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ahead of the curve

tax scout

Tax Scout | October – December, 2020

Main Stories

Dear Readers,

As we venture into 2021 and leave behind 2020, we hope that we have managed to leave behind the travails of the largest ever crisis in the form of the Covid-19 pandemic that humankind has arguably faced in the last 100 years! While there have been promising developments in terms of finding a vaccine, it is still work in progress. We will know more of its efficacy over time. In recent times, the record-breaking infection levels, especially in the US and the UK, is unnerving a lot of people.

The pandemic has driven most countries into a recession. Since a large part of the working population is unable to operate from their offices, it has created significant challenges for most business entities. While large scale retrenchments have not been formally declared, it is evident that the pandemic has created significant levels of unemployment.

With such incomprehensible challenges, the Finance Minister is about to present the Budget on February 1, 2021. She definitely has her task cut out. With record budgetary deficits, she is expected to come up with a magic wand and deliver miraculous results to propel the present fledging recessionary economy to pre-Covid levels, that is expected to grow at 9% plus. She is also expected to provide significant benefits (over and above the benefits announced by her from March 2020 till now) to ensure that the economy is put back on track. We are all going to watch with bated breath what the FM may come up with.

With the above not so fascinating background, we are pleased to present our quarterly tax update, covering some of the important decisions and legislative changes that took place in the last quarter of calendar year 2020 i.e. October 1, 2020 to December 31, 2020.

In our main story, we discuss the recent developments in the sphere of digital economy. While the discussion surrounding the overhauling of existing laws in order to account for growing digital technologies has been at the forefront amongst various international organisations, the subject has gained further significance in the Covid-19 world. Tax regulators around the globe have introduced various measures to counter the digital taxes conundrum, primary among them being the introduction of the new nexus of rule based on significant economic presence; imposition of withholding tax on digital transactions; and imposition of equalisation levy.

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,

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Managing Partner
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India's leading law firm

Index

Index

Decoding the digital taxes conundrum

Background – Why Digital Taxes?

The manner in which businesses are conducted and managed has undergone a paradigm shift in the age of technology. The gradual acceptance of digital business models and their current ubiquity has transformed the traditional brick and mortar set-ups to online superstores. Gradually, enterprises have become territory-agnostic and virtually omnipresent, extending their reach and markets across sovereign borders, thus obliterating the necessity of having a physical presence across the globe.

Traditionally, taxability of business income from cross border transactions used to be determined basis the physical presence of the enterprises and / or people, resulting in the establishment of a Permanent Establishment ("**PE**") in the relevant market jurisdictions. Digital technologies, in addition to removing the requirement of physical presence from the equation, have enabled enterprises to successfully earn income from markets across the world, and since the tax laws have not kept pace with such developments, some of these digital companies have not had to pay any taxes in a number of market jurisdictions. This has caused an erosion of the tax base in the market jurisdictions where the users/consumers are located. This now poses an indomitable challenge in the context of taxation: whether the complex profit-shifting arrangements choreographed by such digital multinational enterprises ("**MNE**") to avoid tax liability in jurisdictions in which they operate digitally or market products, but do not have a PE, deserve to be taxed in such market states even in the absence of a PE. Since the turn of the century, tax administrations as well as international fiscal organisations have realised that the extant laws only cater to the traditional ways of doing business and are insufficient to bring such virtual entities under the tax net, thereby causing inequitable distribution of taxes across multiple jurisdictions around the world. While these discussions have been in the forefront amongst international organisations for a while now, the digital tax debate has become even more topical today since COVID-19 pandemic has made digital technology a game-changer. Countries such as France, the UK, India, etc., are trying to bring these transactions under some sort of a tax net; while OECD is still in the process of coming up with its own recommendations.

Digital Taxes Internationally

Although talks on the issue of base erosion and tax leakage through digitisation and aggressive tax planning models that are being used to exploit the lack of physical presence began at an international level in 1998, the first significant move was made by the OECD in 2013. The Action Plan on Base Erosion and Profit Shifting ("**BEPS**") report in July 2013 acknowledged that in the digital economy, it is difficult to discern the sources of income as well as residences of buyers, sellers and facilitators. In September 2015, the OECD presented its final report ("**2015 Report**"), addressing the tax challenges of the digital economy, whereby all member countries agreed to revise their individual tax policies to adopt a policy more suited for the digital economy (i) the concept of PE, (ii) the rules of transfer pricing, and (iii) effective controlled foreign corporation rules.

The 2015 Report also recognised the need to tax digital players, and primarily considered three measures as additional safeguards against base erosion, the implementation of (a) a new nexus of rule based on significant economic presence ("**SEP**"); (b) a withholding tax on digital transactions; and (c) an equalisation levy ("**EL**"). However, it did not recommend any of these methods, as it was expected that other BEPS measures will have a substantial impact on digital economy issues and mitigate the broader tax challenges. The OECD's October 2020 "Tax Challenges Arising from Digitalisation – Report on Pillar One Blueprint" report is the latest attempt in this direction. The progress so far can be represented in the chart provided below:

OECD's Pillar One

The OECD's Pillar One or "Unified" approach presupposes that all countries are one "unified" entity. It allocates profits as well as taxing rights to market countries through a three-tiered mechanism, involving computation of the enterprise's deemed residual (non-routine) profits, fixed return for marketing and distribution activities in market jurisdictions and additional amounts to be taxed in the market jurisdiction based on the extent of activities undertaken. Taken together, the amounts computed accordingly would reallocate profits and the associated taxing rights to the market jurisdiction. Since the Pillar One proposal does not specify tax rates, an MNE would likely pay taxes at varied rates across the countries in which it operates. It is pertinent to note that the proposal only taxes consumer-facing businesses (in addition to automated digital services or "**ADS**"). This includes not just B2C businesses, but also such B2B businesses that have some form of consumer-facing platforms. Further, the proposal recommends that only such jurisdictions where the enterprises have "sustained and significant involvement in the economy" shall have taxing rights. Once the MNE offers the computed amount to tax in the relevant qualifying market jurisdictions, the ultimate parent entity of the MNE group is required to file returns in its state of residence. A panel of representatives from the respective market jurisdictions shall also be entitled to oversee the filing of returns. The taxpayer may challenge the determinations of this panel and proceed to have the issue resolved under the domestic law. In this manner, the OECD hopes to ring in a "unified" manner of tax assessment of the revenues of digital MNEs.

The threshold for triggering allocation of taxing rights as per the Pillar One model is a consolidated group revenue (of the taxpayer) of EUR 750 million (approx. USD 920 million or INR 67.5 billion). The large global digital market players including Amazon, Netflix and Uber, who target consumers all over the world and particularly in the world's fastest growing e-commerce market, i.e., India, will inevitably have a lot to lose from the outcome of such international negotiations.

As is evident, the OECD blueprint is complex, to say the least. It will require the tax departments of MNEs to undertake multiple calculations for each jurisdiction in which they are present as well as overburden the revenue authorities worldwide. The excessive compliances required to be undertaken by the ultimate parent entity may turn out to be burdensome. Moreover, in computing the baseline fixed return in a particular jurisdiction, the proposal sheds little light on how differences in sectors, market regions, economic conditions and trends would be accounted for. The OECD admits that there are a variety of approaches that could be used to reflect local or industrial differences, which might make consensus difficult. Lastly, it is difficult to envisage how the proposal hopes to gather representatives from all market jurisdictions in which the MNE operates, which may easily be over a hundred, especially in the case of major players and whether they will agree to a uniform set of yardsticks to judge. Thus, many aspects of the proposal are yet to gain shape. Even in the recent public comments received by the OECD on the Pillar One framework, simplicity and certainty, along with continuing commitments to withdraw relevant unilateral measures taken by governments worldwide in the wake of the OECD discussions, have been some of the important asks that businesses around the world expect from the OECD.

It is relevant to note that under Trump administration's protectionist model, the US had completely suspended its discussions at the OECD and continued to threaten retaliatory

1 https://www.nytimes.com/2020/06/17/us/politics/us-digital-tax-talks.html.

action against unilateral digital taxes, vehemently opposing any framework that would slash its tax collections from US-based tech dominators like Google, Amazon, Facebook and Apple or GAFA.[1] Although the EU is eager to rekindle its relationship with President-elect Joe Biden, in particular through a joint agenda for Big Tech,[2] the Biden administration is likely to press for a similar pro-digital-MNCs position,[3] since the US sees GAFA as cherished (revenue-generating) American success stories. It is also pertinent to add at this point that most of these large digital economy players do not pay their fair share of taxes even in the US on the income they earn from outside the US (e.g., from India), as their sophisticated global tax planning structures allow them to receive significant revenues from across the world, without paying any tax anywhere, through a network of intermediary holding companies located in tax friendly jurisdictions like Cayman Islands, Bermuda, Bahamas, Ireland, Netherlands, etc.

The US opposition and delay during the COVID-19 pandemic have been the largest stumbling blocks to the materialisation of the OECD proposal, and the international frustration over this stalling has turned the spotlight around on the United Nation's ("**UN**") 'Article 12B' proposal for digital tax.

Un Article 12B

The structure of Article 12B (Income from Automated Digital Services) is broadly comparable to any other provision in a DTAA, such as the dividend, interest, royalties and fees for technical services articles – the state of residence of the recipient of income from ADS is given the primary right to tax such income. Further, Article 12B also allows the source state to tax the income, which arises in that state at the DTAA rate fixed through negotiations (suggested at approximately 3-4%), subject to typical beneficial ownership requirements. At this point, the MNE is given a very important option – it may choose to be covered by such taxation on a gross basis or it may have its 'qualified profits' taxed at the source state as per domestic law. In such situations, qualified profits amount to 30% of the amount resulting from the beneficial owner's profitability ratio or profitability ratio of its ADS business segment, if available, to the gross annual revenue from ADS derived from the contracting State where such income arises. This is comparable to the computation of the MNE's deemed residual (non-routine) profits under the Pillar One proposal. It is important to note that Article 12B does not contain any group or entity revenue thresholds and would therefore apply to all entities. Further, unlike Pillar One, Article 12B determines and taxes income at the entity level, irrespective of MNE group level taxation.

Interestingly, in contrast to the OECD Pillar One blueprint, the UN Tax Committee does not aim for consensus over Article 12B, since it is in the form of bilateral recommendations that countries can opt and even customise. The provision may be adopted by the UN into its model tax convention, irrespective of consensus, while dissenting or minority views may be recorded in the Commentary to the model tax convention. Given the fervent oppositions and split views at the OECD, the UN adoption of Article 12B seems more imminent than a consensus-based solution at the OECD level.

Moreover, Article 12B is being lauded, especially by developing countries, for its simplicity. It comes in the form of a mere addition to DTAAs that countries have already signed between themselves and is, therefore, much less intricate or problematic in terms of its implementation. On the other hand, Pillar One, if the OECD discussions attain fruition, would require rewriting international tax laws across the world. Further, owing to the ease of adoption of Article 12B by interested countries, the UN proposal is being regarded as a proposal that would deter unilateral measures by states to counter the digital tax issue. Further, unlike the Pillar One proposal, the fact that Article 12B is intended to apply on all companies earning income from ADS in source countries, irrespective of their size or turnover, makes it more palatable to all countries without any allegation of being disadvantageous to any of them.

Nevertheless, a multilateral solution will present more authority and force than a bilateral recommendation. It will entirely eliminate the need for bilateral negotiations, which could take years or decades. In a situation where Article 12B evolves to accommodate future trends and potential practical issues, countries will repeat the amendment process for each DTAA. Most significantly, Article 12B only caters to ADS and not consumer-facing businesses, which the Pillar One proposal addresses. Both proposals are work in progress and hopefully, will culminate into success in 2021.

While the OECD and UN efforts are afoot, since no consensus has been achieved yet, some countries, including India, have already begun framing and levying their own uncoordinated unilateral versions of digital tax.

Digital Taxation In India

In the absence of effective tax rules for digital transactions, as has been widely seen in the past two decades, the IRA has often sought to force-fit existing tax rules, designed for a non-digital world, to widen the tax net to cover digital entities that were not physically seated in India, but derived income directly or indirectly from Indian sources.[4] The first unilateral legislative attempts to tax digital transactions were made pursuant to a report of a CBDT high powered committee, set up to examine the business models for e-commerce in 2016, which had

2 https://www.politico.eu/article/eu-to-us-president-elect-joe-biden-lets-be-tech-allies/.
3 https://www.internationaltaxreview.com/article/b1p6wxlmm080dm/is-bidens-victory-good-news-for-the-oecd-digital-tax-talks.
4 Galileo International Inc. v. DCIT, (2009) 116 ITD 1 (Delhi High Court); Verizon Communications Singapore Pte. Ltd. v. ITO, (2014) 361 ITR 575 (Madras High Court); In re MasterCard Asia Pacific Pte. Ltd., (2018) 406 ITR 43 (AAR); M/s. Google Ireland Ltd. v. DCIT, ITA No. 2845/Bang/2017, order dated February 20, 2019 (Bangalore ITAT).

recommended a significant economic presence ("**SEP**") rule as well as the introduction of an Equalisation Levy ("**EL**").

The SEP rule inserted as Explanation 2A to Section 9 of the IT Act through Finance Act, 2018 (later amended through Finance Act 2020) defines SEP as:

(a) transaction in respect of any goods, services or property carried out by a non-resident with any person in India, including provision of download of data or software in India, the aggregate of payments for which exceeds the prescribed amount; or

(b) systematic and continuous soliciting of business activities or engaging in interaction with more than the prescribed number of users in India.

Since clause (a) of this definition is not even restricted to online/digital transactions, the SEP rule that India proposes to adopt is of a very wide ambit. Moreover, only income attributable to activities forming the SEP would be taxable in India, which renders income attribution another complex and uncertain element of levy of tax on the income of an SEP. Fortunately, the SEP rule has been deferred for the time being and is set to operationalise only in 2022. The digital tax that is currently in effect and has put most e-commerce operators between a rock and a hard place is the EL.

The Controversial Equalisation Levy

EL was introduced in India in 2016. However, it became more intensive in scope and reach through the amendments in the Finance Act, 2020. Interestingly, the Finance Bill, 2020, made no mention of the enhanced "EL 2.0", suggesting that the enhancement of EL was more of an afterthought than a matter of serious planning and public participation. Thus, foreign companies operating in the digital space were given less than five days' notice, before it came into effect on April 1, 2020. There was very little or almost no debate over its introduction since the nation was in the first strict phase of lockdown due to the Covid-19 pandemic.

The EL before 2020 was only applicable to online advertisement services provided by non-resident entities at 6%, deductible by the resident enterprise/ PE availing the service. In its present form, there is an additional EL of 2% on the income of all non-resident e-commerce operators, gained from e-commerce supply or services to resident Indians and Indian Internet Protocol ("**IP**") users and in case of sale of advertisements or data, where the target is an Indian resident or an Indian IP user. The extensive scope and reach of the revised EL came as a bolt from the blue for all stakeholders, as the broadest digital tax currently levied or proposed across the globe. A saving grace is that the new 2% EL is only applicable to large e-commerce operators, i.e., those whose sales, turnover or gross receipts from the e-commerce supply or services is more than INR 20 million (approx. USD 0.27 million or EUR 0.22 million) during the FY. Further, non-resident entities who have PEs in India, are excluded from the levy of EL.

"E-commerce supply or services" is defined broadly to include:

(i) online sale of goods owned by the e-commerce operator;

(ii) online provision of services provided by the e-commerce operator;

(iii) online sale of goods or provision of services or both, facilitated by the e-commerce operator; or

(iv) any combination of the above activities.

E-commerce services could be wide enough to encompass online educational/ vocational courses or programmes, online software sales, cloud/web and other IT services, online streaming, e-magazines, etc. The expanse of the definition, without carve-outs, could also bring online non-resident service providers in the banking, insurance, payment facilitation and telecom sectors within the ambit of EL. Online sale of goods is equally rife with controversy – does EL cover part-online, part-physical sales? What about cash-on-delivery sales? It is also ambiguous whether 'consideration' on which EL shall be levied is the gross value of the goods/services supplied or only the commission retained by the e-commerce facilitator. There are no clarifications from the CBDT on how the EL is proposed to be levied in non-resident to non-resident transactions, which uses Indian IP addresses. Does the IRA have the cyberinfrastructure to detect and bring to tax such transactions? In any event, the same may be easily bypassed through the use of Virtual Private Networks, i.e., VPNs and proxies. Lastly, in world-wide data collection and advertisement scenarios, how will the receipts from Indian targets be culled out and subject to EL?

The enhanced EL has also been plagued with theoretical as well as jurisprudential challenges. Firstly, the legislative competence of the Indian Government to levy a tax that is not on income, but on a gross basis. This is possibly the very reason for which EL provisions are not placed within the IT Act. This also means that the standard deduction of expenses and other permissible deductions under the IT Act would be of no relevance to the determination of the amount of EL. Further, it has been argued that the EL does not conform to many of the traditional and internationally accepted attributes of taxes imposed by nation-states. It has extraterritorial reach, i.e., a right to tax non-residents with no physical nexus to India. As mentioned earlier, EL may be levied on transactions between non-residents and the only nexus to India is the usage of an Indian IP address or the targeting by an advertisement of an Indian user. The Supreme Court has held earlier that laws which have extra-territorial applications must have an impact or nexus

5 GVK Industries Ltd. v. ITO, (2011) 332 ITR 130 (Supreme Court).

with India, or else, they would be regarded as ultra vires Article 245 of the Constitution of India.[5] An extra-territorial EL, which could potentially infringe the residence country's right to tax the non-resident e-commerce operator may, in all probability, lead to jurisdictional turf wars.

Most importantly, since the EL was introduced through the Finance Act, 2016, and is outside the ambit of the IT Act, it would not be covered by any DTAAs. Consequently, non-residents subject to EL cannot claim concessions under DTAAs and will not be entitled to any foreign tax credit for EL paid in India in their country of residence. Arguments have been raised that the EL is an act of unilateral override of the DTAAs by India since all DTAAs specify that business profits such as the receipts, which EL seeks to tax, unless attributable to PEs, cannot be taxed in the source jurisdiction, i.e., India in this case. Principles condemning such override are carved into the Vienna Convention on the Law of Treaties as well as customary international law.

Illustrative list of unilateral digital services taxes levied worldwide as of January 4, 2020

S. No.	Country	Tax rates
EUROPE		
1.	Austria	5%
2.	Czechia	Tax under discussion
3.	Denmark	Tax proposed
4.	France	3%
5.	Greece	Standard tax rates
6.	Hungary	7.5% (suspended till Dec 31, 2022)
7.	Italy	3%
8.	Latvia	Tax proposed
9.	Norway	Tax proposed
10.	Poland	1.5%
11.	Spain	3%
12.	Turkey	7.5%
13.	UK	2%
ASIA		
14.	China	Tax proposed
15.	Indonesia	Tax under discussion
16.	Israel	Tax proposed
17.	Malaysia	Variable
18.	Pakistan	5%
19.	Russia	Tax proposed
20.	Taiwan	Variable
21.	Thailand	Tax under discussion
22.	Vietnam	Variable

S. No.	Country	Tax rates
AFRICA		
23.	Egypt	Tax proposed
24.	Kenya	Standard tax rates
25.	Nigeria	Standard tax rates
26.	Tunisia	3%
27.	Zimbabwe	5%
ASIA		
28.	Brazil	Tax under discussion
29.	Canada	Tax proposed
30.	Costa Rica	Standard tax rates
31.	Mexico	Variable
32.	Paraguay	15%
33.	Uruguay	Standard tax rates
ASIA		
34.	New Zealand	Tax proposed

COLOR GUIDANCE

	Unilateral digital services income taxes implemented
	Draft taxes proposed or being discussed
	Public announcement of intention to levy unilateral tax

Lastly, a unilateral tax like the EL, in the wake of full steam multilateral negotiations at both the OECD as well as the UN, is seen as undermining the international efforts towards achieving a consensus on the subject. Although, India is not a member country of the OECD, it is a member of the Inclusive Framework at the OECD, which is currently presenting digital tax proposals, including Pillar One. Given this situation, the enhancement of the EL at a time when the OECD had already published its Pillar One proposal, seems to emblematise the Indian Government's indifference to its own unwritten responsibility to await a global uniform solution.

However, it is also pertinent to note that the EL was not introduced as a unilateral tax provision, as it has been clarified time and again by the Government and several senior tax officials that India has been forced to come up with this levy as a temporary mechanism since the OECD has not been able to come up with a satisfying solution for all impacted parties. Thus, it is hoped and expected that as and when the OECD comes up with its version of digital economy taxation, the Indian Government will accept the same and scrap the EL.

Unilateral Digital Taxes Outside India

In July 2019, **France**[6] passed a law to retrospectively levy 3% on gross revenues generated by targeted online advertising, data sales and online intermediation platforms, excluding certain services like communication services, etc. Although much is being argued, especially by the US, against the French digital services tax, it is substantially narrower in scope than the Indian EL, since it excludes major online services. The threshold for triggering the French tax is that the annual turnover, of the digital company, derived from French users is over EUR 25 million, as against the EL's threshold turnover requirement of a mere EUR 0.22 million. Another glaring difference is that the French tax does not apply to online sales. In the face of US retaliatory measures against its tax, France agreed to hold off on the digital services tax until the end of 2020.[7] Now, with France having issued tax demands to the tech taxpayers for 2020,[8] the US, upon completion of the United States Trade Representative ("**USTR**") investigations, is set to impose tariffs on identified French imports in January 2021, and France has declared it will retaliate against such sanctions at the EU level.[9] Having said that, it is pertinent to note that France has pledged to revoke the tax immediately upon an international agreement being achieved,[10] something which India has not made official declarations on, but only passing mentions.[11]

At the same time the French digital tax was introduced, the **UK**[12] made its proposal for a 2% tax on internet search engines, social media platforms, online marketplaces and associated online advertising, which derive value from or target UK users. There is no reference to users of UK IP addresses, as is the case with the Indian EL. For the tax to become applicable, the digital entity's worldwide group revenue has to be at least EUR 500 million and revenue from the UK users should be at least EUR 25 million. A helpful safe harbour is provided to entities who are subject to similar digital taxes in other countries, whereby 50% of the digital tax payable in the UK is reduced. Financial service providers who meet specified conditions are specifically excluded from the levy of this tax.

A digital tax was introduced in **Italy**[13] with effect from January 1, 2020, at 3% on revenue from online advertising, interaction facilitation and sale of data, specifically excluding digital supply of goods and services. The threshold for applicability of the tax is that the global revenue of the digital company is at least EUR 750 million and revenue from the territory of Italy at least EUR 5.5 million. Taxability of the revenue depends wholly on the location of the user in the territory of Italy, and not the user's place of residence. The tax legislation has a sunset clause built into it, mandating its expiry once an international agreement is reached.

