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tax scout

Tax Scout | January - March, 2022

Main Stories

Dear Readers,

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

In our main story, we have covered the regulatory and taxation considerations for Indian companies opting to list through special purpose acquisition companies ("**SPACs**"), popularity of which has soared over the last couple of years. The story discusses both the international and domestic stance towards SPACs, the challenges involved and potential solutions towards their adoption in the Indian capital markets.

Additionally, we have also dealt with other important developments and judicial precedents in the field of taxation for this quarter.

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

Regards,
CYRIL SHROFF

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Managing Partner
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India's leading law firm

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SPACS In India: Regulation, Taxation and The Way Forward

Introduction

The concept of a Special Purpose Acquisition Company ("**SPAC**") has gained special attention and momentum in the last couple of years. The year 2020 saw an unprecedented rise in global capital market listings using this route. While the US has been the leader in SPAC transactions since the last three decades, SPACs have also witnessed increased interest within Asian and other countries in the past two years. While the latter half of 2021 saw a temporary disruption, the recent Russia-Ukraine crisis has brought SPACs back to the forefront when it comes to different investment opportunities generally available to the investors.[1]

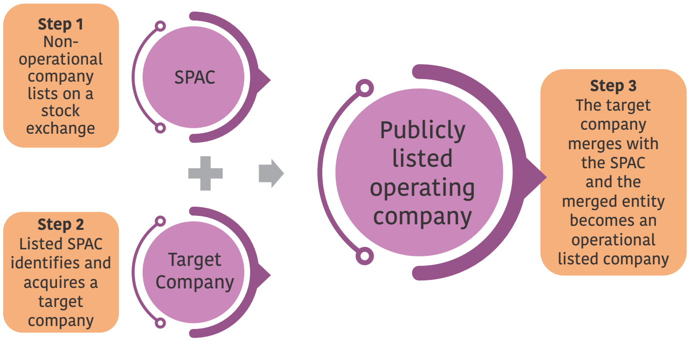
When it comes to India, the Indian regulatory regime presently does not allow access to its equity market using SPACs. However, a few Indian companies,[2] have been able to access foreign markets in the past by accepting an offshore merger. India is predicted to be a lucrative, fast growing market for tech enabled products and services. Despite global investor interest and economic potential in formalising a SPAC enabling regulatory regime, India has been reluctant to bring in amendments to its regulatory regime. In this article, we have discussed the current regulatory regime and taxation considerations for SPACs in India, some of the reasons behind India's strict stance when it comes to acceptance of SPACs, and the way forward.

What is SPAC?

SPACs are commonly referred to as 'blank cheque entities' since they do not have any active business operations of their own. A SPAC is created for the specific purpose of acquiring an existing line of business. It is essentially a 'shell' company, created for the sole purpose of raising money through an initial public offering ("**IPO**"). Unlike a traditional company which starts from scratch and slowly builds its business to eventually get listed in the securities market, a SPAC does not have any operating business of its own. A SPAC is generally backed by seasoned investors or sponsors ("**Founders**") who are experienced professionals in an industry or sector. It is generally a pre-requisite for SPACs to not have a target company in mind at the time of their formation and listing. At this stage, they only identify an industry where they plan to zero-in on target companies. The investors/ shareholders will typically invest in the SPAC basis the reputation of the Founders. The money raised by the SPAC during its IPO is used to select and acquire a target company, with the approval of its shareholders. Upon receipt of the requisite approval, the SPAC and the target business combine into a publicly traded operating company ("**De-SPAC transaction**"). In case the shareholders are not happy with the investment identified by the Founders, they may choose to redeem their shares and get their money back. If no target is identified and acquired within the prescribed period, which is generally 24 months, the SPAC is liquidated, and the money is returned to the shareholders.

1 https://www.bloomberg.com/news/articles/2022-02-24/ukraine-attack-shuts-europe-ipo-market-just-as-busy-march-loomed.

2 https://timesofindia.indiatimes.com/business/india-business/renew-power-lists-in-us-via-spac-mcap-hits-4-5bn/articleshow/85607683.cms; https://economictimes.indiatimes.com/industry/media/entertainment/media/videocon-d2h-makes-its-nasdaq-debut-following-listing-of-325-million/articleshow/46764246.cms; https://www.thehindubusinessline.com/info-tech/yatra-online-to-be-listed-on-nasdaq-on-monday/article9434575.ece.



Compared to a traditional IPO, listing using a SPAC gives more flexibility and also saves costs and time associated with public listings. Most importantly, the valuation of the acquiree company is pre-determined based on internal negotiations and is not subject to excessive market fluctuations. Thus, SPACs serve as an extremely lucrative option for both companies wishing to get listed as well as investors, during periods of market volatility.

