for the services used for CSR.

60 M/S. Power Finance Corporation Ltd. v. Commissioner (Appeal), Central Excise & Service Tax, LTU, New Delhi 2022 (6) TMI 582 - CESTAT NEW DELHI.
61 Essel Propack Ltd. v. Commr. Of CGST Bhiwandi reported as 2018 (362) ELT 833 (Tri-Mumbai).
62 Commr. of C. Ex, Bangalore v. Millipore India Pvt. Ltd., 2012 (26) STR 514 (Kar.).
63 Essel Propack Ltd. v. Commr. Of CGST Bhiwandi reported as 2018 (362) ELT 833 (Tri-Mumbai).

Significant Takeaways

The aforementioned ruling is the first negative ruling under service tax legislation, disallowing availability of credit on service tax paid at the time of procurement of goods/ services for CSR activities.

The decision may also impact availability of ITC under GST legislation. As of now, the Uttar Pradesh AAR in In re *Dwarikesh Sugar Industries Ltd.*[64] has held that CSR activities undertaken to comply with the Companies Act qualify as being incurred in the course of business and were eligible for ITC under GST legislations. However, the Kerala AAR in the case of *M/s. Polycab Wires Pvt. Ltd.*[65] had ruled adversely. It disallowed the availment of ITC on free distribution of electric items like switches, fans, cables, etc., to flood affected areas in light of section 17(5)(h) of CGST Act, 2017.

As all companies meeting a particular threshold are required to undertake CSR activities under the provisions of the Companies Act, a number of litigations on availment of ITC may reach various Courts in the near future. Therefore, the CBIC may consider issuing a clarification to nip the budding issue before taxpayers are issued show cause notice for wrongful availment of ITC.

> **“ CSR activities are not input services. ”**

64 In re Dwarikesh Sugar Industries Ltd., [2021] 125 taxmann.com 329 (AAR- Uttar Pradesh).

65 M/s. Polycab Wires Private Limited [2019 (24) G.S.T.L.103 (A.A.R.–GST)]

REGULATORY DIRECT TAX UPDATES

CBDT issues Circular clarifying the implementation of the SC decision in the Union of India v. Ashish Agarwal

The SC in its decision in *Union of India v. Ashish Agarwal*[66] revived several reassessment notices, which were previously quashed by HCs across India.

Since the amendments brought about by FA 2021, the reassessment procedure has been entirely revamped (effective from April 1, 2022). However, by exercising its power under the Taxation and Other Laws (Relaxation and Amendment of Certain Provisions) Act, 2020 ("**TOPA**"), the CBDT extended the limitation for issuing notices under the unamended section 148 of the IT Act till June 30, 2021. Several taxpayers challenged the reassessment notices issued after April 1, 2021, before HCs on the ground that the notices did not comply with the amended reassessment procedure. In a majority of writ petitions, HCs quashed these reassessment notices for having failed to have complied with the procedural rigors introduced in FA, 2021. Subsequently, the SC overturned these decisions, and revived the reassessment notices, subject to them being deemed to be 'show-cause notices' under section 148A of the amended IT Act to which taxpayers must respond and, basis which, a determination shall be made as to a section 148 notice being issued. The SC directed AOs to provide taxpayers with relevant materials on the basis of which their assessment has been reopened within 30 days. Subsequently, the taxpayer would have two weeks to respond to the AO.

Subsequent to this decision, on May 11, 2022, the CBDT issued an Instruction[67] clarifying the implementation of the SC directions in relation to notices issued between April 1, 2021 and June 30, 2021.

Operation of amended section 149

The CBDT clarified that rights available to the taxpayer under FA 2021 would be available in relation to the reassessment notices issued after April 1, 2021, including the amendments made to section 149 of the IT Act.

The amended section 149 of the IT Act provides that a reassessment notice must be issued within three years of the relevant AY being reopened for it to be valid. However, a reassessment notice may be issued after three years but before 10 years from the relevant AY if the AO is in possession of sufficient evidence to suggest that the income which has escaped taxation is over INR 5 Million.