In addition to the above, the Czech Republic[14] and Norway[15] are discussing proposals to introduce digital tax. Also, the EU proposes to debate the levy of a digital tax at the EU bloc level in 2021,[16] although Ireland opposes the move.[17] Although most prevalent in Europe, these unilateral digital services taxes have also been proposed or effected in other regions of the world. Significantly, Canada,[18] Brazil[19] and Israel[20] have moved to propose a digital services tax in the near future.

6 https://www.ey.com/en_gl/tax-alerts/france-issues-comprehensive-draft-guidance-on-digital-services-tax.
7 https://www.ft.com/content/76cf4008-3db1-11ea-b232-000f4477fbca.
8 https://www.ft.com/content/2cfe3d07-7e69-4f57-b634-8b6002f967cb.
9 https://www.reuters.com/article/france-usa-tax/france-to-seek-eu-riposte-if-u-s-punishes-french-digital-tax-idUSKBN28B4QW.
10 https://news.bloombergtax.com/daily-tax-report/france-vows-to-retaliate-over-2-4-billion-u-s-tariff-threat.
11 https://pib.gov.in/PressReleaseIframePage.aspx?PRID=1671481; https://www.livemint.com/news/india/india-to-drop-unilateral-digital-taxes-once-global-consensus-builds-up-11608130700135.html.
12 https://www.gov.uk/government/publications/introduction-of-the-digital-services-tax/digital-services-tax.
13 https://www.internationaltaxreview.com/article/b1nlwm557ntmdg/italys-digital-services-tax-still-needs-practical-guidance.
14 https://www.ey.com/en_gl/tax-alerts/czech-government-proceeds-with-legislation-on-digital-services-tax.
15 https://news.bloombergtax.com/daily-tax-report-international/norway-to-consider-digital-services-tax-if-oecd-talks-fail.
16 https://ec.europa.eu/taxation_customs/sites/taxation/files/proposal_common_system_digital_services_tax_21032018_en.pdf.
17 https://www.ft.com/content/dba49100-2d22-11e8-a34a-7e7563b0b0f4.
18 https://uk.reuters.com/article/us-canada-budget-tax/canada-plans-digital-tax-in-2022-on-global-tech-giants-such-as-facebook-google-idUSKBN28A2ZM.
19 https://www.internationaltaxreview.com/article/b1lwff5ybp2rvs/new-bill-proposes-the-creation-of-a-digital-services-tax-in-brazil.
20 https://tax.thomsonreuters.com/blog/israel-preparing-digital-services-tax-modelled-off-pending-french-proposal/.

Conclusion

Although the international community has recognised the double non-taxation caused by digitalisation and has consciously worked upon it for nearly two decades, the evolution of an acceptable solution is still too far away. The length of these discussions at the international level, unceasing Western objections to seemingly palatable approaches and histrionics in adaption into smaller, less sophisticated tax systems, must give way to the sovereign rights of states to develop and implement their own digital tax solutions, pending international consensus. However, the reasonableness and validity of such unilateral measures will constantly be brought to test and countries are equipping themselves to not only quash challenges internally, but to also retaliate against international threats like the USTR investigations initiated against many such adopted as well as proposed unilateral taxes, including our EL.

India stuck to its guns and responded that EL is fair and non-discriminatory. India argued that the broad sweep of the tax, in terms of businesses and nature of transactions covered, and the low threshold triggering the levy, i.e., INR 20 million turnover, imply that it is a not a tax targeting the American tech giants, but is a genuine tax meant to harness profits made by any entity through digital activities in India without physical presence. However, recently, the USTR published its findings that the EL is discriminatory, unreasonable and burdens or restricts US commerce since it applies only to non-Indian digital service providers and contravenes prevailing international tax principles. With Presidential sanction, the US could now proceed to raise tariffs against Indian goods and services and impose other sanctions such as suspending trade concessions and restricting service authorisations, which may culminate in a global trade war, more so if trade barriers are raised against France, the UK and other major countries with unilateral digital services taxes. In addition, the challenges to EL will soon come home to roost in Indian courts, where the EL will have to be judicially tested on the touchstones of jurisdiction, constitutionality and non-discrimination.

Until then, the EL is here to stay. The IRA collected INR 40 billion through EL since its introduction in FY 2016-17, out of which INR 11 billion was collected in FY 2019-20, 55% of which was paid by Google, and 33% by Facebook. As on December 2020, its earnings from EL in FY 2020-21 have already reportedly exceeded the collection in the previous year and stands at INR 11.50 billion. The cost of EL, which now includes the 2% EL 2.0, in addition to the 6% advertisement EL, is unlikely to deter foreign investment since digital enterprises rely on India's huge internet-savvy middle-class population for its business, however, non-residents will hope to pass on these costs to Indian counterparties. Indian taxpayers will have to be conscious of triggering EL thresholds, while foreign enterprises will have to continue to devise market strategies that avoid Indian nexus so as to legally bypass the levy of EL.

Rate of erstwhile DDT shall be subject to beneficial rates under DTAA on dividends

In the case of ***Giesecke & Devrient (India) Pvt. Ltd.,***[21] the Delhi ITAT held that the rate of levy of dividend distribution tax ("**DDT**"), although now abolished, shall be subject to beneficial rates specified in applicable DTAAs for dividend taxation.

Facts

Giesecke & Devrient (India) Pvt. Ltd. ("**Assessee**") was an Indian company engaged in the trading of currency verification and processing systems. It was incorporated as a wholly owned subsidiary of a German company. For the AY in question, the AO had made certain additions on account of disallowances of expenditure and transfer pricing adjustments. These additions were upheld by the DRP and, therefore, the Assessee appeared in appeal before the Delhi ITAT. At the ITAT stage, the Assessee raised an additional ground claiming that the rate at which it had paid DDT on the dividends distributed to its German holding company, should be capped in accordance with the prescribed rate for dividends under the India-Germany DTAA.

Issue

Whether the Assessee was entitled to benefit of the India-Germany DTAA qua the rate of tax on payment of dividend to the German holding company?

Arguments

The IRA argued that the additional ground raised by the Assessee was a mala fide attempt to distort the appellate proceedings. It sought the dismissal of the additional ground by contending that the said issue was never raised before any lower authority and that the ground involved not only legal issues, but also required verification of facts. On the other hand, the Assessee relied on the decision of the SC in the case of ***National Thermal Power Corporation Ltd. (NTPC)***,[22] to argue that the additional ground regarding availability of DTAA benefits for DDT was a purely legal issue, therefore, it was capable of fresh adjudication at a higher level.

Decision

The ITAT, relying on the decision of the jurisdictional HC in the case of ***Maruti Suzuki India Ltd.,***[23] where admission of an identical additional ground raised at the ITAT stage was upheld, admitted the additional ground of the Assessee.

Next, the ITAT upon examining the definitions of 'income' and 'tax' in the IT Act, concluded that DDT, being an 'additional' income tax levied under the IT Act was a tax on income. The ITAT noted that the legislative history of the Finance Bill, 1997, and Finance Bill, 2003, through which the DDT regime was introduced and then later re-introduced, evinces the complexity of the classical tax procedure and the need to bring in simplicity in the levy of taxes on dividends. It was considered less cumbersome to collect tax on dividends from a single point, i.e., from the distributing company, rather than requiring the distributing companies to compute income tax deductible from the dividend income in the hands of each shareholder. Further, the memorandum to Finance Bill, 2020, by way of which DDT has now been abolished, remarks that dividend tax *should* be levied on the shareholder and not on the company. The ITAT thus concluded that it was administrative necessity and convenience which drove the introduction of the DDT regime, and the levy is for all intents and purposes, a charge on dividends distributed by the company.

21 PCIT v. Giesecke & Devrient (India) Pvt. Ltd., ITA No. 7075/DEL/2017 (Delhi ITAT).
22 National Thermal Power Corporation Ltd. v. CIT, (1998) 229 ITR 383 (SC).
23 CIT v. Maruti Suzuki India Ltd., WP(C) 1324/2019 (Delhi HC).

In making this finding, the ITAT relied heavily on the Bombay HC decision in the case of ***Godrej and Boyce Manufacturing Company Ltd.,***[24] which had concluded in context of Section 14A of the IT Act that DDT is a tax on companies and not on the shareholders. The Bombay HC had held that the DDT, as an "additional" income tax, required to be paid by the company, was levied even if there were no current profits or taxable income for the year in which the distribution happened.

Lastly, with regard to whether DDT would be subject to DTAA rates, the ITAT observed that Sections 4 and 5 of the IT Act, being its main charging provisions, have been made "subject to the provisions of this Act", including Section 90 of the IT Act, which deals with the relationship of DTAAs with the IT Act. Here, the ITAT made brief reference to ***Davy Ashmore India Ltd.,***[25] where it had been held that in the event of inconsistency between DTAAs and the IT Act, the former shall prevail. Therefore, by extension, any tax levied under the IT Act would be subject to Section 90, i.e., should be capped by the applicable DTAA rates.

On this point, the ITAT also quoted the principle against unilateral treaty override, encoded in the Vienna Convention on the Law of Treaties, as well as customary international law. The principle requires parties to a treaty to act in such a manner so as to not override the treaty or render its provisions redundant. In invoking the principle, the ITAT noted the timing of introduction of DDT in 1997, one year after the coming into effect of the India-Germany DTAA in 1996. Although, the analysis is not evident from the judgment, it may be inferred that the ITAT deemed the denial of the concessional dividend tax rates under the India-Germany DTAA to DDT as a form of unilateral treaty override. Accordingly, the ITAT concluded that tax rates specified in the DTAA in respect of dividends must prevail over DDT rates specified in the IT Act, i.e., DDT rate was capped at 10% as specified in Article 10 of the India-Germany DTAA.

The ITAT then remanded the matter to the AO for the purpose of verifying that the German holding company was not carrying on business in India through a PE and shareholding in the Indian company is not effectively connected to such PE.

Significant Takeaways

In relation to the raising of additional grounds at the ITAT level, the ***NTPC*** decision that the Assessee relied on, required examination of new circumstances, such as a new judicial decision rendered pending the appeal, for allowing an additional ground. Further, it has been held by the SC that the appellate forum must be satisfied that the ground raised as well as reasons for not raising it earlier are bona fide and that the appellate authority may exercise discretion in admitting the additional ground in accordance with law and reason.[26] Therefore, the unrestricted appeal rights conferred on the Assessee by the Delhi ITAT in ***Giesecke*** may not be available in other circumstances to all taxpayers.

Further, the ITAT while rendering this decision has left a few questions unanswered. While the ITAT concluded that DDT is a tax levied on Indian companies distributing dividends, it failed to elaborate on why DTAA benefits, which are by nature available only to non-residents, should be extended to the DDT paid by Indian companies. Moreover, given the invocation of the principle against unilateral treaty override, it is unclear if the ITAT's conclusion will only apply in respect of those DTAAs, which were brought into effect before the introduction of DDT in 1997 and re-introduction in 2003.

Lastly, the decision also gives rise to certain practical issues for companies going forward. It is uncertain if a refund will be available to Indian companies that have hitherto paid DDT at higher rates than those specified under the respective DTAAs and if yes, what would be the procedure for claiming such a refund. In that event, it is also left to be clarified who will be entitled to such a refund – the shareholder or the distributing company. Although DDT has been abolished, clarifications on these points will allow certain non-resident shareholders to claim benefits of concessional rates under DTAAs in respect of dividends they have received from Indian companies to the extent possible under the IT Act.

> **"The DDT levied by the appellant shouldnot exceed the rate specified in the DTAA."**

24 Godrej and Boyce Manufacturing Company Ltd., (2010) 328 ITR 81 (Bombay HC).
25 CIT v. Davy Ashmore India Ltd., (1991) 190 ITR 626 (Cal HC).
26 Jute Corporation of India v. CIT, (1991) 187 ITR 688 (SC).

Reimbursement of expenses incurred on seconded employees not subject to withholding tax

In the case of ***Abbey Business Services India Pvt. Ltd.***[27], the Karnataka HC held that reimbursement of hotel and travelling expenses by an Indian company to its foreign parent in relation to seconded employees is not FTS and therefore, not subject to withholding tax.

Facts

Abbey Business Services India Pvt. Ltd. ("**Assessee**"), an Indian company, was a subsidiary of ANITCO Ltd., a group company of Abbey National Plc, UK ("**Abbey UK**"). Abbey UK entered into an agreement with Assessee, to outsource provision of certain processes and call centers to Msource India Private Ltd. ("**Msource**"), wherein Msource was required to provide certain services to Abbey UK, its affiliates and clients in the UK. Abbey UK also entered into a consultancy agreement with the Assessee for providing specified services and the Assessee was compensated on a cost-plus basis. To further facilitate the outsourcing arrangement, Abbey UK also entered into an agreement with the Assessee for secondment of staff. The Assessee reimbursed certain expenses to Abbey UK without withholding any tax. However, on the portion of reimbursement, which pertained to salary payments, appropriate tax was withheld.

The AO held that the balance payments (payments other than salary) made by Assessee to Abbey UK were in the nature of FTS and, therefore, Assessee was liable to withhold tax. The CIT(A) confirmed the order of the AO. On further appeal, ITAT decided in favour of the Assessee and held that the payments made by the Assessee to Abbey UK, was not in the nature of FTS and hence, no tax was required to be withheld by the Assessee. Aggrieved by this order, IRA filed an appeal before the Karnataka HC.

Issue

Whether the Assessee was required to withhold tax on the reimbursements made to Abbey UK?

Arguments

The IRA argued that the Assessee was rendering technical services to Abbey UK and hence, the payments were made for FTS. The IRA relied on the judgment in the case of ***Centrica***[28] to argue that the Delhi HC on similar facts had decided that the payments would qualify as FTS and thus, the judgment would be squarely applicable to the instant case.

The Assessee, on the other hand, argued that the payments made by it to Abbey UK were reimbursements for hotel and travel expenses incurred by Abbey UK for the Assessee. The Assessee also argued that mere deputation of employees didn't amount to making available technical know-how. The Assessee further argued that the judgment in the case of ***Centrica*** was not applicable as the facts in the two cases were not similar – (i) the HC in the case of ***Centrica*** dealt with the issue of PE; and (ii) the issue in ***Centrica*** was whether expenses incurred towards salary and not hotel or travelling expenses could be treated as expenses for technical services.

Decision

The HC held that the expenses incurred by seconded employees, which were reimbursed by Assessee did not constitute FTS. The HC noted the terms of the secondment contract and observed that seconded employees were working under the control, direction and supervision of the Assessee, and in accordance with the policies, rules and guidelines applicable to the employees of the Assessee. The HC, therefore, held that the Assessee was the employer of the seconded employees for all practical purposes. The HC also held that the payments made by the Assessee were reimbursements against cost incurred by the non-resident enterprise, and as no income element was involved in reimbursement of costs, no tax was liable to be withheld by the Assessee. The HC referred to paragraph 29 of the ***Centrica*** decision, to note that in that case, the Court was dealing with the issue of whether seconded employees constituted Service PE in India or not and thereafter, distinguished it on the ground that in the instant case, the issue of PE was not involved.

Significant Takeaways

Withholding tax on reimbursement of expenses/ salary in relation to seconded employees under a secondment arrangement has been a subject matter of debate before various judicial forums. While in some judicial precedents, it has been held that payment of expenses by the Indian entity amounts to FTS[29], in some cases, it has been held that payment of expenses incurred in relation to seconded employees is a mere reimbursement, not amounting to FTS[30]. Please note that in certain circumstances, it may be difficult to segregate the payments in relation to salary and payments in relation to other expenses, such as travel, hotel, etc. At the heart of the issue is the determination of the real owner of the seconded employees, which depends on various factors such as under whose control

27 DIT v. Abbey Business Services India Pvt. Ltd., (2020) 122 taxmann.com 174 (Karnataka HC).
28 Centrica India Offshore Pvt. Ltd. v. CIT, (2014) 44 taxmann.com 300 (Delhi).
29 Intel Corporation v. DDIT, (2016) 76 taxmann.com 125 (Bangalore ITAT); Nippon Paint (India) Pvt. Ltd. v. DCIT, ITA No. 2562 of 2018 (Chennai ITAT).
30 AT&T Communication Services India (P) Ltd. v. DCIT, (2019) 101 taxmann.com 105 (Delhi ITAT); Temasek Holding Advisors India (P.) Ltd. v. DCIT, (2013) 38 taxmann.com 80 (Mum ITAT).

and supervision do the employees work, who is responsible for the work done by the employee, employee is on whose payroll, whether the employee has a lien on his employment with the foreign company, who contributes to the social security contributions on behalf of the employees, who has the right to terminate the employment, etc. In the present case, after analysing the terms of the agreement, the Karnataka HC noted that the Indian entity was the employer of seconded employees for all practical purposes and there was no obligation to withhold tax on payments to non-resident enterprise made for reimbursements of costs.

In the present case, the HC has distinguished the case of ***Centrica*** on the limited ground that the issue of PE was not involved, unlike the case of ***Centrica***. It is pertinent to note that ***Centrica*** did deal with the issue of FTS and despite IRA specifically pointing that out, the HC distinguished the ***Centrica*** ruling on the limited ground of PE. Further, even though the HC in its earlier part of the judgment has noted that the seconded employees were working under the control and supervision of the Indian entity, it has not specifically discussed this fact while distinguishing the judgment of ***Centrica***. In other words, even though the present ruling is in favour of the taxpayers, one may argue that the ruling does not appropriately consider the judicial precedents.

In light of the above, it is evident that this issue is far from settled and therefore, taxpayers are required to carefully examine the facts of their case to ascertain the nature of payments. The issue of reimbursement of payments, with or without mark-up, towards salaries and other expenses paid to seconded employees may ultimately have to be decided by the SC, in lieu of conflicting decisions by various judicial forums.

“ Expenses incurred by seconded employees, when reimbursed, not liable to tax withholding. ”

Substitution of a DTAA provision results in repeal of earlier provision and making the new provision operative

In the case of ***Autodesk Asia Private Limited***[31], the Karnataka HC held that the substitution of Article 12(2) of the India-Singapore DTAA, *vide* notification dated July 18, 2005, had the effect of deleting the old provision and making the new provision operative for the entire FY.

Facts

M/s. Autodesk Asia Private Limited ("**Assessee**") was a company based in Singapore and engaged in the business of marketing and sale of software. The Assessee sold software licences to Indian customers and also provided certain ancillary services in connection with sale of software. For AY 2006-07, the Assessee filed its return of income declaring 'NIL' taxable income. However, on scrutiny, the AO held that the income received by the Assessee from software supplied and the ancillary services was chargeable to tax for royalty and FTS, respectively, and accordingly made relevant additions. The CIT(A) upheld the order of the AO after which the Assessee approached the ITAT. Before the ITAT, the Assessee did not contend whether the payments received by it were in the nature of royalty and FTS. Instead, the Assessee filed an appeal on the ground that the rate of tax applicable on royalty and FTS was 10%, as per the fresh article 12(2) of the DTAA brought into effect *vide* notification dated July 18, 2005 ("**Notification**"), as against 15% levied by the IRA based on article 12(2) prior to the Notification. The ITAT allowed the appeal of the Assessee, upholding the 10% rate as applicable to the Assessee. Thereafter, the Revenue filed an appeal before the HC.

Issues

Whether the rate of 10% prescribed under the substituted paragraph 2 of Article 12 was in force for the entire FY or only when the Notification substituting the rate of 15% with 10% came into effect?

Arguments

The IRA argued that *vide* the Notification, paragraph Article 12 of the DTAA was substituted with a fresh paragraph, which stated that the rate of tax on royalty income cannot exceed 10%, as against 15%, which was stated in the paragraph prior to Notification. As per IRA, the substituted paragraph 2 came into effect only on August 1, 2005, i.e. when the Notification came into effect. Further, drawing reference from Section 195(1) of the IT Act, the IRA contended that rates in force were the rates applicable on the date on which the credit takes place in the account. Therefore, wherein the Notification had not come into effect on the date of credit, the rate applicable would be 15% as against 10%.

As against this, the Assessee argued that as per the Notification, the existing paragraph 2 of Article 12 of the DTAA was deleted and was substituted by a fresh paragraph 2, which provided a levy of tax on royalty and FTS at the rate of 10%. Therefore, considering that the substitution happened by repeal, the new provision providing for a rate of 10% shall apply for the entire FY. In this regard, the Assessee relied on the SC ruling in the case of ***Indian Tobacco Association***[32], where the SC interpreted the term "substitution" to mean repeal of the earlier provision and its replacement with a new provision.

Decision

The HC resorted to well settled rules of interpretation for deciding the applicability of the Notification. The HC relied on the principle laid down by the SC in the case of ***UP Sugar Mills Association***[33], wherein it was held that substitution of a provision results in repeal of earlier provision and its replacement by new provision. The said principle was also reiterated by SC in the case of ***West UP Sugar Mills Association***[34] and Karnataka HC in the case of ***Govardhan M***[35], wherein it was held that when a new rule is brought in to substitute an old one, the intention is not to keep the old rule alive. The substitution has the effect of deleting the old rule and making the new rule operative.

Given the principles laid out in the aforementioned judgments, the HC held that it was evident that paragraph 2 of Article 12 of the DTAA, which provided for levy of taxes on income in the nature of royalty and FTS at the rate not exceeding 15% was deleted by the Notification and was substituted by a fresh paragraph, which provided for a rate not exceeding 10%. The substitution has the effect of deleting the old rule and making the new rule operative. Thus, the HC held that the new rule was operative for the entire FY and dismissed the appeal of the IRA.

31 Director of Income Tax and others v. M/s Autodesk Asia Pvt. Ltd., [2020] 120 taxmann.com 324 (Karnataka HC).
32 Government of India and Other v. Indian Tobacco Association, (2005) 7 SCC 396 (SC).
33 UP Sugar Mills Association v. State of UP, (2002) 2 SCC 645 (SC).
34 West UP Sugar Mills Association v. State of UP, (2012) 2 SCC 773 (SC).
35 Govardhan M v. State of Karnataka, (2013) 1 KarLJ 497 (Karnataka HC).

Significant Takeaways

From the judicial precedents discussed above, it is fairly settled that the substitution of an existing provision with a fresh provision has the effect of repealing the existing provision, with the effect that the old provision was never intended to be kept alive. However, what is essential to note is that in the present case, the HC has gone further ahead to clarify that not only will the original provision replace the existing provision, but the same shall have the effect for the entire FY as against the date on which it comes into effect, thereby, giving a retrospective applicability to the Notification.

Further, it would also be relevant to note that Section 195 of the IT Act clearly uses the term "*rates in force*" at the time of credit of income to the account of non-resident payee. However, with regard to the ruling of the Karnataka HC, wherein the substituted provision was given effect for the entire FY and not from the date when it came into force, interpretation of the term rates in force would have to be done taking into account the rates that are subsequently brought into force as a result of substitution of provision.