International Acceptance

USA

US securities law permits companies incorporated outside the US to be listed on US stock exchanges. It also allows blank cheque companies, with no business operations, to access the securities market, subject to certain conditions.[3] SPACs suddenly rose in popularity in the US due to the COVID-19 pandemic. They were able to generate a record USD 83 Billion in 2020 (which is approximately double the amount raised through such transactions in the preceding five years) by launching 248 SPACs.[4] This number nearly doubled in 2021, with such transactions generating USD 145 Billion by launching 613 SPACs.[5] However, SPACs are not new investment vehicles but have existed in the US markets for a long time. In the late 1980s and early 1990s, blank-cheque or 'shell' companies were the preferred vehicle for penny stock scams. The US enacted the Securities Enforcement Remedies and Penny Stock Reform Act of 1990, ("**PSRA**") which greatly diminished the prevalence of such non-operational companies.[6] The SPAC was created in 1992, as an alternate to IPO listing, but without the abuses associated with traditional shell companies.

A SPAC in the USA has to meet the strict regulations set out under the PSRA and comply with any other regulations/guidance set out by the Securities and Exchange Commission ("**SEC**") in this regard. However, SPACs did not pick up fervour in the US markets initially, since the PSRA, *inter alia*, made onerous disclosure requirements on SPAC listings and it was easier to raise money through IPO listings given the positive market scenario at that time. As mentioned above, market volatility due to the COVID-19 pandemic brought renewed interest to the SPACs. However, despite the disclosure and other regulatory requirements in the USA, SPACs can still be prone to frauds.[7] Given the sudden boom of SPAC transactions in the USA, the SEC issued several investor guidances to inform retail investors of the risks associated with SPACs.[8] Further, on March 30, 2022, the SEC has come up with proposed rules applicable to SPACs.[9] The proposed rules introduce significant changes primarily aimed at enhancing the disclosure and reporting requirements for SPAC listing as well as for the De-SPAC transaction. While these changes may offer better protection to the investors in these vehicles, the proposed rules are likely to increase the regulatory and compliance burden on SPACs.

Asia

The success of SPAC deals in the USA, especially at a time of increased market volatility, garnered the interest of several Asian nations. Companies in several Asian nations, including China, Malaysia and India, have been exploring accessing the US securities market through the SPAC route. While South Korea and Malaysia allowed SPAC in the past decade but were not that popular; inspired from the US's experience, Malaysia has now revised its framework to make it conducive for SPACs to list. Singapore and Hong Kong have recently amended their securities laws in 2021, to introduce SPACs in their own capital markets.

The Singapore and Hong Kong governments' positive response towards SPACs may be attributed to (i) increased global attention to such transactions; (ii) uncertainty in a volatile market scenario; and (iii) unmet capital needs of local companies, particularly in the technology sector. According to a survey by the Bank for International Settlements, the capital inflow to China and several emerging Asian nations, recovered faster than the rest of the world after the outbreak of the COVID-19 pandemic.[10] Inflow of surplus money may have created a demand for innovative investment options such as SPACs.

3 https://www.sec.gov/corpfin/disclosure-special-purpose-acquisition-companies.
4 https://indianexpress.com/article/explained/what-are-spacs-and-why-are-they-under-the-scanner-7242646/.
5 https://www.nasdaq.com/articles/a-record-pace-for-spacs-in-2021.
6 Page 532 of From Blank Check to SPAC: The Regulator's Response to the Market and the Market's Response to the Regulation (2007) available at https://core.ac.uk/download/pdf/159610375.pdf.
7 https://www.nytimes.com/2021/07/30/business/dealbook/spacs-fraud.html.
8 https://www.sec.gov/oiea/investor-alerts-and-bulletins/what-you-need-know-about-spacs-investor-bulletin; https://www.investor.gov/introduction-investing/general-resources/news-alerts/alerts-bulletins/investor-alerts/celebrity; https://www.sec.gov/news/public-statement/spacs-ipos-liability-risk-under-securities-laws.
9 https://www.sec.gov/rules/proposed/2022/33-11048.pdf.
10 https://www.bis.org/publ/cgfs66.pdf.

Furthermore, the capital markets of Singapore and Hong Kong have been prone to underperforming. Due to this reason, unicorns with extensive potential, in these nations, have recently looked towards foreign markets to raise capital.[11] Thus, a need to retain such potential technology giants, and make their capital markets more attractive to global investors, could be another reason which factored Singapore and Hong Kong in taking the plunge to amend their listing regime. SPAC listings, for these countries, presented a unique opportunity to attract foreign investors and make the local capital markets more viable for domestic companies. For instance, estimates by a Hong Kong-based consulting firm suggest that the SPAC market in the region is expected to be worth almost $40 Billion by 2025.[12] Similarly, Singapore had been struggling to attract newcomers to its markets and was looking at a dearth of IPO listings.[13] The initiation of the SPAC regime in Singapore was able to revive its capital markets. Soon after the initiation of the SPAC regime, it became the most preferred form of raising capital on the Singapore Exchange.[14] The month of January 2022 alone saw three SPAC listings in Singapore,[15] while the entirety of 2021 saw only three IPO listings.[16]

Furthermore, recently the market in the US has become overcrowded, and investor attention has been shifting to the markets of emerging Asian countries, wherein the response may be huge due to spurt of technology driven companies backed by venture capital and private equity partners. Thus, irrespective of the limitations associated with the SPAC, they have proven to be a novel investment tool to give a boost to a country's financial markets, during periods of crisis.