Based on this, the CBDT provided that the reassessment notices are to be dealt with as under:

1. For AYs 2013-14, 2014-15, and 2015-16: Fresh notices under section 148 of the IT Act could only be issued if the amount escaped is over INR 5 Million
2. For AYs 2016-17 and 2017-18: Fresh notices could be issued under section 148 of the IT Act since they were within the period of three years of the relevant AY.

Considering this, the CBDT clarified through the Instruction that the information relating to notices issued after April 1, 2021, for income escaped in AYs 2013-14, 2014-15 and 2015-16 need not be supplied to taxpayers, unless the amount escaped is over INR 5 Million.

66 Union of India v. Ashish Agarwal, 2022 SCC OnLine SC 543 (SC).
67 CBDT Instruction No. 01/2022, Dated May 11, 2022.

Procedure to be followed

Additionally, the CBDT also clarified the procedure that is expected to be followed by AOs issuing notices under section 148 of the IT Act.

- The AO must furnish relevant information to the taxpayer within 30 days of the SC judgment (i.e., June 2, 2022)
- Thereafter, the taxpayer shall have two weeks to respond to the notice to show why a notice under section 148 of the IT Act should not be issued.
- All defenses available to the taxpayer under the amended IT Act (post the FA 2021) shall be available to the taxpayer.
- The AO may make an application requesting more time be given to file a reply to the show-cause notice, in which case, the request shall be considered on merit and an extension may be granted subject to section 148A(b) of the IT Act (i.e., the time given to file a reply shall not be more than 30 days since the date of show cause notice).
- On the basis of the material available on record and the reply filed by the taxpayer, the AO shall pass an order under section 148A(d) of the IT Act, making a determination as to whether the case is fit for assessment and therefore must be reopened.
- If the case is found fit for reassessment, then a notice under section 148 of the IT Act shall be issued to the taxpayer.
- In case, the case is not found fit for reassessment, the order under section 148A(d) of the IT Act shall be intimated to the taxpayer.

CBDT issues guidelines under section 194R of the IT Act

The FA 2022, *inter alia*, introduced section 194R in the IT Act, which provides for deduction of tax at source on providing any benefit or perquisite to a resident, arising from such resident's business or profession. The said provision mandates the person responsible for providing such benefit/ perquisite to deduct tax at the rate of 10% of the value or aggregate of the value of benefit/ perquisite. To remove difficulties in implementing the provisions of section 194R of the IT Act, the CBDT recently issued guidelines[68] to clarify the scope of the said section. The key takeaways from the guidelines are provided below:

1. There is no requirement to confirm whether the benefit/ perquisite is taxable under the IT Act (under section 28(iv) of the IT Act or any other provision). The obligation to deduct tax under section 194R of the IT Act exists while providing any benefit or perquisite to a resident, irrespective of taxability.
2. The provisions of section 194R of the IT Act apply when the benefit or perquisite is paid wholly in cash.
3. Providing capital assets (such as land, cars, furniture, etc.) are also covered within the ambit of section 194R of the IT Act.
4. Sales discounts, cash discounts and rebates are not covered under section 194R of the IT Act.
5. Section 194R is not applicable if the benefit or perquisite is being provided to a Government entity that is not carrying on business or profession (such as a Government hospital).
6. FMV of benefit/ perquisite would be relevant for determining the valuation of such benefit/ perquisite except where:
   a. The benefit/ perquisite has been purchased prior to providing it to the recipient, the purchase price shall be considered the value of the benefit/ perquisite; or
   b. The benefit/ perquisite is manufactured by the deductor, then the price that it charges to its customers will be considered the value of such benefit/ perquisite.
7. GST will not be included for valuation of benefit/ perquisite.
8. Promotional products given to social media influencers will be covered under section 194R of the IT Act, unless such products are returned to the deductor after use.
9. If expenses incurred by the service provider are reimbursed by the service recipient, then such reimbursement shall be treated as benefit/ perquisite, unless the invoice for the same has been obtained in the name of the service recipient.
10. With respect to dealer/ business conferences, the following will be considered as benefit/ perquisite:
    a. Expense attributable to leisure trip or leisure component, even if it is incidental to the dealer/ business conference.
    b. Expenditure incurred for family members accompanying the person attending dealer/ business conference.
    c. Expenditure incurred for participants of dealer/ business conference for days that are on account of prior stay or overstay beyond the dates of such conference.
11. Where the benefit/ perquisite is wholly or partly in kind, advance tax may be paid by the recipient and the deductor can rely on a declaration, along with the challan furnished by the recipient. Alternatively, if the deductor himself deducts