> **"Substitution of provision has the effect of repealing the old provision and bringing into effect the new provision for the entire FY."**

Depreciation on revalued intangibles is available to the successor company

In the case of ***M/s. Padmini Products (P) Ltd.***[36], the Karnataka HC held that a company, which received intangible assets from a partnership firm under a scheme of succession, was entitled to claim depreciation on such intangible assets on cost incurred by it with reference to such intangible assets.

Facts

Padmini Products (P) Ltd. ("**Assessee**"), engaged in the business of manufacturing, dealing and exporting of incense sticks and allied products, under a scheme of succession, succeeded the business of partnership firm 'Padmini Products' ("**Firm**") with effect from February 1, 2005. Under the scheme of succession, all the assets and liabilities of the Firm were transferred to the Assessee and in consideration, shares of the Assessee were allotted at a premium, to the partners of the Firm. The Firm, before its conversion into a private limited company, revalued its intangible assets to approximately INR 65.2 crore, using standard valuation methods.

The Assessee, in its income tax returns for the AY 2005-06 to AY 2008-09, claimed depreciation on the value of intangible assets. The AO stated that since the Assessee did not actually acquire or purchase assets for actual consideration, the value of the assets were of the nature of notional value and therefore, disallowed the Assessee's claim for depreciation on intangible assets. The AO also noted that in terms of the fifth proviso to Section 32 of IT Act (now sixth proviso), which provides that the aggregate deduction, in respect of depreciation of intangible assets allowable to the predecessor and the successor cannot exceed in any previous year the deduction as if the succession had not taken place, the claim of depreciation was not allowable. The order of the AO was upheld by CIT(A) and subsequently, by ITAT. The action of the AO was also justified by relying on explanation 3 to Section 43(1) of the IT Act, which *inter-alia* provides that if the main purpose of transfer of assets is reduction of income tax liability by claiming depreciation on enhanced cost, then the AO, with prior approval of Joint Commissioner, may determine the actual cost to the assessee having regard to the circumstances. Aggrieved of the order of the ITAT, the Assessee went in appeal before the Karnataka HC.

Issue

Whether the Assessee was entitled to claim depreciation on the value of intangible assets, received by it from the Firm under the scheme of succession?

Arguments

The Assessee argued that the intangible assets were revalued by the Firm and subsequently transferred by it to the Assessee. Therefore, the transfer was covered under Section 47(xiii) of the IT Act. Section 47(xiii) of the IT Act, *inter alia*, provides that transfer of an intangible asset by a firm to a company as on succession does not constitute transfer on satisfaction of certain prescribed conditions. The Assessee further submitted that the valuation of the intangible assets and the genuineness of the transaction was not disputed by the IRA. The Assessee argued that the 5th proviso to Section 32(1) of the IT Act did not apply. Further, it was argued that explanation 3 to Section 43 of the IT Act could not have been invoked without giving a notice to the Assessee.

The IRA argued that since transfer of entire business from Firm to Assessee amounted to transfer of capital asset under Section

36 Padmini Products (P) Ltd. v. DCIT, (2020) 121 taxmann.com 237 (Karnataka HC).

45 of the IT Act, it relied on the fifth proviso to Section 32 to argue that the Assessee was entitled to depreciation only to the extent it was allowable in the hands of the Firm, and since the intangible assets were self-generated in the hands of the Firm and there was no question of depreciation thereon, the Assessee was not entitled to claim any depreciation on the intangible assets. The IRA also relied on Section 43(6) of the IT Act, which defines the expression "written down value" to argue that the definition contemplates acquisition of assets, and since, in the instant case, there was no acquisition or transfer of assets, notional valuation of intangible assets was a device to claim depreciation of a non-existent asset. It was further argued that valuation of intangible assets was done without any statutory provision.

Decision

The HC noted that the business of the Firm was built on an intangible experience of aroma, which was secured in the form of various trademarks registered by the Firm. The HC also noted that the valuation of intangible assets or genuineness of the transactions was not questioned by the tax authorities and the intangible assets were transferred to the Assessee for valuable transaction. The HC held that transfer of assets by Firm to Assessee for a consideration, i.e. by way of issue of shares, was a recognised mode of transfer under Section 47 of the IT Act. The HC, therefore, held that Assessee was entitled to claim depreciation with reference to the actual cost incurred by it in relation to intangible assets.

With respect to the applicability of fifth proviso to Section 32(1) of the IT Act, the HC held that the said proviso was appliable to the year of succession (in respect of the overall quantum of depreciation) and not in the years subsequent to the year of succession, as there was no question of aggregate deduction in the subsequent years. The HC also held that explanation 3 to Section 43(1) could not have been invoked, as the AO did not establish that the main purpose of the transaction was to reduce income tax liability by claiming extra depreciation on enhanced cost, and the AO did not take previous approval of the joint commissioner to disregard the enhanced cost.

Significant Takeaways

The judgment states that the provision restricting the aggregate deduction in cases of succession is applicable only in the year of succession and has no applicability in the subsequent years. However, as the proviso states that the depreciation claimed by the successor entity "*in any previous year*", shall not exceed the depreciation that would have been available had the succession not taken place; and the objective behind insertion of fifth proviso to Section 32 appeared to ensure that where the ownership of a business does not change, successor entities do not claim excess depreciation, one may argue that the said proviso is intended to be made applicable to the years subsequent to the year of succession, as well.

Having said the above, the ruling is a welcome one for taxpayers as it clarifies that even in case of self-generated assets, upon conversion of firm into company, depreciation would be available on the actual cost incurred to acquire such intangible assets. The ruling is in line with the judicial precedents[37] on the issue. It is pertinent to note that it may be beneficial to obtain a valuation certificate from an independent valuer, at the time of revaluation of assets by the partnership firm and may help taxpayers to establish the genuineness of the revaluation of assets.

Needless to say, that in light of the specific anti-abuse provision (explanation 3 to Section 43(1) of the IT Act) and GAAR, it is imperative that the revaluation of assets by a partnership firm just prior to its conversion into a company should be backed by robust commercial rationale and commercial substance. Further, consideration paid by the successor company to the partnership firm should also be supported by a valuation report.

“ Provision restricting aggregate depreciation applies only in the year of succession and not in subsequent years. ”

37 DCIT v. CNCS Facility Solutions Pvt. Ltd., ITA No. 3720 and 3721 of 2013 (Mumbai ITAT); DCIT v. Suyash Laboratories Ltd., (2016) 65 taxman.com 217 (Mumbai ITAT).

Proviso to Section 50C of the IT Act is applicable retrospectively

In the case of ***Shri Vummudi Amarendran***[38], the Madras HC held that the proviso to Section 50C[39], which provides that if the date of agreement fixing the amount of consideration and the date of registration for the transfer of capital asset are not the same, then the value assessed by the stamp valuation authority on the date of agreement may be taken for the purposes of computing capital gains, is applicable retrospectively.

Facts

Vummudi Amarendran ("**Assessee**") was an individual who owned a piece of land in Neelankarai Village ("**Land**"). The Assessee, on August 4, 2012, entered into an agreement to sell the Land for a total sale consideration of INR 190 million, and in terms of the agreement, had received an advance consideration of INR 60 million in his bank account. The Land was sold by registered sale deed dated May 2, 2013.

The AO observed that the stamp duty value on the date of registration of sale deed was INR 270 million. The AO stated that the agreement for sale did not constitute transfer for the purposes of IT Act and further held that since the stamp duty value on the date of transfer (i.e. on the date of execution and registration of sale deed) was higher than the sale price, the value of the Land for the purposes of computation of capital gains would be INR 270 million. While the Assessee relied on the proviso to Section 50C to argue that the value on the date of agreement to sell should had been considered, the AO rejected the contention and held that the proviso was applicable only with effect from AY 2017-18 onwards. On appeal, the decision of the AO was set aside by CIT(A). Further, ITAT dismissed the appeal filed by the IRA against the order of CIT(A). Aggrieved of the order of the ITAT, the IRA went in appeal before the Madras HC.

Issue

Whether agreement to sell constituted transfer and whether, the value of Land as on the date of agreement to sell or as on the date of registration of sale deed was to be considered for computing capital gains?

Arguments

The IRA argued that the proviso to Section 50C was inserted *vide* Finance Act, 2016, and was effective from April 1, 2017, prospectively. The IRA relied on Explanatory Notes to Finance Act, 2016, i.e. Circular No. 3 of 2017, wherein it was stated that the above discussed amendment was applicable prospectively. The IRA also argued that the language of the proviso was clear, and it was not clarificatory. The IRA placed reliance on ***CIT v. Vatika Township Private Limited***[40], to argue that the as the amendment was a substantive provision and not clarificatory, it was applicable prospectively.

The Assessee argued that the proviso inserted in Section 50C of the IT Act *vide* Finance Act, 2016, was applicable retrospectively. The Assessee contended that the proviso sought to mitigate the undue hardship faced by the taxpayers, and therefore, was to be given retrospective effect.

Decision

The HC noted that the tax authorities did not doubt the genuineness of the transaction and the advance was paid through a banking channel. The HC relied on the judgment in the case of ***J. Jayalalitha***[41] to state that the guideline or stamp duty value fixed was not final and was only a *prima facie* rate prevailing in the area to ascertain the true market value, and held that the AO could not have based its finding solely upon the guideline value. With respect to the issue of whether proviso to Section 50C was to be given retrospective effect, the HC held in affirmative.

For reaching the above conclusion, the HC relied on the SC judgment in the case of ***CIT v. Calcutta Export Company***[42], wherein the SC gave retrospective effect to a proviso, on the ground that the proviso was inserted to remedy unintended consequences, and supply an obvious omission. The SC added that the proviso enabled reasonable interpretation and retrospective effect served the object behind the amendment. The HC also referred to the report of Income Tax Simplification Committee, wherein it was observed that an amendment made to remove undue hardship to the taxpayers or remove an apparent incongruity was to be treated effective from the date on which the law, containing such an undue hardship or incongruity, was introduced. The HC also noted that while the legal principles laid down in the case of ***Vatika Township (supra)*** were applicable, they did not help the case of IRA.

Significant Takeaways

Section 50C is an anti-abuse provision inserted in the IT Act, inserted with the objective to counter the practice of taxpayers selling their immovable properties at understated prices and reducing capital gain tax liability. A similar anti-abuse provision

38 CIT v. Vummudi Amarendran, (2020) 120 taxmann.com 171 (Madras HC).

39 Section 50C of the IT Act provides that where the consideration received by a taxpayer for the transfer of a capital asset, being land and / or building, is less than the stamp duty value of such property, then for the purposes of computing capital gains, the stamp duty value would be deemed to be the full value of the consideration received as a result of such transfer.

40 2014 (367) ITR 466 (SC).

41 R.Saibharathi Vs. J.Jayalalitha, 2004 (2) SCC 9 (SC).

42 2018 (404) ITR 654 (SC).

is Section 43CA, which deals with immovable properties held as business asset and not capital asset. The said Section 43CA contains a specific sub-section which provides that where the date of agreement and date of registration of a transfer is not the same, then the stamp duty value as on the date of agreement may be taken to determine the amount of consideration. Therefore, the proviso was introduced to Section 50C to provide for a similar position. While the Circular No. 3. of 2017 does specify that the proviso was applicable from AY 2017-18 onwards, the taxpayers have been contending that it should be applied retrospectively and therefore, the issue has remained litigious.

It is a settled legal position, that substantive amendments should be applied prospectively, and clarificatory/ procedural amendment should be applied retrospectively. While in the present case, the HC has relied on the case of Calcutta Export Company (supra), wherein as clarified by SC in the case of ***Shree Choudhary Transport Company v. ITO***[43], the court was dealing with a procedural amendment, the HC has not discussed in detail as to whether the proviso to Section 50C is a clarificatory or substantive amendment, but has limited its observations to state that the proviso was inserted to reduce undue hardship to the taxpayers. One may argue that this in itself would make the provision clarificatory and hence the amendment may be considered to have been introduced with retrospective effect.

The present ruling is a welcome one for taxpayers and confirms the position formulated by various ITATs[44] across the country that the proviso to Section 50C should be made applicable retrospectively. Separately, the HC also lays down an important principle that the stamp duty value adopted by the authorities is not final, and the taxpayers may disagree and prove that the actual market value of the property was lower and hence, that should be considered for the purposes of computing capital gains.

> **“Proviso to Section 50C was inserted to relieve taxpayers from undue hardship.”**

43 (2020) 118 taxmann.com 47 (SC).

44 Dharamshibhai Sonani v ACIT, (2016) 75 taxmann.com 141 (Ahmedabad ITAT); Kishore Hira Bhandari v ITO, (2019) 107 taxmann.com 218 (Mumbai ITAT); Amit Bansal v. ACIT, (2018) 100 taxmann.com 334 (Delhi ITAT); Smt. Chalasani Naga Ratna Kumari v ITO, (2017) 79 taxmann.com 104 (Visakhapatnam ITAT).

Cashless exercise of stock options by an independent consultant taxable as capital gains and not as salary

In the case of ***Shri Chittaranjan A. Dasannacharya***[45], the Karnataka HC held that on cashless exercise of stock options by a consultant, income arises in the nature of capital gains, as right to subscribe to shares of a company constitutes a capital asset under Section 2(14) of IT Act and the said income cannot be treated as salary.

Facts

Shri Chittaranjan A. Dasannacharya ("**Assessee**") was a software engineer employed with Aerospace Systems Private Limited ("**ASPL**"). He was deputed by ASPL to SIRF Technology Inc, U.S. ("**SIRF USA**") from 1995 to 1998 as an independent consultant and from 2001 to 2004 as an employee and thereafter, he returned to India and was employed in SIRF India.

The Assessee was granted certain stock options by SIRF USA in 1996 *vide* which he was given the right to purchase 30,000 shares of SIRF USA at an exercise price of USD 0.08 per share. Alternatively, he was given the option of cashless exercise of stock options i.e. he could sell the underlying shares and the sale proceeds from sale of such shares would get paid to the Assessee, minus the exercise price, which (exercise price) would get paid to SIRF USA. In AY 2006-07, which was the relevant year in this appeal, the Assessee opted for cashless exercise of stock options and offered the income therefrom for taxation as long term capital gains.

The AO in his order disagreed with the approach adopted by the Assessee and split the transaction in question by taxing the difference between market value and exercise price on the date of exercise as income from 'salary', and the difference between sale price and market value as income from short term capital gains. The order of the AO was upheld by the CIT(A) and an appeal was filed by the Assessee before the ITAT against the same.

The ITAT in its order held that the Assessee was an employee of SIRF USA as per the clauses of the stock option plan. Therefore, income arising in the hands of the Assessee on exercise of the stock option plan was taxable as salary. The ITAT in its order placed reliance on ITAT ruling in the case of ***Sumit Bhattacharya***[46] in which a Special Bench of the Mumbai ITAT held that benefit from stock appreciation rights was of the nature of deferred wages and was received as fruit of employment related activity and, therefore, such income was taxable as salary even if an employer-employee relationship was not there.

The ITAT further held in its order that on exercise of a stock option to acquire certain shares, there was no transfer of any capital asset per se and hence, there was no capital gain income. On this basis, the ITAT in its order held that the difference between the fair market value and the amount recovered from the Assessee on the date of exercise of stock option was taxable as salary in the hands of the Assessee. Further, the ITAT held that due to subsequent sale of such shares by the Assessee within a year, the difference between the sale price of shares and their fair market value as determined above was taxable in the hands of the Assessee as short term capital gains. Thereafter, an appeal was filed by the Assessee before the HC against the order passed by the ITAT.

Issue

1. Whether the Assessee and SIRF USA had an employer employee relationship when stock options were granted to the Assessee by SIRF USA?
2. Whether stock options constituted a capital asset under Section 2(14) of IT Act and whether cashless exercise of such stock options constituted transfer of a capital asset under Section 2(47) of IT Act?
3. Whether gains on cashless exercise of stock option by Assessee would be taxable under the head salary and short-term capital gains or as long-term capital gains?

Arguments

The Assessee argued that there was no employer employee relationship between the Assessee and SIRF USA since the stock options were granted to the Assessee when he was working as an independent consultant and, therefore, the income from exercise of stock options was not taxable as salary in the hands of the Assessee. The Assessee further argued that right to purchase the shares of a company was a capital asset under Section 2(14) of the IT Act and relinquishment or extinguishment of such rights constituted a transfer of a capital asset as per Section 2(47) of the IT Act.

The Assessee also pointed out that the reliance placed by the ITAT on the ruling of a Special Bench of the Mumbai ITAT in the case of ***Sumit Bhattacharya***[47] to hold that an employer employee relationship was not essential to tax income under the head salary was also misplaced as said ruling was subsequently reversed by the Bombay HC in its decision in ***Sumit Bhattacharya v. ACIT***[48]**.** The Assessee also argued that the income arising on exercise of stock options was not taxable as

45 ITA No. 153 of 2014 (Karnataka HC).
46 300 ITR 34 Mum. (SB) (Mumbai ITAT).
47 300 ITR 34 Mum. (SB) (Mumbai ITAT).
48 ITA No. 736 of 2008 (Bombay HC).

salary in the hands of the Assessee since the stock options in the instant case were granted in 1996 when the provisions of Section 17(2)(iiia) were not in existence.

The Assessee also placed reliance on other judgments wherein it was held that cashless exercise of stock options results in capital gains and contended that since the IRA had not challenged such judgments, it was not open to the IRA to make a challenge in the present proceedings.

The IRA on the other hand pointed out that as per the clauses of the stock plan, even a consultant who performs services for the company was to be treated as an employee and hence, the Assessee was an employee of SIRF USA and the income from exercise of stock options was taxable as salary.

Decision

The HC held that as per the facts of the present case, the Assessee was working in the capacity of an independent consultant at the time of the grant of stock options by SIRF USA and did not have an employer-employee relationship per se with SIRF USA at that time. Hence, it was held by the HC that income from exercise of stock options granted to the Assessee as an independent consultant could not be treated as income from salary in the hands of the Assessee as income cannot be treated as income from salary unless there was an employer employee relationship.

In this regard, the HC further observed in its order that the reliance that was placed by the ITAT on the ITAT ruling in the case of ***Sumit Bhattacharya (supra)*** was erroneous in as much as the said ruling was subsequently reversed by the Bombay HC in its decision in ***Sumit Bhattacharya (supra)*** by placing reliance on the SC decision in the case of ***ACIT v. Bharat V. Patel***[49] on the same issue. The SC in the aforesaid ruling had held that clause (iiia) was inserted in Section 17(2) of IT Act w.e.f. April 1, 2000, and could not be applied retrospectively in a given case. The HC also observed that in the instant case as well, Section 17(2)(iiia) of IT Act was not part of the IT Act when stock options were granted to the Assessee. Further, the observations earlier made by the ITAT in the case of ***Sumit Bhattacharya (supra)*** that an employer employee relationship was not necessary for taxability of income as salary were also reversed by the Bombay HC.

The HC also placed reliance on the SC ruling in the case of ***Dhun Dadabhoy Kapadia***[50] wherein it was held that right to subscribe to shares of a company constitutes a capital asset under Section 2(14) of IT Act. The HC further held that even as per Explanation 1(e) to Section 2(42A) of IT Act, the term "short term capital asset" uses the expression "*in the case of a capital asset, being the right to subscribe to any financial asset*", which showed that that such rights to subscribe to certain shares constituted a capital asset under the IT Act and cashless exercise of stock options amounted to transfer of such capital asset by way of relinquishment/ extinguishment of rights in such capital asset under Section 2(47) of IT Act.

The HC further held that it has already been settled in several other judgements such as in the case of ***Kamlesh Bahedia***[51], ***N.R. Ravikrishnan***[52] and ***Dr. Muthian Sivathanu***[53] that there arises capital gain income on cashless exercise of stock options, which view has not been further challenged by the IRA. Hence, it was held by the HC held that the IRA cannot take a different view in this case and accordingly, decided that income from sale of stock options was taxable as capital gains income in the hands of the Assessee.

Significant Takeaways

The ruling given by the HC reiterates the principle that an employer-employee relationship is essential for treating income arising in the hands of an assessee as income from salary. The present ruling has also clarified that stock options issued to a consultant would not get treated in his hands as salary income irrespective of the clauses of the stock plan.

The HC in its ruling has also clarified that "rights to subscribe shares" i.e. the stock options constituted capital asset under the IT Act. Hence, a cashless exercise of such stock options constituted "transfer" of such capital asset under Section 2(47) of IT Act as there is relinquishment of such rights when they are exercised. The HC has also appreciated that where it has already been held in previous judgements that there arises capital gain income on cashless exercise of stock options and such view has not been challenged by the IRA, it cannot take a different stance in the present case.

> **" Cashless exercise of stock options granted to an independent consultant cannot be taxed as salary. "**

49 (2018) 98 Taxmann.com 386 (SC).
50 (1967) 63 ITR 651 (SC).
51 (2014) 50 taxmann.com 236 (Delhi ITAT).
52 (2019) 102 taxmann.com 418 (Bangalore ITAT).
53 (2018) 100 taxmann.com 49 (Chennai ITAT).

CASE LAW UPDATES- DIRECT TAX

MISCELLANEOUS

SC upholds the requirement of establishing prejudice to litigant along with breach of principles of natural justice

In the case of ***Sudhir Kumar Singh and others***[54], the SC while laying down tests for upholding breach of principles of natural justice, held that cancelling of tender by the government without providing the contractor with an opportunity of being heard, violated the principle of *audi alteram partem*.

Facts

Uttar Pradesh (UP) State Warehousing Corporation ("**Corporation**") had issued an e-tender on January 6, 2008, for handling and transportation of food grains, which was subsequently cancelled by the Corporation due to "administrative reasons." Subsequently, on April 1, 2018, an e-tender was published on the same terms for "appointment of Handling and Transporter Contractor for food grain in FCI and alleged material etc.," for specific depots/ centres in UP for two years. After receiving the price bids from the technical bidders, the tender was again cancelled by the Corporation stating that it was impractical to go-ahead with such a tender. Thereafter, another e-tender was reissued for the same region and purpose, on June 1, 2018, for a period of two years and Sudhir Kumar Singh ("**Respondent**") was declared as the successful bidder for one of the regions. Thus, an agreement dated July 13, 2018, was entered into between the Corporation and the Respondent for execution of the work under the tender for a period two years.

Meanwhile, two complaints were made to the Government regarding financial irregularities that occurred in the e-tender, which were then forwarded to the Managing Director of the Corporation with directions to furnish a report in five days. The Managing Director made an *ex parte* enquiry into the matter, along with an *ex parte* investigation conducted by the Commissioner, Vindhyachal Mandal Mirzapur. Based on the reports obtained from these *ex parte* enquiry and investigations, the Government cancelled the tenders, and disciplinary proceedings were initiated against certain employees of the Corporation.