Position in India

Listing in India using the SPAC route is presently not permitted. Direct overseas listing of equity and debt instruments has been permitted in permissible foreign jurisdictions by public Indian companies *vide* an amendment to section 23 of the Companies Act, 2013 ("**CA, 2013**"), by the Companies (Amendment) Act, 2020. However, detailed rules and guidelines in this regard are awaited. Prior to this amendment, the Indian regulatory framework only allowed for indirect listing through American Depository Receipts ("**ADRs**") or Global Depository Receipts ("**GDRs**").

Some of the broad reasons for India to shy away from SPACs till now are given below:

Aversion to 'shell' companies

To understand why the Indian regulatory framework favours strict compliance over flexibility, it may be relevant to understand the historic evolution surrounding the adoption of such a regime. India has been wrought with numerous money laundering and tax evasion activities since the time of its independence.[17] In a study conducted by Global Financial Integrity (a Washington DC-based think tank focused on illicit financial flows, corruption, illicit trade and money laundering) in 2008, it has been shown that unaccounted capital outflows accelerated after the 1991 reforms, i.e., after opening up of the Indian economy to foreign investment.[18] According to a study, India lost between $11.6 and $14.3 Billion annually in illicit financial flows during 2000-08.[19] The study further suggested that illicit flows from India are more likely to have been driven by a complex interplay of structural factors and governance issues than by poor macroeconomic policies.

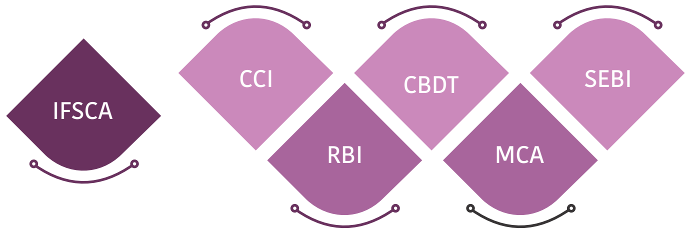
A need was felt to amend the corporate, securities and tax laws of India to manage the proliferation of unaccounted money post the 1991 reforms. The period immediately preceding the overhaul of the erstwhile corporate law regime, also saw numerous financial scams which majorly impacted the Indian economy and its financial markets. In 2012, the CBDT released a White Paper on Black Money which identified manipulation of business expenses through 'hawala' operators by making use of

11 https://www.livemint.com/companies/news/singapores-grab-to-list-in-us-in-40-billion-spac-deal-11618363433726.html; https://www.cnbc.com/2021/09/16/hong-kong-biotech-start-up-prenetics-to-list-on-nasdaq-through-spac-merger.html.
12 https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/competition-stringent-rules-to-constrain-spac-listings-in-hong-kong-singapore-69283655.
13 https://www.bloombergquint.com/business/spacs-can-help-singapore-break-its-driest-ipo-spell-in-years.
14 https://www.globaldata.com/singapore-may-emerge-new-hotspot-spac-ipos-says-globaldata/.
15 https://www.reuters.com/markets/stocks/buyout-fund-novo-tellus-backed-spac-debuts-singapore-2022-01-27/; https://www.reuters.com/world/asia-pacific/singapore-ipo-markets-prospects-brighten-no-quick-fix-sight-2021-09-22/.
16 https://www2.deloitte.com/content/dam/Deloitte/sg/Documents/audit/sg-aud-sg-ipo-market-2021-mid-year-pr-report.pdf.
17 https://www.epw.in/journal/2011/15/special-articles/empirical-study-transfer-black-money-india-1948-2008.html.
18 Page iii of The Drivers and Dynamics of Illicit Financial Flows from India: 1948-2008 of November 2010 available at https://www.gfintegrity.org/wp-content/uploads/2014/02/GFI_India.pdf.
19 https://www.epw.in/journal/2011/15/special-articles/empirical-study-transfer-black-money-india-1948-2008.html.

shell entities, as one of the most common methods of tax evasion.[20] It was also noted that IPOs may be used to generate black money by involving shell companies. Moreover, offshore companies with little to no business operations may be used to manipulate the share issuance process artificially, at the cost of ordinary investors. To resolve this issue, it was noted that since 2009, the Indian Government has been insisting on entering into tax information exchange agreements with countries while negotiating tax treaties. The manipulation of share prices and use of shell entities to convert black money into white money was also noted by the CBDT when it suggested doing away with exemption given under section 10(38) of the IT Act with respect to LTCG on listed securities.[21] Income from LTCG is now taxable in India at the rate of 10% under section 112A of the IT Act. In this backdrop, the CA, 2013 also introduced several provisions pertaining to corporate governance.[22] Similarly, around the same period, the IT Act also underwent several amendments (such as the requirement to prove "source of source" under section 68 for shares issued at premium). Finally, in 2018, the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009 were overhauled and the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2018 ("**ICDR, 2018**") were adopted.