[68] Circular No. 12 of 2022, dated June 16, 2022.

and deposits tax under section 194R, such tax paid by the deductor will also be considered a benefit under section 194R.

12. Calculation of threshold limit of INR 20,000 will be from April 1, 2022, and provision of section 194R of the IT Act will apply on any benefit/ perquisite provided on or after July 1, 2022.

It may be noted that section 194R(2) of the IT Act authorises the CBDT to issue guidelines, with the approval of the Central Government. These guidelines are required to be laid before each House of the Parliament and are binding on the IRA and the taxpayers.

CBDT issues guidelines under section 194S of the IT Act

The FA 2022, *inter alia*, introduced section 194S in the IT Act, which provides for deduction of tax by any person who is responsible for paying any consideration to a resident in India in lieu of transfer of virtual digital assets ("**VDAs**"). The said provision mandates that tax needs to be deducted at the rate of 1% at the time of payment or credit of any sum to any resident as consideration for transfer of a VDA. To remove difficulties in implementing the provisions of section 194S of the IT Act, the CBDT recently issued guidelines[69] to clarify the scope of the said section. The key takeaways from the guidelines are provided below:

1. In a peer-to-peer transaction, the buyer is required to deduct tax under section 194S of the IT Act.
2. Where a buyer is paying the exchange (and the exchange does not own the VDA), which is then making payment to the seller, tax will be deducted by the exchange.
3. If the credit or payment between an exchange and a seller is through a broker (and the broker is not a seller), both the exchange and the broker will be liable to deduct tax. However, the broker may solely deduct tax if the exchange and the broker enter into a written agreement to this effect.
4. Where the VDA is owned by the exchange, obligation to deduct tax lies on the buyer or their broker. However, the exchange may deduct tax if there is a written agreement to this effect. The exchange will be required to furnish a quarterly statement (Form 26QF) for all such transactions.
5. Where consideration is paid partly or wholly in kind, the person responsible for deducting the tax needs to ensure that the tax has been paid before releasing the consideration.
6. Buyer or their broker may enter into a written agreement with the exchange such that the exchange agrees to deduct tax under section 194S of the IT Act with respect to transactions on the exchange's platform. In such case, buyer/ broker will not be considered an assessee-in-default for failure to deduct tax.
7. Where one VDA is exchanged for another, both parties will be considered 'buyers' under section 194S of the IT Act and have corresponding obligation to deduct tax. For practical purposes, responsibility to deduct tax may be shifted to the exchange under a written agreement in such cases.
8. Where tax is once deducted under section 194S of the IT Act, it would not be required to be deducted again under section 194Q of the IT Act.
9. TDS under section 194S will be on a "net" basis after excluding GST/ other charges levied by the deductor for rendering services.
10. No tax is to be deducted by payment gateways under section 194S of the IT Act.
11. Calculation of consideration for transfer of VDA, triggering deduction under section 194S of the IT Act shall be considered from April 1, 2022, while obligation to deduct tax under section 194S will begin from July 1, 2022.
12. If the buyer is a non-specified person, tax shall be deposited as per existing withholding provisions and the statement shall be filed in Form 26Q. Whereas, if the buyer is a specified person, the tax shall be deposited and the statement shall be filed through a challan-cum-statement in Form 26QE.