The Respondent, thus, filed a writ petition in July 2019 before the Allahabad HC, challenging the "illegal and arbitrary" termination of their contract with the Corporation after successful completion of one year of the two-year term period stipulated under the contract. The Respondent prayed for setting aside of the orders of the Corporation, cancelling the tender.

The HC observed that the order terminating the agreement between the Corporation and the Respondent ("**Agreement**") was basis the report of the Managing Director, who did not offer the Respondent any opportunity of being heard. Thus, the HC observed that this resulted in the termination of the agreement between the Corporation and Respondent for no fault of the Respondent. Accordingly, the HC held that the order terminating the agreement was liable to be set aside, inter alia, for breach of principles of natural justice.

The HC also quashed the enquiry and investigation reports and the proceedings initiated against the two employees of the Corporation.

Against the order of the HC, the Corporation along with State of UP (collectively referred to as "**Petitioners**") filed an appeal before the SC.

54 State of UP v. Sudhir Kumar Singh and others, Civil Appeal No. 3498 of 2020 (SC).

Issues

Whether the ex parte investigation and passing of order terminating the Agreement by the Corporation was breach of principles of natural justice?

Arguments

The Corporation argued that the writ petition of the Respondent only prayed quashing of the order of the Corporation terminating the tender. However, the HC went way beyond to not only quash the order of the Corporation, but also the enquiry report of the Corporation and the proceedings undertaken by the Corporation against the delinquent officers.

The Corporation also argued that the financial disparities were so great that it made it clear that the contracts for all the designated centers ought not to have been entered into at all. The HC ought to have appreciated the huge financial loss that was caused as a result of the awarding of the contract and ought not to have interfered with the cancellation of the tender.

The Corporation further argued that even if the principles of natural justice were breached, no prejudice was caused as it would have been a mere exercise in futility to hear the affected parties before setting aside the order granting the tender. The Corporation also argued that the HC should not have interfered in contractual matters and ought to have left the Respondent to approach a civil court to file a suit for appropriate reliefs.

On the contrary, the Respondent argued that the HC judgement ought not have been interfered with, considering that the Respondent had already pumped in a lot of money and had worked the contract for a period of over one year successfully and without any compliant whatsoever from the Corporation. The Respondent also reiterated the fact that nobody had challenged the award of the tender to them, the challenge was only of the e-tender, therefore, the cancellation of the tender was done behind their back in an arbitrary and illegal manner. If the Respondents would have been given an opportunity of being heard, they would have established the reasonableness of the rates offered. Further, the Respondent also argued that they had suffered serious prejudice in their ability to work only for one out of the two-year period stipulated in the contract.

Decision

The SC agreed with the argument of the Petitioner that relief sought before the HC was confined to setting aside the cancellation of the tender, but the HC went ahead and also set aside the investigation report of the Corporation and quashed the disciplinary proceedings against the delinquent employees. The Respondents also conceded that their prayer was limited to setting aside of the cancellation of the tender. Therefore, the SC set aside the HC judgment insofar as it quashed the investigation report of the Corporation and proceedings against delinquent employees of Corporation.

On the argument of the Petitioner that the Respondent should have resorted to civil court for enforcement of breach of contractual obligations instead of approaching the HC, the SC relied on a coordinate bench ruling in the case of ***ABL International Limited***[55], wherein it was observed that if a State acts in an arbitrary manner, even in a matter of contract, an aggrieved party can approach the Court by way of writ. The SC also relied on its ruling in the case ***Rishi Kiran Logistics***[56], wherein it was held that writ petition being a public law remedy, a "public law element" should be present to invoke Article 226 of the Constitution. Further, the SC also relied on the case of ***Nawabkhan Abbaskhan***[57], wherein it was held that whenever a plea of breach of natural justice is made against the State, the said plea, if found sustainable, would amount to arbitrary State action under principles of constitutional law, and attracted provisions of Article 14 of the Constitution of India. Relying on the above rulings, the SC held that in the present case, the Respondent had approached the HC with writ alleging breach of principle of *audi alteram partem* by the State and thus, involved a "public law element". Given the same, the Court dismissed the argument of the petitioner that remedy of writ could not have been invoked by the Respondent.

With respect to whether the rule of *audi alteram partem* was actually breached in the present case, relying on a catena of judgements, the SC laid down the following tests for upholding breach of principles of natural justice:

i. The breach of *audi alteram partem* rule could not by itself mean that prejudice is caused;

ii. Prejudice must be caused to the litigant except in mandatory provision of law, which is detrimental not only in individual interest, but also in public interest;

iii. No prejudice is caused to the person complaining of the breach of natural justice where such person does not dispute the case against him or it;

iv. In cases where facts can be stated to be admitted or indisputable, and only one conclusion is possible, the Court should not pass futile orders of setting aside or remand when there is, in fact, no prejudice caused. This conclusion must be drawn by the Court on an appraisal of the facts of a case, and not by the authority who denies natural justice to a person;

55 ABL International Limited and Another v. Export Credit Guarantee Corporation of India Limited and Others (2004) 3 SCC 553 (SC).
56 Rishi Kiran Logistics v. Board of Trustees of Kandla Port and others (2015) 13 SCC 233.
57 Nawabkhan Abbaskhan v. State of Gujarat (1974) 2 SCC 121.

v. The "prejudice" exception must be more than a mere apprehension or even a reasonable suspicion of a litigant. It should exist as a matter of fact or be based upon a definite inference of likelihood of prejudice, flowing from the non-observance of natural justice.

On the touchstone of these tests, the SC held that the Respondent had been kept completely in the dark in so far as the cancellation of the order awarding the tender was concerned and thus the rule of *audi alteram partem* was breached in entirety. The SC also agreed with the argument of the Respondent that prejudice had been caused to them, not only from the fact that one year of the contract period had been taken away, but also that if the HC judgment is set aside by the SC, the Respondent would be debarred from bidding for any of the Corporation's tenders for a period of three years. Thus, the SC upheld the order of the HC on the ground that principle of natural justice had been breached in the instant case. It also observed the fact that huge financial loss had been caused to the Corporation as a result of the awarding of the tender, but it was a matter for the Corporation to probe and take remedial action against the persons who were responsible for the same.

Significant Takeaways

Previously, there have been several rulings wherein HC or SC have on multiple occasions upheld violation of principles of natural justice only on account of lack of proper and adequate opportunity of being heard. For instance, in the case of ***Rameshwaram Paper Mills (P) Ltd.***[58]**,** the HC had upheld the requirement of adequate and proper opportunity of being heard to ensure fair hearing. Similarly, SC in the case of ***Rajesh Kumar***[59], had held that deciding a case without getting the reply would amount to violation of principles of natural justice.

In the instant case, the SC has thoroughly analysed significant judicial precedents on the applicability of principle of natural justice and laid down certain significant tests to invoke their applicability. One of the important takeaways from the tests laid down by the SC is that mere establishment of the fact that there has been a breach of principle of natural justice is not enough. The litigant would also have to establish that there has been prejudice caused as a result of the breach.

Thus, the SC has upheld the requirement of not only establishing violation of principle of natural justice, but also causation of prejudice to litigant claiming violation.

" SC reiterates the principles of audi alteram partem. "

58 Rameshwaram Paper Mills v. State of UP, Writ Petition No. 1301 of 2009 (HC).
59 Rajesh Kumar v. DCIT, Civil Appeal no. 4633 of 2006 (SC).

Maintenance of a computerised database of qualified IT personnel and transmission of such information to clients by the Assessee qualifies as human resource services for the purpose of claiming deduction under Section 10A of IT Act

In the case of ***NTT Data Global Advisory Services Private Limited***[60], the Karnataka HC held that the activity of maintenance of a computerised database of qualified Information Technology ("**IT**") personnel and providing information of potential candidates to clients, necessarily implied creation and transmission of data through electronic means to the clients. Such activity would amount to provision of human resource services and would, therefore, be covered as IT Enabled Services under the CBDT Notification[61] dated September 26, 2000, making it eligible for deduction under Section 10A of IT Act.

Facts

NTT Data Global Advisory Services Private Limited ("**Assessee**") was a company engaged in providing certain software related and other professional services. It also included services pertaining to the maintenance of a computerised database of qualified IT personnel and transmission of information related to such personnel to its clients. The Assessee had also claimed deduction under Section 10A of the IT Act in its income tax return.

However, the AO during the course of assessment proceedings for the relevant AY, i.e. AY 2007-08, excluded the income from the aforesaid recruitment related services rendered by the Assessee from the export turnover for the purpose of computing deduction under Section 10A of the IT Act. The order of the AO was subsequently upheld by the CIT(A) and an appeal was filed by the Assessee before the ITAT against such order passed by the CIT(A).

Section 10A of the IT Act is a beneficial provision under the IT Act, which provided for 100% deduction of profits derived by newly established undertakings in free trade zones, engaged in the export of articles or computer software. For this purpose, Explanation 2 to Section 10A of the IT Act defines the term computer software as '*any customised electronic data or any product or service of a similar nature, as may be notified by the Board*'. In exercise of powers conferred by clause (b) (i) of Explanation 2 to Section 10A of the IT Act, the CBDT *vide* Notification dated September 26, 2000, specified the information technology enabled products or services, which would be eligible for deduction under Section 10A of the IT Act and specifically mentioned human resource services. ITAT in its order held that transmission of data pertaining to qualified IT personnel qualified as human resource services and IT enabled services as specified in the CBDT Notification dated September 26, 2000. Therefore, the ITAT decided the issue pertaining to claim of deduction under Section 10A in respect of said services in favour of the Assessee. Against such ITAT order, an appeal was filed by the IRA in the HC.

Issue

Whether the nature of recruitment related services (as described above) rendered by the Assessee would qualify for deduction under Section 10A of IT Act?

Arguments

The IRA argued that the nature of services rendered by the Assessee was not human resource services as Assessee was only engaged in providing placement, which was akin to the services of a commission agent. Mere compilation of information of candidates and use of computers did not amount to rendering IT enabled services. On this basis, the IRA contended that the Assessee was not eligible for deduction under Section 10A of the IT Act. The IRA also relied upon the ruling of the Delhi HC in the case of ***ML Outsourcing Services***[62] to allege that the nature of services rendered by the Assessee did not qualify as human resources services, the meaning of this term was deliberated at length in the aforesaid ruling, such that it was held that "human resource" meant personnel of a business organisation and "service" meant anything associated with the personnel of a business organisation, including their selection or recruitment and, therefore, it was held that the process of acquiring and recruiting employees was not to be included in the expression human resource services.

In the instant case, the Assessee was engaged in hiring overseas IT consultants for its clients and was held eligible for deduction under Section 10A of the IT Act. IRA also argued that further fact finding was required in the matter in order to ascertain whether expenses on training were incurred by the Assessee for its own employees or for other persons who were candidates for other companies.

The Assessee on the other hand argued that it was eligible for deduction under Section10A of the IT Act, irrespective of whether or not it incurred any expenditure on training of its own employees or other persons. The Assessee argued that the aforesaid CBDT Notification deals with IT enabled products or services that qualify for the benefit under Section 10A of IT Act,

60 ITA No. 544 of 2013 (Karnataka HC).
61 CBDT Notification No. 890 (E) dated September 26, 2000.
62 ITA No. 1255 of 2011 (Delhi HC).

which specifically includes human resource services. The Assessee further argued that the services it had rendered qualified as human resource services, as explained by the Delhi HC in the ruling in the case of ***ML Outsourcing Services (supra)*** and relied on certain other rulings, which explained the scope of the various activities specified in the CBDT Notification dated September 26, 2000.

Decision

The HC observed that Explanation 2 to Section 10A of IT Act, while defining the term 'computer software', had empowered the CBDT to notify services that would be covered by the expression 'product or services of similar nature'. The HC further observed that the relevant Notification dated September 26, 2000, issued by the CBDT uses the term human resource services as also IT enabled product or services.

The HC then observed that from the assessment order, it could be seen that the Assessee was engaged in the maintenance of computerised database with regard to various types of qualified IT personnel and provided its customers with information pertaining to such potential candidates who would satisfy their requirements. On this basis, the HC held that the Assessee was basically engaged in creating an electronic database of qualified personnel and transmitting it through electronic means to its customers. It further held that irrespective of whether or not the Assessee provided any training to its own employees or the personnel recruited by its customers, the Assessee was still engaged in human resource services and such services were squarely covered by aforesaid CBDT Notification dated September 26, 2000.

Hence, the HC decided the issue in favour of the Assessee and held that it was entitled to claim deduction under Section 10A of the IT Act in respect of such services.

Significant Takeaways

Through this ruling, the HC has provided clarifications on the meaning and ambit of the term export of "computer software" used in Section 10A(1) of the IT Act. The term "*computer software*" is then defined in clause (b) (i) of Explanation 2 to Section 10A of the IT Act as "*any customised electronic data or any product or service of similar nature, as may be notified by the Board*". The ruling would pave the way for much clarity on the scope of the services eligible for deduction under Section 10A of the IT Act and could reduce the litigation on the issue of scope of 'human resources services' covered under the CBDT Notification.

Both the parties in this ruling had placed reliance on the Delhi HC ruling in the case of ***ML Outsourcing Services (supra)***. It is pertinent to note that the Delhi HC in the said ruling had provided some clarifications on the ambit of the term human resource services and explained that anything associated with personnel of a business organisation such as services related to their selection or recruitment would qualify as human resource services, for instance, the process of acquiring and recruiting employees would be included in the expression human resource services and, therefore, held that the nature of recruitment related services rendered by the assessee in that case, such as sourcing, interviewing and shortlisting candidates by use of IT enabled tools and applications would also qualify as human resource services.

The HC, even in the present ruling, has meaningfully analysed the aforesaid CBDT Notification dated September 26, 2000, and the nature of services actually performed by the Assessee to come to a conclusion that services performed by the Assessee would also qualify as human resources for the purpose of application of said CBDT Notification dated September 26, 2000.

> **"Maintenance of a computerised database of qualified IT personnel and transmission of such information to clients qualifies as human resource services."**

Voluntary contribution received on behalf of beneficiaries assessed in the hands of a private discretionary trust under Section 56(2)(vii) of IT Act; trust assessed as representative assessee of beneficiaries

In the case of ***Shriram Ownership Trust***[63], the Madras HC held that where a donation was received by a private discretionary Trust on behalf of beneficiaries who were individuals and duly identifiable, the Trust would be treated as a representative assessee of beneficiaries under Section 160(1)(iv) of the IT Act and the benefit derived by the Trust on behalf of the beneficiaries would be taxed in its hands in the capacity of an "individual". The HC also held that said income would be taxed in the hands of the Trust as "income from other sources" under Section 56(2)(vii) of the IT Act.

Facts

Shriram Ownership Trust ("**Assessee trust**") was a private discretionary Trust established for the distribution of retirement benefits to the owners and senior personnel from the Shriram Group of companies when they attain 60 years of age. Such individuals were the beneficiaries of the Assessee Trust. During the relevant year, i.e. FY 2013-14, Assessee Trust received a donation amounting to INR 25 crore from six companies from the Shriram Group of companies, which was credited to the balance sheet of the Assessee Trust under the head 'Addition to Corpus' and was not routed through its profit and loss account.

The Assessee Trust filed its Return of Income ("**ROI**") for the relevant year. Its case got selected for scrutiny on the primary issue of contribution of INR 25 crore received by the Assessee Trust during the year. On this issue, the Joint Commissioner of Income Tax ("**JCIT**"), under the provisions of Section 144A of the IT Act issued notice treating the Assessee Trust as a representative assessee on behalf of the beneficiaries under Section 160(1)(iv) of the IT Act and issued directions under Section 144A of the IT Act for treating the Assessee Trust as an individual and taxing the corpus donation received by it on behalf of the beneficiaries under Section 56(2)(vii) of the IT Act as "income from other sources".

During the course of the assessment proceedings, the Assessee Trust argued that it was an association of persons ("**AOP**") and not an individual. However, the AO passed the assessment order, making addition under Section 56(2)(vii) of the IT Act as described above. In the appeal filed by the Assessee Trust against the aforesaid order, the CIT(A) upheld the order passed by the AO and relied upon the SC ruling in the case of ***Indira Balkrishna***[64], wherein it was held that an AOP stands for an association, which is formed for a common purpose. Hence, the CIT(A) in his order held that in the instant case, the beneficiaries did not come together for a common purpose, and, therefore, the Assessee Trust could not be considered to be an AOP.

An appeal was filed by the Assessee Trust before the ITAT against the order passed by the CIT(A). The ITAT in its order deleted the addition as it observed that an "individual" as referred to in Section 56(2)(vii) of the IT Act only referred to a natural living person, though it also stated that the manner in which any assessee described itself in its ROI was not per se determinative of its status. It placed reliance on the SC ruling in the case of ***Kamalini Khatau***[65] to hold that a private discretionary Trust cannot be treated only as an individual for the purpose of taxation under the IT Act. The SC in the case of ***Kamalini Khatau*** had held that as per Section 164 of the IT Act, the income of a discretionary Trust can also be taxable as if it were an AOP where the share of the beneficiaries was indeterminate.

Against the said ITAT order, an appeal was filed by the IRA before the HC.

Issue

1. Whether the Assessee Trust was assessable in its representative capacity as an individual when the beneficiaries of the Trust were individuals and identifiable, when it has already been held in several rulings that a private discretionary trust could be assessed as an individual?
2. Whether contribution received by the Assessee Trust on behalf of the beneficiaries can be taxed in its hands in the capacity of an "individual" under Section 56(2)(vii) of the IT Act as the term individual used in the said provision was not restricted to natural living persons?

Arguments

The IRA argued before the HC that as per Section 161(1) of the IT Act, the Assessee Trust being a representative assessee, had to be taxed in the like manner and to the same extent as the beneficiaries and the beneficiaries being individuals, the Assessee Trust's status was also that of an individual. Reliance was placed by the IRA on several rulings, including the HC rulings in the case of ***Venu Suresh Sheela Trust***[66] and ***Arihant Trust***[67] to support the argument that a Trust can be assessed as an individual and that the word individual as used in the relevant provisions of the IT Act was not restricted to natural persons.

63 T.C.A No.248 of 2018 (Madras HC).
64 (1960) 39 ITR 546 (SC).
65 (1994) 209 ITR 101 (SC).
66 (1998) 233 ITR 99 (Madras HC).
67 (1995) 214 ITR 306 (Madras HC).

It may be noted that in ***Venu Suresh Sheela Trust***, it was held that for application of Section 80L of the IT Act, a private discretionary Trust can be considered as an individual and the term individual is not restricted to natural persons only and the HC ruling in ***Arihant Trust*** was passed, making similar observations relying upon ***Venu Suresh Sheela Trust*** in the context of Section 194A of the IT Act. The ITAT in its order had held that these decisions were not relevant as these decisions were rendered with respect to those provisions under the IT Act, which granted relief to an assessee whereas the instant case pertained to a charging provision under the IT Act.

Reliance was also placed by the IRA on the HC ruling in the case of ***Marsons Beneficiary Trust***[68] in which the beneficiaries or even trustees were held to be not forming an AOP. The HC in aforesaid case relied upon the principles laid down in ***Indira Balkrishna*** ruling to hold that beneficiaries did not form an AOP. It was argued by the IRA that even in the case of the Assessee Trust, the beneficiaries have not come together with a common purpose and hence, it cannot be treated as an AOP.

Further, the IRA argued that income of every kind, which was not specifically included in the total income was charged under the IT Act under the head 'income from other sources' and income derived by the Assessee Trust was assessable under Section 56(2)(vii) of IT Act as an individual and the Assessee Trust cannot be allowed to act as a conduit for tax evasion.

Whereas it was the argument of the Assessee Trust that Section 56(2)(vii) of the IT Act could not be invoked as it applied only to individuals and HUFs and the term "individual" used in the said provision was only for natural human beings, it placed reliance on SC ruling in the case of ***Smt. Sodra Devi***[69] in this regard.

The Assessee Trust also contended that it fell within the ambit of Explanation to Section 2(31) of the IT Act and consequent to insertion of such explanation, reliance placed by IRA on SC ruling in the case of ***Indira Balkrishna*** was misplaced. Explanation to Section 2(31) of the IT Act was inserted by the Finance Act 2002 w.e.f. April 1, 2002, to provide that an AOP or an artificial juridical person, etc., shall also be deemed as a "person" under Section 2(31) of IT Act, even if it was not formed with the object of deriving profits. The CIT(A) in his order had already rejected the said argument, by stating that the Assessee Trust was not covered within the ambit of this explanation and the said amendment was in fact brought in order to bring charitable trusts within the ambit of said provision.

In addition to the above, the Assessee Trust argued that it constituted an AOP, especially since it filed its ROI in ITR -5, which was filed for Trusts. It also contended that Section 161 of the IT Act did not apply as beneficiaries were indeterminate and their individual share in income was also indeterminate.

Further, it also contended that the judgments relied upon by the IRA such as ***Venu Suresh Sheela Trust, Arihant Trust*** and ***Marsons Beneficiary Trust*** were all rendered prior to the insertion of Explanation in Section 2(31) of IT Act and were passed in different contexts as in those cases, the beneficiaries were known or their individual shares were determinate.

Decision

The HC relied upon SC ruling in the case of ***Indira Balkrishna*** and held that since in case of the Assessee Trust, there was no such common purpose shared by the trustees/ beneficiaries, the Assessee Trust was not an AOP. The HC clarified that legal principle laid down in said decision was still relevant and cannot be set aside because Explanation to Section 2(31) of the IT Act was inserted *vide* Finance Act, 2002, merely to include entities that were not formed with an intention of earning profit.

It held that the Assessee Trust was to be treated as a representative assessee under Section 160(1)(iv) of the IT Act as it received income on behalf of and for the benefit of the beneficiaries and since beneficiaries were individuals and were identifiable, Assessee Trust was also assessable as an "individual". The HC rejected the argument of the Assessee trust that the beneficiaries were not known as the Trust deed duly mentioned the persons who were beneficiaries. Also, it relied upon rulings of the SC in the case of ***Yogendra Nath Naskar vs. CIT***[70] and ***WTO vs. C.K. Mammed Kayi***[71], along with other rulings to hold that the term 'individual' was not restricted to human beings and this was irrespective of any references to a wife or a daughter in other provisions of the statute. The HC also observed that the ruling in the case of ***C.K. Mammed Kayi*** had already considered the ruling in the case of ***Smt. Sodra Devi***[69] before passing its judgment.

Further, the HC in its order did not agree with the ITAT's observation that the judgments relied upon by the IRA, such as ***Venu Suresh Sheela Trust, Arihant Trust*** and ***Marsons Beneficiary Trust***, were not relevant as they were all rendered prior to the insertion of Explanation to Section 2(31) of the IT Act as these decisions were rendered with respect to those provisions in the IT Act, which granted relief to an assessee, whereas the instant case pertained to a charging provision under the IT Act. The HC held that this was not a valid reason for distinguishing a judgment.

As for the argument of the Assessee Trust that its status shown in its ITR was that of an AOP, the observations made by the CIT(A) and ITAT in their orders, that the status shown by an assessee in its ITR was irrelevant while ascertaining taxability as per the IT Act, were upheld by the HC. Further, the HC appreciated the findings of the AO/ CIT(A) that the Assessee Trust was trying to

68 (1990) 52 Taxman 454 (Bombay HC).
69 (1957) 32 ITR 615 (SC).
70 (1969) 74 ITR 33 (SC).
71 (1981) 129 ITR 30 (SC).

circumvent the provisions of the IT Act by accepting the sum on behalf of beneficiaries and acting as a conduit and observed that the ITAT in its order did not even examine these aspects.

Significant Takeaways

For taxation purposes, a private Trust acts as a pass-through entity and a representative assessee as provided for under Section 160 of the IT Act. It is assessed on behalf of the beneficiaries of the Trust. Further, as per Section 161(1) of IT Act, a Trust has to be taxed in the like manner and to the same extent as the beneficiaries, therefore, the status of the beneficiaries in a given case is relevant for determining the status of the Trust for taxation purposes. There are several Court rulings including those by the SC, which have clarified that a Trust can be assessed as an individual under the IT Act, depending on the status of the beneficiaries and the term individual as referred to in the relevant provisions of the IT Act does not only refer to natural persons.

As for whether or not a Trust can be assessed as an AOP, the legal principle as laid down by the SC in the case of ***Indira Balkrishna*** with respect to requirement of a common purpose has been adequately emphasised in the present judgment and it still holds true while determining whether or not a group of persons could constitute an AOP for taxation purposes.

“ Private discretionary Trust assessed as a representative assessee of the beneficiaries and taxed under Section 56(2)(vii) of the IT Act for contributions received. ”

Issue related to non-deduction of TDS concluded in proceedings under Section 201 of IT Act cannot be reagitated in assessment proceedings

In the case of ***Sutherland Global Services Private Limited.***[72], the Madras HC held that the ITAT does not have jurisdiction to remand back to the AO the issue of non-deduction of TDS when the same issue has already been settled in proceedings under Section 201 of the IT Act and attained finality. It further held that the ITAT exceeded its jurisdiction in directing the AO to examine if there was any shifting of profits by the Assessee to its holding company, outside India under the garb of commission expenditure when it was not even the case of the AO itself that there was any shifting of profits outside India.

Facts

Sutherland Global Services Private Limited ("**Assessee**") was an Indian company and a subsidiary of Sutherland Global Services Inc., a U.S. company ("**SGS USA**"), which was engaged in providing BPO services and IT-enabled services, predominantly to third party clients. It also rendered support services for BPO operations and transaction processing services to its AEs located outside India.

SGS USA was responsible for carrying out business development for the group, which included the Assessee, for which purpose an agreement for marketing services was also entered into between the Assessee and SGS USA. As per said agreement, SGS USA received business development commission for procuring business for the Assessee at an amount equal to 5% of the turnover of the Assessee.

During the relevant year i.e. FY 2007-08, under the terms of such agreement, Assessee paid business development commission to the tune of INR 22.41 crore to SGS USA, without deduction of any TDS therefrom. According to the Assessee, there was no sum chargeable to tax in India as per the provisions of Section 195 of IT Act and hence, there was no requirement to deduct any TDS.

During the course of the assessment proceedings, the AO disallowed aforesaid commission expenditure under Section 40(a)(i) of the IT Act due to non-deduction of TDS. The Assessee filed an appeal before the CIT(A) who upheld the disallowance made by the AO and observed that business development commission paid by the Assessee to SGS USA resulted in income chargeable to tax in India and TDS was deductible at the time of making such payment. Against such order passed by the CIT(A), an appeal was filed by the Assessee before ITAT.

It is pertinent to note that in separate proceedings in case of the Assessee under Section 201 of IT Act, for default in deduction of TDS on said commission expenditure, the CIT(A) passed an order holding that business promotion services rendered by SGS USA to be not in the nature of technical services as defined under Section 9(1)(vii) of IT Act or consultancy services as provided under Article 12 of the India-USA DTAA. The CIT(A) in his order further held that the software that is being put to use by the Assessee for tracking of sales efforts was a standard software and was not owned by SGS USA and also there was no technology that was made available to Assessee in this regard. Hence, it was held that there was no requirement for deduction of TDS by Assessee on such payment. Further, no appeal was filed by the IRA against the order passed by the CIT(A).

Therefore, during the course of hearing in the appeal that was filed by the Assessee before the ITAT in the main assessment proceedings, the Assessee in addition to its arguments on merits specifically contended that proceedings under Section 201 of the IT Act for TDS deduction default on the same commission expenditure had already concluded and the issue had been decided by the CIT(A) in favour of the Assessee. Therefore, the issue related to the deduction of TDS on business development commission attained finality and the disallowance made during the course of assessment proceedings should also be deleted.

However, the ITAT in its order observed that it was the final fact finding authority and could not be restrained from looking into all the facts and it remanded the said issue to the AO to analyse the nature of services rendered by SGS USA to the Assessee and to decide whether TDS was deductible on such business development commission. The ITAT also directed the AO to determine whether there was any concerted effort on part of the Assessee to shift profits to SGS USA through incurring said commission expenditure.

The Assessee filed an appeal before the HC against the said order passed by the ITAT.

Issue

1. Whether ITAT had powers to remand back the issue of non-deduction of TDS on business development commission paid by the Assessee to the AO even though the issue was settled and had attained finality in separate proceedings under Section 201 of IT Act?
2. Whether ITAT had exceeded its jurisdiction in remanding the issue of alleged profit shifting by the Assessee through payment of business development commission to SGS USA to the AO, especially when it was not the case of the AO itself in its original assessment order that there was any profit shifting being done by the Assessee in the garb of said commission expenditure?

72 ITA No. 32 of 2019 (Madras HC).

Arguments

Before the HC, the Assessee argued that the ITAT had exceeded its jurisdiction by remanding back the issue of disallowance of commission expenditure to the AO when in fact the issue of deductibility of TDS had already been decided in favour of the Assessee by the CIT(A) in proceedings carried out under Section 201 of the IT Act and had attained finality.

As for the remand back by the ITAT on the issue of alleged profit shifting by the Assessee to SGS USA, the Assessee relied upon certain rulings on the general proposition that the ITAT can only adjudicate on issues that are subject matter of appeal before it and that it cannot delve into new issues or take away the benefits already granted to an assessee by the AO. On this basis, the Assessee also contended that the ITAT did not have jurisdiction to remand back on the issue of profit shifting as it did not form part of original assessment order.

Decision

The HC observed that even if the ITAT was the final fact finding authority, it did not have the jurisdiction to remand back to the AO issue of non-deduction of TDS when the same issue had already been settled in proceedings under Section 201 of IT Act and had attained finality. The HC further observed that in case ITAT was of the view that the said order was not binding on the ITAT, then adequate reasons should have been given in its order in this regard. Therefore, the HC decided the issues of disallowance of business development commission in favour of the Assessee and deleted the disallowance in this regard.

On the issue of remand back by the ITAT to the AO to examine if there was any shifting of profits by Assessee to SGS USA under the garb of such commission expenditure, the HC held in its order that the ITAT had exceeded its jurisdiction as it was not even the case of the AO that there was any shifting of profits outside India. The HC observed that an Assessee cannot be worse off in its appeal as compared to its position prior to filing of appeal and, thus, reversed the order of the ITAT.

Significant Takeaways

This is a welcome ruling for taxpayers who have received a favourable ruling in proceedings carried on under Section 201 of the IT Act for alleged default in TDS deduction on certain expenditure as they will not have to go through a lengthy litigious process again during the course of assessment proceedings if there is a disallowance on account of the same expenditure due to non-deduction of TDS.

Further, there are several rulings wherein it has already been settled that the ITAT cannot decide on issues that are not in appeal before it or remand back an issue to the AO for delving into new issues such that an assessee who exercised his right to appeal on a specific issue is put in a worse position post filing of appeal.

However, it should be noted that no appeal was filed by the IRA against the order of the CIT(A) in proceedings under Section 201 of IT Act and considerable time had already passed after expiry of timeline for filing of an appeal against the CIT(A) order. In case an appeal was filed by the IRA against the order of the CIT(A) in ITAT, which was pending for adjudication at the time of hearing of the Assessee's appeal in HC in the main assessment proceedings, the issue of deductibility of TDS on aforesaid commission expenditure could have been decided by the HC on merits of the case.

Also, it should be noted that the HC, even in the present ruling has duly observed that in case the ITAT was of the view that the said order was not binding on the ITAT, it could have even taken such a view but only by providing adequate reasons in its order in this regard. This implies that the HC has not laid down a blanket rule to be adopted by the Courts in future in similar situations. Rather, it laid out the general proposition for similar situations, unless there are detailed reasons provided in the order itself for not following a particular decision that was taken in the other proceedings of an assessee on the same issue.

> **" Issue already decided in proceedings for non-deduction of TDS under Section 201 of IT Act that had attained finality cannot be reagitated in assessment proceedings. "**

Mumbai ITAT upheld the tax-exempt status of Tata Trusts

In the case of ***Sir Dorabji Tata Trust***[73]**,** Mumbai ITAT quashed the revisionary assessment order under Section 263 of the IT Act, thereby upholding the tax-exempt status of the Trust.

Facts

Sir Dorabji Tata Trust ("**Assessee**") was registered as a charitable institution under Section 12A of the IT Act. The Assessee, for the relevant FY 2014-15, filed its return of income and was assessed with Nil taxable income. Subsequently, the CIT set aside the assessment order AO on the grounds that it was "*erroneous and prejudicial to the interest of the revenue*" under Section 263 of the IT Act. The CIT held the order of AO as erroneous and prejudicial to revenue's interest on the following grounds:

i. The AO failed to make inquiry with respect to the fact that the salary paid to the trustees of the Assessee was in excess of the limits specified in the Trust deed. It was noted that the Assessee had reimbursed INR 91.11 lakhs to Tata Services Ltd. ("**Tata Services**") for payments made to Mr. A.N. Singh ("**Mr. Singh**"), for the services rendered by him to the Assessee. Similarly, it was noted that the Assessee had reimbursed the entire renumeration of Mr. R. Venkataramanan ("**Mr. Venkaratamanan**") to Tata Sons Ltd. ("**Tata Sons**"), who served as their Vice President. Thus, the CIT noted that these individuals were also the Trustees of the Assessee, and the amount paid to them by the Assessee was in excess of the limit specified in the Trust deed.

ii. The CIT observed that the Assessee had invested its funds in shares, which did not fall within the purview of prescribed modes under Section 11(5) of the IT Act for Trusts claiming exemptions under Section 11 of the IT Act. Thus, the CIT held that the AO had failed to investigate whether these investments were prohibited under Section 13(1)(d) of the IT Act and to determine whether such investments would result in denial of exemptions to the Assessee.

iii. Clause (h) of sub-section (2) of Section 13 provides that if the funds of the Trust have been invested in any concern in which any person referred to in sub-section (3) of Section 13 has substantial interest, it shall be deemed that the assessee Trust has used or applied its income for the benefit of such person and thereby operation of Section 11 or 12 would cease so as to exclude it from the total income. On perusal of records of A.Y.2014-15, it was also noticed that the Assessee continued to hold 27.98% shares in Tata Sons and continued to hold shares in its group companies. Further, as per Article of Association of Tata Sons, the trustees and the trustees of Sir Ratan Tata Trust jointly appointed non-executive directors on the board of Tata Sons. Given the shareholding of the Assessee in Tata Sons and the close relationship of the trustees of the Assessee with Tata Sons, the applicability of Section 13(2)(h) on the Assessee should have been examined by the AO more carefully.

Based on the aforesaid grounds, the CIT passed an order setting aside the original assessment order and directed the AO to make a de-novo assessment after proper examination of various issues, including the above-mentioned issues.

On similar grounds, other than the ground on remuneration of trustees, the CIT invoked the applicability of Section 263 with respect to a few other Tata Trusts as well, namely Sir Ratan Tata Trust and JRD Tata Trust.

Aggrieved by the CIT order, the Assessee along with the other Trusts, filed separate appeals before the ITAT.

Issues

1. Whether the CIT was justified in passing an order setting aside the original assessment and directing a fresh assessment for the Assessee under Section 263 of the IT Act?
2. Whether the AO made insufficient inquiry on the remuneration paid to the Trustees of the Assessee?
3. Whether the AO made deficient inquiries about the investments of the Assessee Trust and whether they formed part of the corpus of the Assessee?
4. Whether the Assessee Trust exercised any control in the affairs of Tata Sons and whether the trustees derived any benefit in the form of payments from Tata Sons?

Arguments

The Assessee placed reliance on the Bombay HC decision in the case of ***Gabriel India***[74] wherein it was held that an order was erroneous only when it was not in accordance with the applicable law or which has been passed without making proper enquiry in due haste. Thus, the Assessee argued that the AO, in the instant case passed the order only after reviewing the specific information sought from the Assessee, therefore, the order of the AO cannot be said to have been passed without making proper enquiry.[75] The Assessee further argued that even post revision under Section 263, there would be no tax effect and thus, the order of the AO could not be held as prejudicial to the interest of the revenue.

Regarding the excess payments made to Mr. Singh and Mr. Venkatramanan, the Assessee argued that the trust deed

73 Sir Dorabji Tata Trust v. Deputy Commissioner of Income Tax Exemption Circle 2(1), Mumbai, ITA No. 3909/ Mum/ 2019
74 CIT v. Gabriel India (1993) 203 ITR 108 (Bombay HC).
75 Dawjee Dadabhoy & Co. v. CIT (1957) 31 ITR 872 (Calcutta HC).

entitled the trustees of the Assessee to appoint Managing Trustee and fix their remuneration. Given the expansive role of Mr. Singh as Managing Trustee of the Assessee, the excess remuneration paid by Tata Services to Mr. Singh for his role as managing trustee was reimbursed by the Assessee. As regards Mr. Venkatramanan, the Assessee argued that no payment was made by it to Mr. Venkatraman during the relevant FY.

With regard to the investment of funds of Assessee in shares, the Assessee argued that such investments were not made in the relevant FY. These investments were made prior to June 1, 1973, and only accretions that have happened subsequently are by way of bonus to those shares. Hence, the question of any verifications under Section 13 for the relevant FY does not arise.

Regarding applicability of Section 13(2) of the IT Act on account of 27.98% shareholding of the Assessee in Tata Sons, the Assessee argued that while it held shares in Tata Sons, none of the trustees have received any benefit from Tata Sons in the capacity of being trustees. Therefore, the applicability of Section 13(2) did not arise in the Assessee's case.

On the other hand, the IRA argued that the order passed by the AO was erroneous and prejudicial to the interest of the revenue as the AO had failed to make enquires with respect to certain issues concerning the Assessee and argued that CIT was justified in setting aside the order of the AO under Section 263 of the IT Act.

Decision

Interpretation of what constitutes an order "erroneous and prejudicial to the interests of the revenue"

The ITAT examined the scope of provisions of Explanation 2(a) to Section 263 to the effect that when an order is deemed to be "*erroneous and prejudicial to the interests of the revenue*" and when CIT is of the view that "*the order is passed without making inquiries or verification, which should have been made*".

The ITAT explained that the expression "*when the commissioner is of the view*" used in explanation 2 to Section 263 itself does not mean the view so formed by the CIT was not subject to any judicial scrutiny. The ITAT rejected the IRA's submission that once the CIT recorded his view that the order was passed without making inquiries or verifications, which should have been made, it cannot be questioned, and the validity of the revision order must be upheld.

The ITAT also opined that unless the AO does not conduct inquiries and verifications expected of a prudent, judicious and responsible public servant in the ordinary course of performance of duties, CIT cannot legitimately form the view that "*the order is passed without making inquiries or verification which should have been made*". The ITAT also explained that all that was required to be done by the AO was to examine the income tax return and claims made therein as to whether those were *prima facie* in accordance with the law and where one had any reasons to doubt the correctness of a claim made in the income tax return, probe into the matter deeper in detail.

Remuneration paid to Trustees

Regarding the allegation of the CIT, the reimbursements made to Tata Sons and Tata Services for payments made to Mr. Singh and Mr. Venkataraman, the ITAT found that no payments were made to Mr. Venkataraman during the relevant FY or to anyone else on his behalf. On payments made to Mr. Singh, the ITAT found that the remuneration of Mr. Singh was fixed when he was appointed as Managing Trustee in 2007 for the services rendered by him. There were no excess payments being paid to the Trustees, in violation of the trust deed of the Assessee.

Examination of investments held by the Assessee

Regarding the allegation of the CIT that the AO carried out insufficient examination of the investments of the Assessee Trust, the ITAT observed that the assets had been held as on June 1, 1973, and in the duration of forty plus years, the exemption was never declined to the Assessee trust on the ground that these did not form part of the corpus. Thus, there was no good reason to doubt that these shares were not part of the corpus, given that there is no change in the legal or factual position and the AO was correct in not probing into something that has been accepted for over four decades. Further, the ITAT noted that while notifying the assessee under Section 10(23C) of the IT Act, the CBDT accepted that the shares were held as a part of the corpus. ITAT stated that even if these investments were held to be contrary to the provisions of Section 11(5), all that could have been done by the AO was to decline exemption under Section 11 in respect of income from these investments, i.e., dividends, which was anyway completely tax neutral for the Assessee.

Control exercised by the Assessee trust in the affairs of Tata Sons

ITAT took note of CIT's observation that Mr. Cyrus Mistry ("**Mr. Mistry**") had written a letter alleging that the trustees of the Assessee were having control over the business of Tata Sons and that the trustees were "taking lots of services and benefits from Tata Sons". It was alleged by the CIT that the AO failed to make a detailed investigation on the allegations made by Mr. Cyrus Mistry. ITAT observed that the letter from Mr. Mistry was received by the AO at the fag-end of the assessment proceedings and hence it was not possible for the AO to form a definite conclusion within the statutory time frame for completion of the assessment.

With respect to invocation of provisions of Section 13(1)(c) and Section 13(2)(h), the ITAT clarified that the mere fact that the Assessee Trust itself had over 20% equity investments in Tata Sons did not suggest or imply that the trustees must also be having 'substantial interest' in Tata Sons Limited. Thus, when none of the specified persons were stated to have any

substantial interest in Tata Sons, the question of direct or indirect benefit under Section 13(1)(c) read with Section 13(2)(h) did not arise.

As regards the shareholding of Assessee Trust in Tata sons, ITAT highlighted that these trusts collectively held about 66% of shareholdings in Tata Sons. ITAT opined that it was a unique shareholding structure where majority of shareholdings in Tata Sons is not in the hands of the promoter family, but with the charities that are under an obligation to use the earnings for charitable purposes.

As regards the Assessee Trust exercising control over Tata Sons by way of appointing directors, the ITAT expressed that the unless there was a specific disabling clause to that effect, merely because the Assessee Trust had control over the investee company, the benefits envisaged for the charitable institutions, which meet other statutory requirements, could be declined.

Given the above, the ITAT quashed the revision under Section 263 of the IT Act and upheld the assessment order granting exemption under Section 11 of the IT Act.

Relying on the ITAT decision, the coordinate bench of ITAT quashed the revision of AO order under Section 263 for ***Sir Ratan Tata Trust***[76] and ***JRD Tata Trust***[77], as well.

Significant Takeaways

The ITAT decision has significantly defined the contours of the powers exercised by the CIT under Section 263 of the IT Act to hold an AO order prejudicial to the interest of IRA. The ITAT has unequivocally stated that the powers are not unfettered and cannot be invoked on mere difference of opinion between the CIT and the AO. Where due caution has been exercised by the AO, the order could not be held has erroneous.

Lastly, the Finance Act, 2020, had completely revamped the registration procedure of a charitable trust under the IT Act wherein, *inter-alia*, registration issued to any Trust shall be valid for a maximum period of five years only, after which the Trust shall have to compulsorily apply for renewal of registration, and the eligibility shall be reassessed at the time of such renewal application. Given the same, all charitable and religious institutions, which were already issued registration under Sections 10(23C),12A, 12AA of IT Act are required to take fresh registration under the newly introduced Section 12AB. Initially, the registration process was expected to start from June 01, 2020, and be completed by August 31, 2020. However, applicability of the new Section 12AB was postponed to April 01, 2021, through Taxation and Other Laws (Relaxation of Certain Provisions) Act, 2020. Once the new Section 12AB is introduced, the Trusts including the Tata Trusts discussed in the ruling would have to obtain registration all over under the new provision.

“ ITAT quashes the revision order, thereby upholding the tax-exempt status of Tata Trusts. ”

76 Sir Ratan Tata Trust v. Deputy Commissioner of Income Tax Exemption Circle 2(1), Mumbai, ITA No. 3737/ Mum/ 2019 (ITAT).
77 JRD Tata Trust v. Deputy Commissioner of Income Tax Exemption Circle 2(1), Mumbai, ITA No. 3738/ Mum/ 2019 (ITAT).

Credit of unutilised cess levied in the pre-GST regime is a dead claim and cannot be utilised against the output GST liability.

In the case of ***Sutherland Global Services Private Limited***[78], the Division Bench of the Madras HC reversed the decision of the single judge and held that an assessee is not entitled to carry forward and set off the unutilised credit of Education Cess (“**EC**”), Secondary and Higher Education Cess (“**SHEC**”), and Krishi Kalyan Cess (“**KKC**”) (collectively referred to as “**Cesses**”) paid in the pre-GST regime against the output GST liability.

Facts

Sutherland Global Services Private Limited (“**Assessee**”) was engaged in the provision of technical and call center services all over the country. In the pre-GST regime, the Assessee had paid Cesses on the services provided by it and had unutilised credit of Cesses lying in its ledger. The EC and SHEC were abolished by the Finance Act, 2015, and the KKC was repealed by the Taxation Laws (Amendment) Act, 2017.

However, the electronic credit ledger of the Assessee continued to show the balance of unutilised Cesses till the implementation of GST. The request of the Assessee to carry forward and utilise the credit of Cesses against the output GST liability was rejected by the GST authorities. Thereafter, the Assessee approached the Madras HC against the said order, wherein the Single Judge Bench of the Madras HC held that the Assessee was entitled to adjust such unutilised credit carried forward in its ledger against its output GST liability in terms of Section 140 (8) of the CGST Act as the transition provision was not restricted to “eligible duties”. The Revenue filed an appeal against the decision of the single judge, which gave rise to the present judgment.

Issue

Whether the unutilised credit of Cesses reflecting in the electronic credit ledger of the Assessee was available to it for set off against its output GST liability?