It may be noted that section 194S(6) of the IT Act authorises the CBDT to issue guidelines, with the approval of the Central Government. These guidelines are required to be laid before each House of Parliament and are binding on the IRA and the taxpayers.

CBDT amends compliance check functionality for identifying non-filers of returns

By way of FA 2021, sections 206AB and 206CCA were inserted in the IT Act, which provide for tax deduction and collection respectively, at a higher rate in case of certain non-filers (specified persons). The term "specified persons" was defined as a person who satisfied both conditions i.e., (a) had not filed the return of income for two PYs for which the due date of filing of return of income under section 139(1) of the IT Act has expired;

[69] Circular No. 13 of 2022, dated June 22, 2022; and Circular No. 14 of 2022, dated June 28, 2022.

and (b) the aggregate of TDS or TCS for these two years was INR 50,000 or more.

In order to enable the deductor/ collector to easily identify whether the deductee/ collectee is a specified person, a compliance check functionality was released by the IRA.

By way of FA 2022, the abovementioned sections 206AB and 206CCA of the IT Act have been amended to restrict the definition of specified person to a person who has not filed return of income for the immediately preceding PY. Further, certain relaxations have been made with regard to applicability of these sections on certain payments like virtual digital asset, rent, etc.

In accordance with the above, the CBDT has recently issued a Circular[70] whereby the amended logic for identification of a specified person has been provided and explained. The same may be used to understand the manner in which the compliance check functionality is utilised and how its applicability may be referred by various taxpayers.

However, the Circular makes a disclaimer that the functionality does not contain details of non-residents who have a PE in India. Hence, in case of making or collecting payment from such non-residents, the deductors/ collectors are required to make their own judgment and carry out necessary due diligence in this regard.

Further, the Circular also clarifies that since the compliance check functionality has been developed to provide ease of compliance, there is no need for the deductor/ collector to ask for the relevant information and evidence of furnishing of return of income from the relevant deductee/ collectee.

For providing the details of the changes in the compliance check portal, the CBDT has also issued a *Notification*[71] detailing the procedures and steps to be taken by the deductors/ collectors.

70 CBDT Circular No. 10/ 2022 dated May 17, 2022
71 CBDT Notification No. 01 of 2022, DGIT(S)/ADG(S)-21, Compliance Check/432/2021-22 dated June 9, 2022

Extension for furnishing project certificate for availing concessional customs rate benefit

The CBIC *vide* Notification No. 31/2022-Customs dated June 7, 2022 has extended the time period for furnishing the final Mega power project certificate from 120 months to 156 months and the period of validity of security in the form of Fixed Deposit Receipt or Bank Guarantee from 126 months to 162 months, in case of provisional mega power projects for availing the concessional customs rate benefit.

Electronic Cash Ledger under Customs

The Government *vide* Notification No. 20/ 2022-Customs, dated March 30, 2022, announced the date for enforcement of the chapter pertaining to electronic cash ledger w.e.f. June 1, 2022. In this regard, CBIC has notified Customs (Electronic Cash Ledger) Regulations, 2022, detailing the procedure of maintaining cash ledger, manner of making payments, and claiming of refund. However, now *vide* Notification No. 47/2022-Customs (N.T.), dated May 31, 2022, the CBIC has exempted the deposit of cash in electronic cash ledger for all class of persons and all categories of goods till November 29, 2022. Post this, only the following category would be exempted from the deposit of cash in electronic cash ledger:[72]

a) goods imported or exported in customs stations where customs automated system is not in place;

b) accompanied baggage; and

c) any payment other than customs duty, IGST, cess, surcharge, interest or penalty.

Deposit of GST during the course of search, inspection or investigation

The CBIC *vide* Instruction No. 01/2022-23 (GST-Investigation), dated May 25, 2022, has clarified the mechanism for voluntary payment of GST to safeguard the interest of taxpayers. The law specifically provides for recovery of short paid or unpaid taxes post adjudication of show-cause notice issued for such default. Thus, no recovery can occur during search, inspection or investigation. The law also provides for voluntary payment of taxes before the issuance of show-cause notice by submitting DRC-03 on GSTN portal. Thus, the taxpayer has the option to voluntarily pay GST during search, inspection or investigation. The CBIC has also clarified that if any complaint is received for use of force or coercion by any tax officer, a proper enquiry would be undertaken against such officer.