Arguments

The Revenue contended that the levy of Cesses was abolished prior to July 2017 and such Cesses were also not subsumed under the GST Legislations. Therefore, the claim for unutilised credit of Cesses had already expired before the implementation of GST and could not be revived now, i.e. after two years of the GST regime. The Revenue further contended that the Cesses were not covered under the definition of the term “eligible duties” mentioned in Section 140 of the CGST Act as there was a distinction between cess and other taxes and duties. The Revenue contended that the Cesses were levied to achieve a specific purpose and would not be used for the benefit of general public. It submitted that even though the Cesses was credited in the Consolidated Fund of India, the proceeds from EC were later to be transferred to Prarambhik Shishka Kosh (“**PSK**”) to be utilised towards the provision of basic education. Thus, such proceeds were not used for the general public purpose and would not take the colour of taxes or duties.

The Revenue also argued that the CCR allowed Cesses to be set off only against the output cess liability and not against any tax liability. Therefore, the unutilised credit of Cesses would not stand on par with the unutilised ITC of duties or taxes for set off against the output GST liability. The Revenue further argued that even though there was no statutory time limit for utilisation of credit, the right to utilise the same would remain indefeasible only when the facility of working it out remained intact.

78 Assistant Commissioner of CGST & CE v Sutherland Global Services Private Limited; TS 878 HC 2020 (Mad) (Madras HC).

However, as the Cesses were abolished before GST, along with the facility for working out the earned credit, the right to utilise the Cesses had also ceased.

Finally, the Revenue contended that Section 140 of the CGST Act was to be construed harmoniously and the absence of the words "eligible duties" in Section 140 (8) of the CGST Act was an unintentional oversight. The draftsmen only provided for transition of "eligible duties" to the GST regime, and as the Cesses were abolished and not subsumed on enactment of GST, the transition of such Cesses was not eligible under Section 140 of the CGST Act.

On the other hand, the Assessee contended that since it had already paid the Cesses and availed credit for the same, utilisation of such credit was a vested right, which could not be taken away without the authority of law. It argued that Section 140 (8) of the CGST Act allowed taxpayers having centralised registration to utilise CENVAT credit lying in the electronic credit ledger. Therefore, the Assessee was allowed to utilise such credit even after the levy of Cesses was abolished. Further, it was argued that the words "eligible duties" were only inserted (by way of retrospective amendment) in Section 140 (1) and (2) and not in Section 140(8) of the CGST Act. The Revenue was not empowered to read such words and expressions, which were not found in the provision. Therefore, the Assessee was eligible to carry forward the credit of the Cesses even after implementation of the GST regime by virtue of Section 140(8) of the CGST Act.

Additionally, the Assessee argued that Explanation 1 of Section 140 of the CGST Act, which defined eligible duties to only include duties enumerated therein, was not notified to extend its applicability to Section 140 (1) of the CGST Act. Therefore, eligible duties would have to be construed in normative sense, which would include duties eligible for availment as CENVAT credit. Relying on Circular No. 87/06/2019- GST, dated January 02, 2019, which provided that the terms 'duties and taxes' would be used interchangeably, the Assessee submitted that Cesses were to be included under the term "eligible duties" as it was in the nature of taxes (being duties of excise).

The Assessee also contended that in the present case, the proceeds of the EC were credited in the Consolidated Fund of India and there was no correlation to the PSK fund. Further, there was no separate fund created to deposit the proceeds of SHEC and KKC as well. Therefore, the Cesses were in the nature of tax and not fee.

Decision

The HC at the outset, proceeded to decide on the nature of the Cesses and clarified that Cess collected by the Government was to be spent for a dedicated purpose and therefore, was different from taxes even though collected in the form of taxes or duties. Further, agreeing with the contention of the Revenue, the HC held that only the duties specified as "eligible duties" in explanation 1 of Section 140 of the CGST Act (which did not include Cesses) was eligible for carry forward and adjustment against the output GST liability. Therefore, even where the Assessee had centralised registration and had unutilised credit of Cesses in its electronic credit ledger, he was not entitled to carry forward the same in terms of Section 140(8) of the CGST Act.

The HC also held that there was no vested right, which accrued to the Assessee in the present case, as the credit of Cesses was no more in the nature of input CENVAT credit after abolishment of the levy. Mere accounting practices and accounting entries in the electronic credit ledger would not confer a vested right on the Assessee.

The HC further held that the adjustment of credit of Cesses could not be allowed against output GST liability as facility of cross utilisation of credit of Cesses against duty/taxes payable, did not exist even prior to July 01, 2017. Therefore, it was held that the unutilised credit of Cesses lying in the electronic credit ledger of the Assessee was a dead claim.

Lastly, the HC looked into the propagation of the GST regime and observed that 16 taxes and duties were subsumed under the GST regime. However, the Cesses were not subsumed under GST and therefore, the question of transitioning the unutilised credit of such Cesses in GST would not arise. The plain scheme of the GST law would be defeated by allowing input credits in respect of such Cesses, which were not subsumed under the GST regime.

Significant Takeaways

The ruling by the Madras HC has finally laid to rest the treatment of unutilised credit of Cesses in the GST regime, for now. The HC analysed in detail the nature and treatment of Cesses vis-à-vis the transition provisions under the CGST Act. The Madras HC held that ITC is not a vested right and can be availed only upon fulfillment of specific conditions under Section 140 of the CGST Act i.e., it should be covered under "eligible duties". Therefore, this ruling is in line with the recent GST clarifications and decisions which held that input tax credit is not a vested right of the taxpayer, but a concession granted and can be curtailed and regulated by imposing conditions on its availment.

However, the present ruling raises a cause of concern for many taxpayers who were earlier allowed the transition of such unutilised credit of Cesses and have already utilised these credits against their output GST liability. Such taxpayers would have to reverse the amount equivalent to the credit utilised, along with applicable interest and penalty.

The HC also failed to comment on the omission of the retrospective amendment to import the words "eligible duties" under Section 140(8) of the CGST Act. Considering that this express omission in the provision was relied upon by taxpayers to claim credit of the Cesses, the silence of the HC on the same has paved the way for the decision to be challenged in the Supreme Court.

The HC has also failed to take into account that the objective of GST was to prevent cascading effect of taxes. The EC and SHEC were abolished in 2015 with a view to subsume them into the excise duty charged, and therefore, credit of such Cesses should have been allowed against the output tax liability. However, by relying on the abolishment to proclaim the unutilised credit as a dead claim, the HC has effectively blocked the credit of the taxpayers, which is against the principle of GST. The HC also failed to adjudicate on the scope of the lapsing provision, thus leaving open the question of claiming refund on such balance of unutilised credit of Cesses. In light of all these unresolved issues leading to a premature judgment, the taxpayers will turn to the SC to consider the legality of the transition provision and gain a favorable interpretation.

> **"Credit of EC and SHEC cannot be carried forward to the GST regime."**

Assessee cannot be excused from physical appearance on mere apprehension of contracting COVID-19

In the case of ***P.V. Rao***[79]**,** the HC held that a mere apprehension of contracting COVID-19 was not sufficient ground for seeking exemption from physical appearance sought during an investigation. The HC also observed that judicial interference at the stage of investigation ought to be exercised with circumspection.

Facts

Mr. P.V. Rao ("**Petitioner**") was the chief financial officer of Think and Learn Private Limited ("**Company**"), which was engaged in providing educational courses and classes through its online applications. The Respondent initiated an investigation against the Company under Section 67 of the CGST Act for alleged GST evasion and inspected its premises at Bangalore from October 27, 2020, to October 29, 2020. While the statement of the Petitioner was also recorded during the inspection, owing to his ill-health, he was unable to continue with the questioning. Thereafter, the Respondent summoned the Petitioner to tender his statement and present evidence at New Delhi. However, the Petitioner requested to be allowed to appear *vide* video conferencing as it was not safe to travel due to the rising Covid-19 infections. The Respondent refused to permit the Petitioner to record his statement through video conferencing. Therefore, the Petitioner approached the HC, praying for a writ of mandamus directing the Respondent to allow the Petitioner to appear via video conferencing.

Issue

Whether apprehension of contracting Covid-19 was a reasonable ground for seeking recording of statement through video conferencing in an ongoing investigation as opposed to appearing physically for the same?

Arguments

The Petitioner submitted that he was in a high-risk group during Covid-19 due to his age-related comorbidities and health issues. Therefore, in order to protect himself against the risk of contracting Covid-19, he was be unable to travel from Bangalore to Delhi. The Petitioner submitted medical reports and additional affidavit in support of his contentions. The Petitioner also relied on the case of ***Ilangovan G v. Union of India***[80] whereby the Telangana HC had directed the department not to insist on physical appearance of taxpayers in light of the pandemic. The Petitioner referred to board circulars[81], which stated that senior officers of large companies should not be issued summons casually. The Petitioner submitted further that the Delhi HC in the case of ***National Building Construction Company Limited v. Union of India***[82], had held that when facts were to be ascertained and documents were required, the personal presence of a senior officer was necessary only if there were compelling reasons. Therefore, the Petitioner submitted that in light of the precedents, his personal attendance, as a senior official of the Company, ought not to be insisted upon at this stage of inquiry. Lastly, the Petitioner referred to the guidelines issued by the Hon'ble Supreme Court for functioning of courts through video conferencing during the pandemic and contended that such guidelines were duly followed by the CBIC in personal hearing for matters under Customs Act. Therefore, the same also ought to be applied in the case of the Petitioner.

The Respondent submitted that the Petitioner was not cooperative during the investigation and therefore, the prayer sought in the petition did not merit indulgence of the HC. During inspection of the premises of the Company for alleged tax evasion, the Petitioner, time and again, requested to be excused from the investigation, citing ill-health, and the Respondent considered his requests favourably. The Respondent contended that detailed clarifications were required from the Petitioner as the investigation was at an initial state wherein the data was sensitive and incriminating in nature. If the Petitioner was allowed to record the statement through video conferencing, the clarifications submitted by him could be motivated and influenced. This would adversely impact the investigation.

Decision

The HC took on record the measures adopted by the various courts to reduce physical presence, but held that judgments pertaining to the same would not apply to the present situation as the statement to be recorded was not during the course of trial by the court of law. It noted that evidence recorded at the stage of inspection would lead to ascertainment of relevant facts, which would impact the entire investigation, and therefore, judicial interference had to be exercised with caution at the investigation stage.

The HC observed that the Petitioner had consistently avoided recording his statement during inspection of the premises of the Company. The HC also observed that the test reports and medical documents submitted by the Petitioner did not indicate that he was suffering from any serious ailments, which impeded him from undertaking travel. Where the Petitioner insisted on

79 P.V. Rao v. Senior Intelligence Officer, DGGSTI 2020-VIL-566-Del (Delhi HC).
80 WP 15690 of 2020 (Telangana HC)
81 Circular F.No 208/122/89-CX.6 dated October 13, 1989; CBEC Instruction F. No. 207/07/2014-CX-6 dated January 20, 2015
82 2019 (20) GSTL 515 (Del) (Delhi HC).

his inability to travel, the HC recommended that the Petitioner undergo fresh examination from a medical board of a Government hospital to ascertain his fitness regarding travel from Bangalore to Delhi; which was not acceptable to the Petitioner.

Therefore, the HC held that mere apprehension of contracting Covid-19 would not tilt the balance of convenience in the favour of the Petitioner, and it could not be urged as a singular ground for directing the Respondent to record statements through video conferencing. The HC thereafter directed the Respondent to conclude the recording of the statement in such a manner that the Petitioner would be required to undertake travel only once, and to put in place all safety measures and protocols.

Significant Takeaways

The HC has set a strong precedent in disallowing the recording of statement via video conferencing during investigations on the sole ground of the apprehension of contracting Covid-19. While the decision appears to be in line with the approach of the courts, which have commenced limited physical appearances in hearings, it may be noted that the HC did not dismiss the request of the Petitioner outright. It verified the facts of the case to analyse the Petitioner's medical history and determine on medical terms whether there was any actual risk to the Petitioner if he were to travel. The HC was also open to an independent verification by the medical board of a Government hospital in order to ascertain its deduction. Therefore, while the judgment has precedential value, it is important to note that this decision cannot be applied by the department uniformly to outrightly reject the requests of taxpayers/ assessee to be excused from physical appearances. However, the judgment is a strong precedent for an assessee to contest their case on genuine medical reasons. Further, the practice of the judiciary to verify the medical conditions of the assessee by directing a medical examination by an independent board should be insisted upon as a precedent before dismissal of requests pertaining to appearances via physical hearing.

Separately, the HC appears to have maintained the independence between the judiciary and the executive by refusing to interfere with the investigation conducted by government officials.

> **“ Physical appearance during tax investigations cannot be averted merely on the risk of contracting Covid-19 due to travel during the pandemic. ”**

High Court upholds the validity of the provision providing for refund of unutilised ITC only on input goods accumulated on account of inverted duty structure

In the case of ***TVL. Transtonnelstroy Afcons Joint Venture***[83], the Madras HC held that the provision to refund unutilised ITC, accumulated on account of inverted duty structure, was not unconstitutional. It was held that the said provision merely set out the eligibility condition for claiming such refund and therefore, was legal and valid.

Facts

TVL. Transtonnelstroy Afcons Joint Venture ("**Petitioner**") was a contractor providing services to Chennai Metro Rail Limited and used input goods and services. The rate of tax on input goods and input services procured by the Petitioner exceeded the rate of tax on output supplies. Consequently, there was an accumulation of unutilised ITC in the Petitioner's electronic credit ledger. The Petitioner filed a claim for unutilised credit refund on account of inverted duty structure, which was rejected by the GST department ("**Respondent**").

The Petitioner (along with various other petitioners) challenged the constitutional validity of Section 53(3)(ii) of the CGST Act[84] as well as the vires of amended Rule 89(5) of the CGST Rules[85].

Issues

1. Whether Section 54(3)(ii) of the CGST Act violated Article 14 of the Constitution?
2. Whether Rule 89(5) of the CGST Rules, as amended, was ultra vires Section 54(3) of the CGST Act?

Arguments

The Petitioner argued that Section 54(1) of the CGST Act dealt with refund and enabled framing of rules only in respect of the form and manner of seeking refund. The language 'in the manner prescribed' used in Section 54(1) of the CGST Act did not allow for framing of rules for fixing a time limit for claiming such refund. Further, the Petitioner argued that the general power to frame rules prescribed under Section 164 of the CGST Act could not be resorted to for framing rules in respect of Section 54 of the CGST Act i.e. to create disabilities that were not contemplated by the CGST Act.

Further, with respect to Section 54(3)(ii) of the CGST Act, the Petitioner argued that the said provision clearly enabled a registered person to obtain a full refund of all accumulated ITC. It contended that for the purpose of interpreting Section 54(3)(ii) of the CGST Act, the meaning ascribed to the word "input" in Section 2(59) of the CGST Act would not be adopted. The word 'input' used in Section 54(3)(ii) of the CGST Act would be construed as per common parlance, which would mean both input goods and input services. It argued that the provision used the words "output supplies" in juxtaposition with the word "inputs", which indicated that the intention of the Parliament was to deploy these words as per their meaning in common parlance. In arguendo, the Petitioner also contended that even where the word "inputs" was to be construed as per the statutory definition, it was a fit case to read the words 'input services' into Section 54 of the CGST Act in terms of the rule of *casus omissus*, so as to uphold the constitutional validity of the said provision.

The Petitioner also argued that the validity of Section 54(3)(ii) of the CGST Act could also be upheld by resorting to reading down the word 'inputs' from the said provision. Unless the word 'inputs' was read down, there would be a violation of Article 14 of the Constitution as the said provision created discrimination between persons who were similarly situated by making an invidious classification.

Further, it was argued that Section 54(3) of the CGST Act provided for the general rule for entitlement to refund in respect of any unutilised ITC. The proviso thereto qualified the principal sub-section by setting out the eligible classes and the criteria in each class for claiming refund. Thus, it did not curtail the entitlement to refund the entire unutilised ITC, but merely set out the eligibility conditions for claiming such refund.

Lastly, with regard to Rule 89(5) of the CGST Rules, the Petitioner argued that the amendment to the said rule so as to exclude credit accumulation on account of input services was *ultra vires* Section 54(3) of the CGST Act. It argued that when the statute itself did not curtail the quantum of refund, it could not have been curtailed by amending the relevant rules.

On the other hand, the Respondent argued that the term 'input' used in Section 54(3)(ii) of the CGST Act intended to carry the meaning ascribed to it in Section 2(59) of the CGST Act, which only included input goods. It argued that the ambit and scope of the expression 'any unutilised ITC' was curtailed by the proviso to Section 54(3) itself as it qualified the enacting clause by also limiting the source/ type and, consequently, quantity of

83 TVL. Transtonnelstroy Afcons Joint Venture vs. Union of India, 2020-VIL-459-MAD (Madras HC)

84 Section 54(3)(ii) of the CGST Act provides the provision for refund of unutilized credit where the credit has accumulated on account of rate of tax on inputs being higher than the rate of tax on output supplies.

85 Rule 89(5) of the CGST Rules provides the formula for computation of refund amount in case of inverted duty structure .

unutilised ITC in respect of which such refund was permissible. Therefore, the Respondent argued that the Parliament had consciously and intentionally excluded input services in Section 54(3)(ii) of the CGST Act, and consciously and intentionally used either the defined term "inputs" or "input services" as appropriate in the said provision.

The Respondent further argued that the refund provisions were to be treated on par with exemption notification as the benefit of refund was in the nature of an exemption or reduction of tax only. Therefore, such refund provisions were to be interpreted strictly and literally as the Parliament had wide latitude while construing tax and other economic legislations. The Respondent argued that the classification of registered person for the benefit of refund, basis differentiation between those who procure input goods and input services was legitimate. Such differentiation was found in the Constitution as well as in GST Acts.

With regard to reading down of the word 'inputs', the Respondent argued that reading down was typically intended to provide a restricted or narrow interpretation to the provisions and not for the purpose of providing an expansive or wide interpretation. Accordingly, words could not be added to the statute for the purpose of reading down the statute.

The Respondent further argued that the amended Rule 89(5) of the CGST Rules was in conformity with Section 54(3)(ii) of the CGST Act, which also used the term 'input'. It contended that the said rule merely supplements Section 54(3)(ii) of the CGST Act and that it fulfilled the purpose of eliminating arbitrariness in determining the entitlement to refund on the basis of the said provision.

Decision

The Madras HC observed that the Parliament had used a double negative in the proviso to Section 54(3)(ii) of the CGST Act, which made it abundantly clear that unless a registered person met the requirements of clause (i) or (ii) of Sub-section 3, no refund would be allowed. It also observed that if the intention of the legislature was to provide a refund of the entire unutilised ITC, the words "credit accumulated on account of" would be rendered futile. Therefore, the HC held that proviso to Section 54(3)(ii) merely restricted the source/type and quantity of unutilised ITC in respect of which refund was permissible.

The HC further held that the amended Rule 89(5) of the CGST Rules was in conformity with Section 54(3)(ii) of the CGST Act. It stated that the unamended Rule 89(5) of the CGST Rules had in fact, exceeded the scope of Section 54(3)(ii) of the CGST Act as it extended the benefit of refund to the credit that accumulated both on account of the rate of tax on "inputs" and "input services" being higher than the rate of tax on output supplies, which was not contemplated in Section 54(3)(ii) of the CGST Act. The words 'Net ITC' was re-defined in the amended Rule 89(5) so as to provide for a refund only on unutilised ITC that accumulated on account of input goods. Hence, the HC held that Rule 89(5) of the CGST Rules, as amended, was *intra vires* both the general rule making power under Section 164 and Section 54(3) of the CGST Act.

As regard the constitutional validity of Section 54(3)(ii) of the CGST Act, the HC held that while interpreting a taxing statute, the requirement to stay true to the statutory definition was more compelling. The HC observed that if the word 'input' was given a common parlance meaning, then input services as well as capital goods would be considered for refund. The HC stated this could never be the intention of the legislature, as the term 'input' was defined to specifically exclude capital goods from input goods. Further, the provision as well as Explanation to Section 54 also used the terms "inputs" and "input services" separately and distinctively, thereby indicating the legislative intent to distinguish one from the other. Therefore, the word 'input' was to be interpreted to encompass only input goods, other than capital goods, and excluding input services, as defined under Section 2(59) of the CGST Act.

Further, the HC held that refund of ITC was in the nature of a benefit or concession. Thus, the right of refund was purely statutory and, therefore, could not be availed except strictly in accordance with the conditions prescribed for the same.

Lastly, the HC held that the Economic legislations were interpreted on a different benchmark, especially when it came to classification. The latitude to make classification in matters related to taxation was wider than in other forms of legislation. Goods and services had been treated differently from time immemorial. Accordingly, the HC held that the classification was valid, nonarbitrary and far from invidious and hence, Section 54(3)(ii) of the CGST Act was legal and valid.

Significant Takeaway

The present decision of the HC is a detailed and well-reasoned order as the HC looked into all the issues raised during the arguments by both the parties. The HC even took note of the findings of ***the VKC Footsteps India Pvt. Ltd.***[86], wherein the Gujarat HC had passed a contradictory order, which allowed the refund of ITC pertaining to input services as well in case of inverted duty structure.

86 VKC Footsteps India Pvt. Ltd. vs. Union of India [TS-585-HC-2020(GUJ)-NT] – (Gujarat HC).

However, while the order seems to be a correct order on merits, the HC failed to consider the fundamental principles behind overhauling the erstwhile indirect tax regime and introducing GST, i.e. to remove cascading effect of taxes by way of set-off against credits or refunds in order to ensure a seamless flow of credits from supplier to the last retail point.

Limiting the benefit of refund in case of accumulation of credit due to inverted duty structure not only restricts the flow of credit for taxpayers availing services, but also creates a differential treatment for goods and services, which was never the intention of the legislature. The ideology behind introducing GST was to have a similar treatment for all taxpayers, irrespective of their inward/outward supply, and therefore, having such differential benefit defeats the purpose. Thus, the present case comes as a major setback for the taxpayers who have accumulated ITC pertaining to input services.

Further, due to the dissenting views of different HCs, the taxpayers are now left in a state of confusion. While the order is binding only in the state of Tamil Nadu, it is likely that the tax department in other states, especially Gujarat, would wait for the final verdict of the SC on the present issue. Hence, even after the present order, the legal battle on the issue would continue and only time would decide the fate of such taxpayers.

> **“ Refund of accumulated credit pertaining to input services on account of inverted duty structure is not allowed. ”**

SEZ Unit / developers are not eligible to claim refund of ITC availed on supplies received from non-SEZ suppliers

In the case of ***Vaachi International (P) Ltd***[87], the Appellate Authority held that the GST legislations include the provision of refund claim by the suppliers who have made supplies to SEZ unit/developers with payment of tax and such benefit of claiming refund of ITC of their procurement would not be available to SEZ units.

Facts

Vaachi International (P) Ltd ("**Appellant**") was engaged in the business of exporting dried ornamental plant, materials and candles. The Appellant procured material from various suppliers located in Domestic Tariff Areas ("**DTAs**") and availed ITC on GST paid to such suppliers. Thereafter, it claimed refund of ITC availed for the period from July, 2017 to March, 2018. However, the adjudicating authority rejected the refund claim on the premise that benefit of such refund was available only to the suppliers located in the DTAs who made zero rated supplies to SEZ units/developers with payment of tax. Aggrieved by the same, the Appellant filed an appeal before the Appellate Authority.

Issue

Whether the Appellant was eligible to claim refund of ITC availed on material procured from suppliers located in DTA?

Arguments

At the outset, the Appellant contended that it had availed ITC in terms of GST legislations and there was no prohibition in availing of ITC by a SEZ unit under Section 16 (2) of the CGST Act. The Appellant relied on the provisions under Section 54(3) of the CGST Act,[88] read with Section 16 of the IGST Act, to highlight that the refund of unutilised ITC could be claimed in case of zero-rated supply made without the payment of IGST. Zero rated supplies included export of goods and/or services. Therefore, as the Appellant was engaged in exporting dried ornamental plant, materials and candles out of India, its transactions qualified as zero-rated supplies and was eligible for refund of the unutilised ITC reflecting in its credit ledger.

The Appellant also relied on Rule 89(2)(f) of CGST Rules, which stated that a supplier of goods and/or services to an SEZ unit had to submit a declaration along with its refund application. Such declaration is filed to state that the SEZ unit has not availed of the ITC. In the common parlance of law, a declaration represents the evidence for the declaring party that it had performed, or refrained from an action to the best of its knowledge. Therefore, in the present case, the declaration served was filed to prevent duplicity of refund claim i.e. to ascertain that the SEZ unit would not claim refund on unutilised ITC for the same supplies on which the refund of tax was claimed by the supplier of SEZ unit.

Therefore, Section 89(2)(f) was enacted to prevent duplicate refund claims and not to prevent SEZ units from claiming refund of ITC.

Further, as an arguendo, to counter the allegations of duplicate claims raised by the department, the Appellant also contended that the department was well positioned to check whether refund claims were filed by both the SEZ unit and the supplier located in the DTAs, as the DTA unit was required to submit a declaration that the SEZ unit had not availed any ITC.

The Appellant also submitted that as per the proviso to Rule 89(1) of CGST Rules, the facility to claim refund was available to both the recipient and the supplier of deemed export supplies (i.e. supplies to EOU/STPI). Therefore, as SEZ units were similarly placed as EOU/STPI units in the context of export benefits, the facility to claim refund should also be available to the SEZ unit .

On the other hand, revenue authority contended that SEZ units were not eligible to claim refund of ITC on export of goods and/or services without the payment of IGST. The revenue authority relied on Section 54 of CGST Act, read with Rule 89(2) of CGST Rules, which provided that a refund was statutorily available only to taxpayers who made zero-rated supplies to a SEZ unit/developer with the payment of tax. The rationale behind such provision was to ensure that the refund of tax paid was claimed only by the suppliers to SEZ, on filing of declarations from their SEZ recipients, to avoid duplicity of the claims. In other words, as the suppliers of SEZ unit may be located in different places, it was not possible for the department to track their refund claims against the supplies made to such SEZ unit.

Decision

The Appellate Authority observed that as per Rule 89 of CGST Rules, in respect of supplies to SEZ units/developers, the benefits of refund of unutilised ITC availed on procurement of raw material from DTA was to be available only to the suppliers of goods to the SEZ unit or the developers. It also held that the SEZ units/developers were not permitted to avail ITC on supplies received by them from non-SEZ suppliers and such refund could only be claimed by such supplier to SEZ unit/developer.

87 Vaachi International (P) Ltd, [2020] 121 taxmann.com 191 (AA - GST – AP).
88 Any reference to CGST legislation would include reference to relevant SGST Act, rule, etc.

Therefore, the Appellate Authority concluded that SEZ unit/developers were not eligible to claim any refund against the ITC involved in supplies received by them from DTA suppliers. The suppliers who made supplies to SEZ unit/developers with payment of IGST were eligible to claim refund in terms of the CGST Act.

Significant Takeaway

The aforementioned ruling has presented a dilemma for the SEZ units/developers, who procure raw material from DTA by making payment of GST, whether to claim refunds or not. The unavailability of ITC on the tax paid on supplies received by the SEZ units/developers would lead to huge capital blockage, especially in cases where the suppliers are unwilling to supply to SEZ unit at zero rate so as to avail of refunds on the taxes paid by them.

It is a legitimate expectation of SEZ unit/developer to be eligible for refunds on the unutilised ITC just as their counterparts in Export Oriented Unit/Software Technology Park of India (EOU/STPI) who procure goods at zero rate (being a deemed export) and avail the refund. Further, there is no provision in the GST regime which prevents SEZ units/ developers from claiming refund of ITC on tax paid to the suppliers. By reading non-existent restrictions in the law, the Appellate Authority has broken the golden rule of interpreting the taxing statues in a strict manner. While the department may rely on this case to deny refund claims of SEZ units/ developers, the SEZ units/developers have a strong reason to approach the higher judicial fora to challenge the present decision on grounds of illegality. A flood of litigation is anticipated, challenging similar rejection of refund claims in the future.

> **“Claims of refund filed by SEZ units/developers on unutilised ITC on procurement of material from DTA are not in accordance with provisions of the GST law and ought to be rejected.”**

HC refuses to stall a legitimate investigation and give any directions for refunding credit

In the case of ***M/s. S.S. Industries***[89], the High Court refused to stall the investigation into the allegations of fraudulent transactions as *prima-facie* case was made by the investigating authority. However, the HC indicated that the investigation should be completed and communicated to the Petitioner within six weeks from the date of order. The HC also observed that Rule 86A of the CGST Rules, which allowed the authorities to block ITC, could not be used as a tool to harass the assessee.

Facts

M/s. S.S. Industries ("**Petitioner**") was a partnership firm, *inter alia*, engaged in the business of manufacture of steel products goods like TMT bars, rounds etc.

The Petitioner, during AY 2017-18 and 2018-19 had received inputs against tax invoices from 36 registered dealers across the country and had duly recorded the ITC availed against these invoices in its electronic credit ledger.

An investigation was initiated by the Directorate General of Goods and Services Tax Intelligence, Jaipur (Rajasthan) ("**Respondent**") against one of the suppliers of the Petitioner. During the inquiry, it was revealed that the said supplier had issued fake invoices to various buyers (manufacturers of steel products) including the Petitioner, without making any actual supplies and the ITC availed by all the buyers including the Petitioner was inadmissible.

On July 23, 2019, the Petitioner allegedly was forced to deposit an amount of INR 25 Lakh in cash and subsequently, on January 14, 2020, ITC amounting to INR 84,34,547/- was blocked by the Respondent in terms of Rule 86A of the CGST Rules. The Respondent declined to refund the amount deposited by the Petitioner as well as refused to unblock the ITC in the credit ledger. Accordingly, the Petitioner filed the writ petition before the HC.

Issue

Whether the Respondent was empowered to block ITC under Rule 86A of the CGST Rules, even when the inquiry/ investigation into the allegations of fraudulent transactions by the supplier was pending?

Arguments

The Petitioner argued that it had followed the a uniform method of payment and accounting for all suppliers. However, the dispute had arisen only with respect to the supplies received from six out of the thirty six registered dealers. Hence, the same was a sufficient reason for blocking such a huge amount of ITC.

It was further argued that the payment of a substantial amount was made by the Petitioner to the suppliers, which showed that the transactions were genuine and not sham or merely on paper. The Petitioner also pointed out that all the inputs received from the suppliers had been recorded in the credit ledger and in the statutory production register maintained by it. It was argued that if such inputs were only on papers, the Petitioner could not have manufactured the final products.

The Petitioner argued that the Respondent had not furnished any material before the HC in the form of statements, if any, of the input suppliers or the statements of the transporters, etc., to suggest that the transactions were sham. The Petitioner also argued that the unilateral action of blocking ITC and preventing the Petitioner from utilising such credit in the absence of the assessment of any tax liability was illegal and unjustified.

Placing its reliance on various judgments[90], the Petitioner argued that unless there was an assessment and demand, the amount deposited by it under coercion/threat of arrest, could neither be appropriated nor retained by merely stating that the same was voluntarily deposited.

The Petitioner further argued that when the suppliers (who were alleged to have issued the fake tax invoices to the Petitioner) were allowed to surrender their registrations without any liability, the proceedings for the very same transactions against the Petitioner were neither justifiable nor permissible under Section 76 of the CGST Act, which laid down provisions for issuance of a showcause notice.

The Petitioner also argued that the procedure under Rule 86A of the CGST Rules required two conditions to be satisfied; First, recording of the reasons in writing by the officer who ordered blocking of ITC, and second, communication of such reasons to the affected person. However, at no point of time during the proceedings, the reasons were communicated to the Petitioner.

The Petitioner argued that with the introduction of Rule 86A of the CGST Rules, the vested right of the Petitioner with respect to credit was sought to be curtailed on such flimsy grounds i.e. a suspicion that the transactions were sham. It submitted that drastic powers conferred under Rule 86A of the CGST Rules could not have been exercised merely on such flimsy grounds.

Further, the Petitioner submitted that if the decision of blocking the credit was not communicated to the person affected by it, then how would the affected person know that the restriction had ceased to have effect with efflux of time in terms of Rule 86A(3) of the CGST Rules?

The Respondent along with other respondents (together referred as "**Respondents**") submitted that the litigation on

89 M/S S.S. Industries v. Union of India [2020 (12) TMI 1120]

90 Century Metal Recycling Pvt. Ltd. v. Union of India, (2009) 234 ELT 234 (P&H); Concepts Global Impex v. Union of India, 2019 (365) ELT 32 (P&H); Abhishek Fashions Pvt. Ltd. v. Union of India, 2006 (202) ELT 762 (Guj.)

hand was very serious as it was alleged that the Petitioner had availed ITC on the strength of fake/bogus invoices. They stated that the investigation was in progress and there was more than a *prima facie* case to invoke Rule 86A of the CGST Rules for the purpose of blocking the unutilised ITC.

The Respondents pointed out that in the course of the investigation, the statements of various persons had been recorded including one of the partners of the Petitioner and in such statements, there was a clear-cut admission of fraud.

The Respondents also submitted that as soon as the investigation was over, a showcause notice under Section 74 of the CGST Act, along with the materials relied upon, particularly the documentary evidence would be issued to the Petitioner.

The Respondents argued that the formalities like recording the transactions in the statutory returns and forms, and making payment through the RTGS against the goods in accordance with the invoice and payment for the transportation, etc., were all a show to give a colour of genuineness to the transactions.

The Respondents stated the object behind the introduction of Rule 86A of the CGST Rules was to curb such fraudulent activities and the same was rightly invoked in the present case.

Decision

The HC held that the invocation of Rule 86A of the CGST Rules for the purpose of blocking ITC could be justified if the concerned authority's opinion was *prima facie* based on some cogent materials suggesting that the ITC was availed basis fraudulent transactions like fake/bogus invoices etc. However, such subjective satisfaction had to be based on some credible materials or information and be supported by supervening factor.

The HC also held that the power conferred under Rule 86A of the CGST Rules could be termed as very drastic; such far-reaching powers could be used sparingly and only on subjective weighty grounds. The HC also observed that the power under Rule 86A of the CGST Rules could not be used as a tool to harass assessees or in a manner that would have an irreversible detrimental effect on the business of the assessees.

The HC rejected the Petitioner's claim of ITC was an indefeasible right *vis-a-vis* Rule 86A of the CGST Rules. It made a remark that since the Petitioner had not been able to avail the ITC, in such circumstances, it could not be said that they had an indefeasible right as the aspect of availment of credit and utilisation of credit occur in two different stages.

The HC also observed that the Government needed to apply its mind for the purpose of laying down some guidelines or procedure for invocation of Rule 86A of the CGST Rules. In the absence of the same, the said rule could have been misused, having an irreversible and detrimental effect on the business.

The HC stated that even though no specific order had been passed and communicated to the Petitioner, it could not be said that exercise of power under Rule 86A of the CGST Act for the purpose of blocking ITC was mala fide, as the rule was silent with regard to passing of any specific order assigning *prima facie* reasons for invoking the rule.

The HC concluded that there were highly disputed questions of fact as regards the debit of the ITC from the electronic credit ledger. However, it observed that the current investigation has exceeded the maximum timeline of one year prescribed under Rule 86A of the CGST Rules and could not continue for an indefinite period of time. But since, a *prima facie* case had been made out against the Petitioner, the HC refrained from passing any order under writ jurisdiction. Instead, the HC stated that the investigation should be completed within a period of six weeks from the date of the receipt of its order and be communicated to the Petitioner.

Lastly, the HC stated that the Constitutional validity of Rule 86A of the CGST Rules was not under challenge in the present case and therefore, they did not intend to test its validity.

Significant Takeaways

This is a welcome decision by the HC as it clarifies that credit cannot be blocked in terms of Rule 86A of the CGST Rules as a matter of routine and the power envisaged under the rule should be used subjectively. Further, the decision would be useful in contesting blockage of ITC, where the credit has been blocked without a *prima facie* case being made by the authorities.

However, the decision also indicates that on plain reading of Rule 86A of the CGST Rules, it is evident that the rule does not warrant passing of an order or issuance of a notice prior to blocking of ITC. This may lead to misuse of power by the authorities against innocent taxpayers, unless and until the government lays down a procedure as directed by the HC for the purpose of invoking Rule 86A of the CGST Act. Since the HC has not specified a strict timeline for the issue of such guidelines, it is feared that the authorities would continue to harass taxpayers due to the wide powers given to them under Rule 86A of the CGST Act.

> **“ Power to block credit should be used sparingly and only on subjective weighty grounds and reasons. ”**

Supreme Court upholds constitutionality of imposition of GST on lotteries

In the case of ***Skill Lotto Solutions Pvt. Ltd.***[91], the SC held that the levy of GST on sale of lottery tickets was constitutional and the definition of 'goods' under the CGST Act was not ultra-vires the constitutional provisions. The SC also held that the prize money was not to be excluded from the value of supply for GST purposes.

Facts

Skill Lotto Solutions Pvt. Ltd. ("**Petitioner**") was an authorised agent, for sale and distribution of lotteries organised by the State of Punjab.

The Parliament enacted the Lotteries (Regulation) Act, 1998, to regulate the lotteries and to provide for matters connected therewith and incidental thereto. States had enacted individual legislations, regulating the lotteries and levying tax on the sale of lottery tickets, prior to the parliamentary enactment regulating the lotteries.

In terms of Section 2(52) of the CGST Act, the term "goods" was defined to mean every kind of movable property other than money and securities, but included actionable claim. Further, *vide* notification dated June 28, 2017 ("**Notification**"), for lotteries run by the State Government, the value of supply of lottery was deemed to be 100/112 of the face value of the ticket or the prize as notified in the official gazette of the organising State, whichever was higher; where with regard to lotteries authorised by the State Government, the value of supply of lottery was deemed to be 100/128. Accordingly, the Petitioner filed the present writ petition before the SC challenging the definition of goods as well as the Notification.

Issue

1. Whether levy of GST on sale of lottery tickets was constitutional?
2. If yes, whether prize money was to be excluded while determining face value of lottery ticket while computing GST liability?

Arguments

The Petitioner argued that the levy of GST on lottery was *ultra vires* to the Constitution, as lottery was not goods, and as per the CGST Act, and GST was levied only on goods. The Petitioner also contended that the definition of the term 'goods' in Section 2(52) of the CGST Act was unconstitutional, as Article 366(12) of the Constitution defined 'goods' to include only materials, commodities and articles and thus, actionable claims were excluded from it.

The Petitioner also contended that the provisions of the CGST Act, treating lottery as goods were contrary to the judgment of the Constitution Bench of the SC in ***Sunrise Associates***[92], wherein it was categorically held that lottery was not a good. The Petitioner further submitted that provisions of the CGST Act were self-contradictory. It defined the words "actionable claim" as the definition ascribed to it under the Transfer of Property Act, 1882 ("**TOPA**"), which only meant a claim and not goods.

The Petitioner also argued that the inclusion of actionable claim within the meaning of goods seemed to be a deliberate attempt to make lottery fall within the scope of GST, which rendered the definition of "goods" contrary to the meaning ascribed to it by the Constitution, as held in ***Gannon Dunkerley & Co.***[93].

The Petitioner further submitted that the Parliament did not enjoy an absolute power to make an inclusive definition of something for it to be taxed, which was not otherwise taxable. The Petitioner contended that there was a clear hostile discrimination in taxing only lottery, betting and gambling, whereas all other actionable claims were not taxable as they were treated neither as supply of goods nor supply of services in terms of Schedule III to the CGST Act.

The Petitioner also submitted that lottery acquired property only when prize was declared and the levy of GST on sale of ticket was not permissible as a ticket was only a chance and not an actionable claim. The Petitioner further stated that in other countries, GST was levied by excluding the prize money.

Lastly, as the Petitioner had challenged the differential rate of tax on lotteries organised by the States and lotteries authorised by the State. It sought to reserve its right to challenge the notification, which was issued during the pendency of the present writ petition to provide a uniform rate of tax on such lotteries, separately in appropriate proceedings.

The Union of India and other respondents ("**Respondents**") challenged the maintainability of the writ petition under Article 32 of the Constitution and submitted that lottery was "*res extra commercium*" and the Petitioner could not claim right under Articles 19(1)(g) and 301 of the Constitution. Further, the Respondents submitted that the laws relating to economic activities needed to be viewed with greater latitude than laws touching civil rights. They contended that the argument of the

91 Skill Lotto Solution Pvt. Ltd. v. Union of India & Ors. [2020-VIL-37-SC] (SC).
92 Sunrise Associates v. Govt. of NCT of Delhi and Ors. [2006] 5 SCC 603 (SC).
93 State of Madras v. Gannon Dunkerley & Co., (Madras) Ltd., [1959] SCR 329 (SC).

Petitioner that definition of goods in Section 2(52) of the CGST Act was contrary to ***Sunrise Associates (supra)*** was misplaced, as the SC had held that an actionable claim was a movable property and thereby, goods in the wider sense.

The Respondents pointed out that the Parliament had the competence to levy GST on lotteries under Article 246A of the Constitution. Further, under Article 279A of the Constitution, the GST Council had approved the levy of GST on lottery tickets. Hence, the inclusion of actionable claims in the definition of goods under Section 2(52) of the CGST Act was in keeping with the legislative and taxing policy.

The Respondent submitted that the argument on the ground of discrimination in the rate of tax was no longer available to the Petitioner as Rule 31A of the CGST Rules had been amended *vide* notification dated March 2, 2020, merging the two separate erstwhile rates, i.e., regarding value of supply of lottery run by the State Government and value of supply of lottery authorised by the State Government.

The Respondents also submitted that ***Gannon Dunkerley (supra***), relied by the Petitioner, would not be relevant in the present case as the decision dealt with the definition of the term "sale" and was not concerned with the interpretation of :goods".

The Intervenor submitted that since the Constitution permitted tax only on goods, and not on actionable claims, the Parliament did not have the power to tax lottery. The Intervenor further submitted that the definition of 'goods' under the CGST Act had to be guided by the definition of 'goods' given under the Constitution.

The Intervenor further submitted that the prize money ought not be taxed and the tax, if any, would be levied only on the invoice value, i.e. the transaction value of the lottery ticket or the lottery scheme after deducting the prize money. Also, the lottery ticket had zero value and was only a chance, which cannot be taxed. The Intervenor stated that exclusion of all actionable claims from levy of GST, except in the case of lottery, betting and gambling was nothing but a hostile discrimination.

Decision

The SC observed that the since the writ petition was alleging violation of Article 14 of the Constitution with respect to a Parliamentary Act and as the SC had earlier entertained a writ petition earlier under Article 32 of the Constitution with respect to lottery, the present writ petition filed under Article 32 of the Constitution was also maintainable.

The SC observed that the definition of 'goods' under Article 366(12) of the Constitution was an inclusive definition and did not specifically exclude actionable claims. It held that inclusive definitions were always intended to enlarge the meaning of words or phrases used in the definition. The Constitution framers were well aware of the definition of 'goods' under the Sales of Goods Act, 1930 ("**SOGA**"), and never intended to give any restrictive meaning to 'goods' in the Constitution. Further, the decision of ***Gannon Dunkerley & Co. (supra)*** did not lend support to the submission of the Petitioner.

In relation to the case of ***Sunrise Associates (supra)***, the SC observed that the Constitution Bench came to the conclusion that lottery was an actionable claim, considering the definition of "goods" in the Tamil Nadu General Sales Act, 1959. Therefore, the finding by the Constitution Bench could not be held to be *obiter dicta.*

The SC further held that the definition of 'goods' under Section 2(52) of the CGST Act did not violate any constitutional provision nor is it in conflict with the inclusive definition of the same, given under Article 366(12) of the Constitution. Further, Article 246A of the Constitution began with a non obstante clause, which conferred very wide powers on the Parliament to make laws with respect to goods and services tax.

The SC held that when the Parliament had included lottery, betting and gambling for the purpose of imposing GST and not taxed other actionable claims, it would not amount to an irrational differentiation as lottery, betting and gambling were well known concepts and were regulated and taxed by different legislations, since before independence.

The SC placed reliance on the decision in the case of ***R.M.D. Chamarbaugwala and Anr.***[94] and observed that it was the duty of the State to strive to promote the welfare of the people by securing and protecting a social order in which justice, social, economic, and political, shall form the institutions of national life. Hence, there was no hostile discrimination in taxing lottery, betting and gambling and not taxing other actionable claims. Accordingly, there was no violation of Article 14 in sr. no. 6 of Schedule III to the CGST Act.

With regard to the question of abating the prize money from the value of lottery, the SC observed that the Petitioner's reliance on the circular dated February 14, 2007, was not relevant under the GST regime as the same was issued under the service tax regime.

The SC further observed that when there were specific statutory provisions enumerating what should be included and excluded from the value of the supply as per Section 15 of the CGST Act read with Rule 31A of the CGST Rules, the Petitioner's contention that the prize money was to be abated for determining the value of taxable supply would not be accepted. The SC observed that the prize paid by the distributor/ agent was not contemplated to

94 State of Bombay v. R.M.D. Chamarbaugwala and Anr., AIR 1957 SC 699 (SC).

be excluded from the value of taxable supply. Hence, while determining the taxable value of the supply of lottery, the prize money was not to be excluded for the purpose of the levy of GST.

The HC observed that the reliance placed by the Petitioner on taxing statutes in other countries was not relevant as the taxing policies and the taxing statutes of various countries were different and in accordance with the taxing regime suitable and applicable in different countries and that the issue in present writ petitioned needed to be answered by looking into the statutory provisions of the CGST Act.