Relaxation in requirement to submit Bill of Export as an evidence of export obligation

DGFT *vide* Policy Circular 39/2015-20, dated June 7, 2022, has relaxed the condition for submitting bill of export in case of exports made by SEZ units under Advance Authorisation for supplies made prior to April 01, 2015. In order to discharge export obligation, the taxpayer would be required to submit corroborative evidence such as:

a. ARE-1 form attested by jurisdictional officer;

b. Evidence of receipt issued by the SEZ unit; or

c. Evidence of payment made by the SEZ unit.

[72] Notification No. 48/2022-Customs (N.T.) dated May 31, 2022.

Paper Import Monitoring System

DGFT Notification No. 11/2015-20, dated May 25, 2022, has notified the requirement to mandatorily register the importation of certain specific paper under the paper import monitoring system within 5-75 days before the expected date of arrival of import. The system will be effective from October 1, 2022.

Telangana State One Time Settlement Scheme

The state government of Telangana *vide* G.O.M. No. 45, dated May 9, 2022, introduced a settlement scheme for settling arrears pending at various stages of litigation for multiple legislation. The benefits announced are as follows:

Situation (ii):

Legislation	Tax Benefit	Interest and Penalty benefit
Andhra Pradesh General Sales Tax Act, 1957	40% of balance tax will be collected from the dealer and remaining 60% of demand will be waived off.	For the dealers/ persons availing the scheme, the interest and penalty shall be waived off
Telangana Value Added Tax Act, 2005, and CST Act	50% of balance tax will be collected from the dealer and the remaining 50% of demand will be waived off.	
Telangana Entry of Goods into Local Areas Act, 2001	60% of balance tax will be collected from the dealer and the remaining 40% of demand will be waived off.	

The scheme however comes with the following conditions:

a. Each AY would be treated as a distinct unit.

b. 100% of undisputed tax shall be payable by the taxpayer.

c. Taxpayer would not be eligible for refund under this scheme.

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
BEPS	Base Erosion and Profit Shifting
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
DDT	Dividend Distribution Tax
DIT	Learned Director of Income Tax

GLOSSARY

ABBREVIATION	MEANING
DGFT	Directorate General of Foreign Trade
DRP	Dispute Resolution Panel
DTAA	Double Taxation Avoidance Agreement
EL	Equalisation Levy
EPCG	Export Promotion Capital Goods
FA	Finance Act
FMV	Fair Market Value
FTP	Foreign Trade Policy
FTS	Fees for Technical Services
FY	Financial Year
GAAR	General Anti-Avoidance Rules
GST	Goods and Services 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
MFN	Most Favoured Nation
MLI	Multilateral Convention to Implement Tax Treaty related measures to prevent Base Erosion and Profit Shifting

GLOSSARY

ABBREVIATION	MEANING
MoU	Memorandum of Understanding
MRP	Maximum Retail Price
NAA	National Anti-profiteering Authority
NCLT	National Company Law Tribunal
OECD	Organisation 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
RBI	Reserve Bank of India
SC	Hon'ble Supreme Court
SEBI	Security Exchange Board of India
SEZ	Special Economic Zone
SGST	State Goods and Services Tax
SGST Act	State Goods and Services Tax Act, 2017
SLP	Special Leave Petition
ST Rules	Service Tax Rules, 1994
TCS	Tax Collected at Source
TDS	Tax Deducted at Source
TPO	Transfer Pricing Officer
TRC	Tax Residency Certificate
UK	United Kingdom
USA	United States of America
UTGST	Union Territory Goods and Services Tax
UTGST Act	Union Territory Goods and Services Tax Act, 2017
VAT	Value Added Tax
VAT Tribunal	Hon'ble VAT Tribunal

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ahead of the curve

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