Accordingly, the SC held that the levy of GST on sale of lottery tickets was constitutional and the definition of "goods" under the CSGT Act was not beyond the constitutional provision. The SC also held that the prize money was not to be excluded from the value of supply for GST purposes.

Significant Takeaways

The issue of constitutional validity of the levy of indirect taxes on lottery has been put forth before the SC on multiple occasions, and the said decision puts to rest all the pending disputes on the levy of GST on lotteries. This decision also echoes the settled principle that when the statutory provisions are clear and specific, the courts would not interfere with the taxing policy.

It may also be relevant to note that the Petitioner had also challenged the rate disparity between state-run and state-

authorised lotteries. However, since subsequently the GST Council has implemented a single tax rate, the issue was reserved by the Petitioner by seeking liberty to challenge it separately. On the other hand, the request of the companies engaged in online gaming, casinos and horse racing to levy GST on value excluding the prize money has been referred to the Law Committee by the GST Council, however, the decision in this regard is pending. Thus, while the levy has been confirmed by the SC, the value on which such levy is to be computed is something which is still a subject matter of discussion before the legislatures.

"Levy of GST on lotteries does not amount to hostile discrimination."

REGULATORY DIRECT TAX UPDATES

CBDT notifies further relaxations for availing Vivad Se Vishwas Scheme for reducing pending direct tax disputes, also issues further clarifications *vide* FAQs

The Finance Minister in her Budget Speech on February 1, 2020, announced the "*Vivad se Vishwas*" scheme ("**Scheme**") for resolution of pending income tax disputes. In this regard, the CBDT *vide* a recent Notification[95] dated October 27, 2020, notified the last date for filing a declaration under the Scheme as December 31, 2020. Vide same notification, it also extended the due date for payment of taxes in accordance with the Scheme without an additional amount from December 31, 2020, to March 31, 2021. Hence, from April 1, 2021, onwards, the payment of taxes under the Scheme shall be made along with an additional amount, as provided for in the Scheme.

Subsequently, the CBDT *vide* a separate Circular[96] dated October 28, 2020, also relaxed the time limit of 15 days for payment of taxes that is prescribed under Section 5(2) of the Direct Tax Vivad Se Vishwas Act, 2020 ("**DTVSV Act, 2020**"), from the date of receipt of certificate from the designated authority ("**DA**"), in order to avoid causing undue hardship to the taxpayers in whose case the period of 15 days expires before March 31, 2021. In this regard, the CBDT, *vide* the said Circular, clarified that where declaration is filed under the Scheme on or before December 31, 2020, the DA shall allow the declarant to make payment of taxes without an additional amount by March 31, 2021.

In addition to the above, the CBDT also issued a Circular[97] dated December 4, 2020, in the form of answers to 34 more FAQs to clarify various other aspects of the Scheme. This is further to an earlier Circular[98] dated March 4, 2020, in which the CBDT provided answers to 55 FAQs pertaining to the Scheme. Salient contents of the aforesaid Circular dated December 4, 2020, are as follows:

1. It was clarified that the following cases shall be covered under the Scheme:
   i. In case an assessment order is stayed by the HC/ SC due to pendency of a writ petition or an appeal in HC/ SC, even in such cases the Scheme can be availed by an assessee, subject to withdrawal of such writ petition or appeal from the HC/ SC;
   ii. An appeal or a writ petition against an order passed under Section 263 of the IT Act (i.e. for revision of orders that were prejudicial to the interests of the IRA), which contains specific directions and income is quantifiable (and not general directions due to which income is not quantifiable);
   iii. Where time limit to file appeal has expired between April 1, 2019, and January 31, 2020, (both dates included) and application for condonation of delay has been filed before December 4, 2020, and the appeal is admitted by the appellate authority before filing a declaration under the Scheme;
   iv. Cross objections filed and pending as on January 31, 2020, however, the main appeal also needs to be settled along with the cross objections;
   v. Miscellaneous Application pending as on January 31, 2020, where the main appeal had been dismissed in limine and in such a case disputed tax amount shall be computed as per the main appeal dismissed;
   vi. An appeal, writ petition or SLP in respect of a block assessment made under Section 158BA of the IT Act, if the disputed tax does not exceed INR 5 crore for the said block assessment;

95 Notification S.O. 3847(E) dated October 27, 2020.
96 Circular No. 18/2020 dated October 28, 2020.
97 Circular No. 21/2020 dated December 4, 2020.
98 Circular No. 9/2020 dated April 22, 2020.

vii. Where an appeal is pending as on January 31, 2020, and the taxpayer has filed an application for resolution under MAP, which is pending or where the assessee has not accepted MAP decision;

viii. Where IRA has filed an appeal or writ petition against an order of AAR, passed in favour of an assessee such that the total income was quantifiable. In such a case, 50% of the disputed tax would be payable;

ix. Where an appeal has been set aside to CIT(A)/ DRP and it is still pending before CIT(A)/ DRP as on January 31, 2020;

x. Where prosecution proceedings instituted against the taxpayer have been decided in his favour in an appeal and time limit for filing of appeal by IRA has expired and such appeal has not been filed;

xi. Where an appeal is filed against an intimation issued under Section 143(1) of the IT Act and adjustment has been made under sub-clauses (iii) to (vi) of clause (a) of Section 143(1) of the IT Act;

xii. An appeal filed under Section 248 of the IT Act (i.e. by a taxpayer denying liability to deduct tax in certain cases);

xiii. Where the taxpayer or IRA have filed a declaration/ application under Section 158A/158AA of the IT Act (i.e. where identical question of law is pending before HC/ SC in another case by January 31, 2020).

2. It was also clarified that following cases shall not be covered under the Scheme:

   i. Where proceedings are pending before Income Tax Settlement Commission ("ITSC") or where a writ petition has been filed against the order of ITSC,

   ii. Where prosecution is instituted against the taxpayer due to default in deduction of TDS in a FY on or before the date of filing of declaration under the Scheme,

   iii. In case a Trust has been denied registration under Section 12A of IT Act, appeal against such order.

3. Where an appeal or arbitration is pending as on January 31, 2020, however, disposed thereafter, but before the filing of a declaration under the Scheme, disputed tax amount shall be computed as per the position as on January 31, 2020.

4. Where assessment order under Section 143(3)/ 144 of the IT Act is passed, based on the search carried on in some other taxpayer's case, such case shall be considered as a search case for the purpose of the Scheme.

5. Where prosecution has already been instituted for an AY, taxpayer is not covered under this Scheme even for issues not relating to such prosecution. Further, prosecution proceedings instituted in one AY do not debar an assessee from filing declaration for any other AY.

6. Enhancement notice issued by CIT(A) after January 31, 2020, but before December 4, 2020, shall be taken into account for determining amount payable under the Scheme. However, enhancement notice issued on or after December 4, 2020, but on or before December 31, 2020, shall not be taken into account for determining amount payable under the Scheme.

7. Where an additional ground filed in relation to an appeal is filed by January 31, 2020, it shall be considered while computing the amount of tax payable under the Scheme.

8. Where addition on same issue is repeated in both assessment and reassessment proceedings, both the appeals will be settled together and tax on such issue will be payable only once and if there is a difference in the tax liability, higher of the two tax liabilities will be considered for payment.

9. Where prepaid taxes i.e. TDS/ TCS are clearly identifiable with the source of income, they will be adjusted against tax liability with respect to such income and remaining prepaid taxes will be adjusted against the remaining tax liability.

10. Appeals against penalty order under Section 271B, 271BA and 271DA of the IT Act are required to be settled separately from the main appeal.

11. Where an appeal is settled for an addition made under Section 68 of the IT Act, pertaining to a loan amount, such amount cannot be capitalised in the books merely because such addition is settled under the Scheme.

12. Where an issue is settled under the Scheme, the immunity from prosecution with respect to that issue shall also extend to the director or partner of the declarant being a company or a firm.

13. Where an appeal involving an issue of disallowance of expenditure due to non-deduction of TDS is settled under the Scheme, it does not imply that consequential relief will be available in proceedings under Section 201 of the IT Act

14. Where a deductor has settled his appeal related to proceedings under Section 201 of the IT Act under the Scheme and the deductee is also in appeal in respect of the same TDS amount, the deductee will get credit for such payment and will not be required to pay again. However, the deductee shall be required to pay interest and penalty in respect of such tax amount. Similarly, where the deductee has settled his appeal under the Scheme and paid taxes, the deductor will not be required to pay such amount of tax again. However, the deductor is required to pay interest and penalty in respect of such tax amount.

15. Once an appeal against an order under Section 201(1) of the IT Act is settled under the Scheme, there would be 100% waiver of the interest that is levied under Section 201(1A) of the IT Act even where interest portion is covered by a separate order.

16. Declaration filed by an assessee can be revised any number of times before the DA issues a certificate under Section 5(1) of DTVSV Act, 2020.

CBDT issues notification to amend EL Rules, 2016

As discussed in our cover story, Finance Act, 2020, expanded the scope of EL to include e-commerce supply or services. Pursuant to these amendments, CBDT *vide* Notification No. 87 of 2020, dated October 28, 2020 ("**Notification**"), notified certain consequential amendments to the Equalisation Levy Rules, 2016 ("**EL Rules**").

The Notification has amended Rule 4 of EL Rules to provide the manner in which EL would be paid by e-commerce operators. It *inter alia*, provides that e-commerce operators are required to deduct and pay EL to RBI, or at any branch of the State Bank of India, or other authorised bank, accompanied by the EL challan.

Rule 5 of the EL Rules has been amended to provide that an e-commerce operator is required to submit a statement of specified services, or e-commerce supply or services on Form No. 1 electronically (either using a digital signature or an electronic verification code). This Form is to be submitted by June 30, every year, immediately following the relevant FY. Further, the rule authorises the Principal DGIT(Sys) or DGIT(Sys) to perform various actions, including inter-alia, specifying the procedure for electronic filing of Form No. 1, to ensure secure capture and transmission of data. Separately, from the review of Form No. 1, we note that in case of expanded EL, the e-commerce operator is required to provide quarterly details of consideration received/receivable and EL discharged thereon, instead of transaction wise or service provider wise details under the advertisement EL.

Rule 8 of the EL Rules prescribes the manner in which an e-commerce operator may file an appeal against the order of AO, imposing penalty for failure to deduct EL. This appeal is to be filed in Form No 3 and the Principal DGIT(Sys) or DGIT(Sys) have been authorised to perform various actions, including inter-alia, specifying the procedure for electronic filing of Form No. 1, to ensure secure capture and transmission of data. Certain consequential amendments have also been made in other rules of EL Rules.

In addition to the above, the Notification substituted Form No. 1, relating to the statement of specified services, or e-commerce supply or services; Form No. 3 relating to appeals to the CIT(A); and Form No. 4 relating to appeals to the Appellate Tribunal. The forms mandate e-commerce operators to quote either PAN or Aadhar number while filing annual statement and appeal forms.

CBDT issues notification to extend certain timelines

CBDT, in light of the prevailing pandemic situation, on December 31, 2020, issued Notification No. 93 of 2020 ("**Notification**") to extend timelines for various compliances under the IT Act. Please note that these timelines were already extended by the Taxation and Other laws (Relaxation of Certain Provisions) Ordinance, 2020, on March 31, 2020, which was later replaced by the Taxation and Other laws (Relaxation and Amendment of Certain Provisions) Act, 2020. The new timelines have been summarised below:

1. The due dates for furnishing IT returns for the AY 2020-21, for taxpayers who are required to get their accounts audited has been extended to February 15, 2021, from January 31, 2021.
2. Due dates for furnishing tax audit report and audit report with respect to international/ specified domestic

transactions for AY 2020-21 has been extended to January 15, 2021 from December 31, 2020.

3. The due dates for furnishing IT returns for AY 2020-21, for other taxpayers has been further extended to January 10, 2021 from December 31, 2020.
4. Last date for making a declaration under the VsV Scheme has been extended to January 31, 2021, from December 31, 2020.

Central Government notifies Sovereign Wealth Fund eligible for exemption

Section 10(23FE) of the IT Act exempts income arising to specified persons, including sovereign wealth funds outside India, on any investment made in India, subject to certain conditions. One of the conditions to avail the exemption is that the sovereign wealth fund should be notified by the Central Government in the official gazette. Central Government, in exercise of this power, has notified MIC Redwood 1 RSC Limited, Abu Dhabi, UAE, ("**Assessee**") as a sovereign wealth fund exempt under Section 10(23FE).[99]

The exemption is available on investments made in India on or after publication of the notification in the Official Gazette, but on or before March 31, 2024. The exemption on the said investments is also subject to certain conditions that are as follows:

i. The Assessee shall file income-tax returns for all the relevant FYs falling within the period beginning from the date on which the said investment is made and ending on the date on which the said investments are liquidated ("Relevant Fys"), on or before the due dates prescribed under the IT Act;

ii. The Assessee shall get its books of accounts audited for all the Relevant FYs by any accountant specified under Explanation to Section 288(2) and furnish such audit reports in the format prescribed in the annexure to the notification, at least one month prior to the date specified for furnishing the income-tax return;

iii. The Assessee shall furnish quarterly statement in respect of investments made by it in the said quarter, within one month from the end of each quarter in the prescribed format;

iv. The Assessee shall maintain segmented accounts of income and expenditure in respect of such investment as is exempt under Section 10(23FE);

v. The Assessee shall continue to be owned and controlled, directly or indirectly, by the Government of Abu Dhabi;

vi. The Assessee shall continue to be regulated under the law of the Government of Abu Dhabi;

vii. The earnings of the Assessee shall be credited either to the account of the Government of Abu Dhabi or to any other account designated by that Government so that no portion of the earnings incurs to any private person;

viii. The Assessee does not and shall not have any loan, borrowing, advances, deposits, or investment in it of any kind, directly or indirectly from any person other than the Government of the Abu Dhabi;

The Assessee shall only invest the surplus fund of the Government of Abu Dhabi and that the Government shall not raise any loan, debt, etc., directly or indirectly, from the market or any entity to make the said investment;

ix. The asset of the assessee shall vest in the Government of Abu Dhabi upon dissolution;

x. The Assessee does not and shall not undertake any commercial activity, whether within or outside India, other than the said investment or investment of similar nature;

xi. The Assessee shall have monitoring mechanism to protect the said investment with the investee, but shall not manage day-to-day operations of the investee or appoint executive directors in the investee company or participate in the decision-making process or control them; and

xii. The Assessee shall not carry out asset management activity for any person other than itself.

99 Notification No. 89 of 2020.

REGULATORY INDIRECT TAX UPDATES

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

Notification No. 92/2020- Central Tax dated December 22, 2020, has enforced the following amendments w.e.f. September 01, 2020:

a. Inclusion of service for composition scheme under Section 10 of the CGST Act;

b. Time limit to avail ITC in case of debit note under Section 16 of the CGST Act has been extended to the due date of furnishing of the return for the month of September, following the end of financial year to which such debit note pertains;

c. Jurisdictional GST authority has now been empowered to cancel registration under Section 29 of the CGST Act for the person who have voluntarily opted for registration and now wish to opt out of the same;

d. Time limit for submission of an application for revocation of order of cancellation of registration (in a case where registration is cancelled by the proper officer on his own motion) can now be extended by 30 day by joint/ additional commissioner and another 30 days by commissioner;

e. Power has been conferred on the government to notify specific categories of services or supplies in respect of which a tax invoice shall be issued within specific timeline as prescribed under Section 31 of CGST Act;

f. No late fee is to be imposed for non-furnishing of certificate of tax deduction at source to deductee under Section 52 of CGST Act.

g. Penalty under Section 122 of CGST Act has been introduced, which is to be imposed on a person who retains the benefit of the following transactions, carried out at his instance:

    a. Not issuing invoice or issuing false invoice,

    b. Issuing invoice which violate provision of statute,

    c. Takes or utilises ITC without actual receipt of goods and/or services (contravention of act),

    d. Takes or distributes ITC in contravention of Section 20, or the rules made thereunder.

    Such penalty would be equivalent to the tax evaded or input tax credit availed of or passed on.

h. Penalty under Section 132 of CGST Act has been restricted to the person who retains the benefit of offences mentioned therein. The list of offences has also been modified to include the following:

    a. Availment of ITC using an invoice or bill issued in violation of GST provision or fraudulent availment of input tax credit without any invoice or bill,

    b. Evasion of tax in any other form.

i. In Schedule II, which categorises activities as supplies of goods or service, the phrase "whether or not for a consideration" in relation to transfer of business has been omitted w.e.f. July 01, 2017.

Extension of timeline

a. <u>Antiprofiteering provision</u>: The time-limit for completion or compliance of any action under the antiprofiteering provision, which falls during the period between March 20, 2020, and March 30, 2021 (which is yet to be completed), is extended up to March 31, 2021, *vide* Notification No. 91/2020-Central Tax dated December 14, 2020.

b. <u>Annual Return</u>: The filing of annual return for the FY 2019-20 has been made optional *vide* Notification No. 77/2020-

Central Tax, dated October 15, 2020. The time limit for filing annual return has been extended to October 31, 2020, *vide* Notification No. 95/2020- Central Tax, dated December 30, 2020.

c. Dynamic Quick Response ("**QR**") code: The inclusion of QR code on invoices issued by a registered person whose aggregate turnover in any preceding financial year from 2017-18 onwards exceeds Rs 500 crore to an unregistered person (B2C invoices) was made effective from December 01, 2020. The imposition of penalty for non-compliance with such requirement for the period December 01, 2010 to March 31, 2020, has been waived *vide* Notification No. 89/2020-Central Tax, dated November 29, 2020, provided that the concerned person is complying with the same from April 01, 2021 onwards.

d. Custom Duty Exemption against scrips issued under the RoSCTL scheme and additional ad-hoc incentive for apparel and made-ups sector: The benefit has been extended up to March 31, 2021, or until RoSCTL scheme is merged with the RoDTEP scheme, whichever is earlier.[100]

e. Extension of Courier Imports and Exports (Electronic Declaration and Processing) Regulations, 2010, to COVID vaccine and its relevant accessories *vide* Notification No. 115/2020-Customs (N.T.), dated December 30, 2020.

Requirement to mention HSN Code

Registered persons are required to mention four digits of HSN (where aggregate turnover in preceding FY is up to five crore) or six digits of HSN (where aggregate turnover in preceding FY is more than five crore) in invoices issued by them with effect from April 01, 2021. However, a registered person with aggregate turnover in preceding FY up to 5 crore, is not required to mention HSN code for supplies made to unregistered recipients.[101]

Further, a registered person supplying chemicals specified in the Notification No. 90/2020-Central Tax, dated December 01, 2020, would have to mention eight number HSN in tax invoice issued by them with effect from December 01, 2020.

E-invoicing under the GST Legislation

Notification No. 13/2020-Central Tax dated March 21, 2020, read with Notification No. 88/2020- Central Tax, dated November 10, 2020, provides that registered persons having aggregate turnover exceeding one hundred crore rupees in any preceding financial year from 2017-2018 onwards shall issue an e-invoice w.e.f. January 01, 2021, for the supply of goods and/or services or for exports. Invoice issued in any other manner would not be treated as a valid invoice. The e-invoice can be generated on GST electronic portal by furnishing relevant information. However, the following suppliers would not be required to comply with the aforesaid system:

a. SEZ unit,

b. insurer or a banking company or a financial institution, including a non-banking financial company,

c. goods transport agency supplying services in relation to transportation of goods by road in a goods carriage,

d. supplier supplying passenger transportation service,

e. supplier supplying services by way of admission to exhibition of cinematograph films in multiplex screens.

100 Notification No. 36/2020 - Customs dated October 05, 2020.
101 Notification No. 78/2020-Central Tax dated October 15, 2020

GLOSSARY

ABBREVIATION	MEANING
AAR	Hon'ble Authority for Advance Rulings
AAAR	Hon'ble Appellate Authority for Advance Rulings
ACIT	Learned Assistant Commissioner of Income Tax
AE	Associated Enterprises
AO	Learned Assessing Officer
APA	Advance Pricing Agreement
AY	Assessment Year
Customs Act	Customs Act, 1962
CbC	Country by Country Reporting
CBDT	Central Board of Direct Taxes
CBEC	Central Board of Excise and Customs
CCR	CENVAT Credit Rules, 2004
CEA	Central Excise Act, 1944
CENVAT	Central Value Added Tax
CESTAT	Hon'ble Customs, Excise and Service Tax Appellate Tribunal
CETA	Central Excise Tariff Act, 1985
CGST	Central Goods and Service Tax
CGST Act	Central Goods and Service Tax Act, 2017
CGST Rules	Central Goods and Service Tax Rules, 2017
CIT	Learned Commissioner of Income Tax
CIT(A)	Learned Commissioner of Income Tax (Appeal)
CRISIL	Credit Rating Information Services of India Limited
CST	Central Sales Tax
CST Act	Central Sales Tax Act, 1956
CT Act	Custom Tariff Act, 1975
CVD	Countervailing Duty
DCIT	Learned Deputy Commissioner of Income Tax
DIT	Learned Director of Income Tax
DGFT	Directorate General of Foreign Trade

GLOSSARY

ABBREVIATION	MEANING
DRP	Dispute Resolution Panel
DTAA	Double Taxation Avoidance Agreement
EL	Equalisation Levy
EPCG	Export Promotion Capital Goods
FMV	Fair Market Value
FTP	Foreign Trade Policy
FTS	Fees for Technical Services
FY	Financial Year
GAAR	General Anti-Avoidance Rules
GST	Goods and Service Tax
GST Compensation Act	Goods and Services Tax (Compensation to States) Act, 2017
HC	Hon'ble High Court
IBC	Insolvency and Bankruptcy Code, 2016
IFSC	International Financial Services Centre
IGST	Integrated Goods and Services Tax
IGST Act	Integrated Goods and Services Tax Act, 2017
INR	Indian Rupees
IRA	Indian Revenue Authorities
IT Act	Income-tax Act, 1961
ITAT	Hon'ble Income Tax Appellate Tribunal
ITC	Input Tax Credit
ITO	Income Tax Officer
IT Rules	Income-tax Rules, 1962
Ltd.	Limited
MAP	Mutual Agreement Procedure
MAT	Minimum Alternate Tax
MLI	Multilateral Convention to Implement Tax Treaty related measures to prevent Base Erosion and Profit Shifting
MoU	Memorandum of Understanding

GLOSSARY

ABBREVIATION	MEANING
MRP	Maximum Retail Price
NAA	National Anti-profiteering Authority
NCLT	National Company Law Tribunal
OECD	Organization for Economic Co-operation and Development
PAN	Permanent Account Number
PCIT	Learned Principal Commissioner of Income Tax
PE	Permanent Establishment
Pvt.	Private
PY	Previous Year
R&D	Research and Development
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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