Thus, the strict regulatory framework in India is a product of the persisting issue of tax seepages and unaccounted money, both prevalent in India. Moreover, despite the introduction of such regulatory measures, major financial scams in India, including the IL&FS scam, Yes Bank scam and Nirav Modi scam, etc. have continued to make use of complex corporate structures involving several shell companies, to launder money and evade tax. Thus, in the absence of a domestic compliance mechanism which would be able to plug seepages of revenue abroad, Indian regulators may continue to be wary of complex SPAC structures, which involve the listing of non-operational companies in the first instance. However, such an outlook does not appreciate the fact that the manner in which a SPAC operates is totally different from a shell company. While the SPAC starts off as a 'shell' company, it only remains so for a limited period and finally merges into an operating company identified within a specified time-period. In case of failure to acquire/merge with an operating company within the limited time frame, the SPAC ceases to exist and needs to necessarily return the money back to its investors. Regulators may want to approach SPACs as a unique investment mechanism and bring adequate measures to protect investors, instead of relying on a framework which continues to treat all non-operational companies equally, irrespective of the purpose they are set up for.

Regulatory Concerns



SPAC Listing in India

The current regulatory framework punishes shell companies, in several ways. To tackle the illegal activities of shell companies, powers have been given to the relevant administrative authorities under various statutes. The Prohibition of Benami Property Transactions Act, 1988, which was operationalised in the year 2016, prohibits the accumulation of assets under a fake name to avoid taxation. The Prevention of Money Laundering Act, 2002 makes the transfer of black money through a shell company punishable. The CA, 2013 limits the number of layers of subsidiaries that a company can hold. The Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015, restrains undisclosed foreign income and assets and prescribes high tax rates and penal consequences if undisclosed foreign income or assets are found for a taxpayer. The Indian Penal Code, 1860 provides for persons involved in any fraudulent schemes using shell companies to be held punishable under section 420 (cheating).

While jurisprudence suggests that these provisions do not intend to punish all shell companies, merely the ones involved in fraudulent activities, there is a presumption under corporate law, that non-operational companies exist only for fraudulent/non-genuine purposes. In this respect, section 248 of the CA, 2013 gives the Registrar of Companies ("**RoC**") powers to remove the name of any company from the register of companies if such company fails to commence its business operations within one year of its incorporation. It may also be used by the RoC to strike off the name of an operational company, if it fails to fulfil certain statutory compliances.[23] While the opportunity of appeal

[20] https://dor.gov.in/sites/default/files/FinalBlackMoney.pdf.
[21] https://dor.gov.in/sites/default/files/Measures_Tackle_BlackMoney.pdf.
[22] https://www.mca.gov.in/MinistryV2/background.html.
[23] Basant Kumar Berlia v. Registrar of Companies, West Bengal, 2019 SCC OnLine NCLAT 21; Devang B. Parikh v. Registrar of Companies, Gujarat, 2017 SCC OnLine NCLT 11782.

remains available after any *suo moto* strike off proceedings are initiated by the RoC, section 248 of the CA, 2013 leaves wide discretion on the RoC to remove the name of any company from the register of companies. A SPAC takes around 24-36 months to complete the De-SPAC transaction. Thus, in the absence of commencement of any business operations, SPACs may be faced with unnecessary notices and questioning in this regard by the RoC. Thus, section 248 of CA, 2013 proposes a major hindrance for SPACs in India, if it were to apply blanketly to include even SPACs. Hence, a relaxation may be given to SPACs in this regard in terms of extended timeline under this provision.

A similar sentiment is also echoed under the ICDR, 2018. Regulation 6(1) requires companies to have minimum INR 30 Million net tangible assets for the preceding three years, and an average pre-tax operating profit of at least INR 150 Million during the preceding three years and a net worth of at least INR 10 Million in each of the preceding three years, to be eligible to proceed with an IPO. This is not feasible for a company incorporated solely for raising money to acquire another company. Regulation 6(2) allows listing even if these conditions are not fulfilled, however, any listing pursuant to Regulation 6(2) requires that at least 75% of the net IPO offer should be subscribed by qualified institutional buyers. Only 10% of the net offer can be made to retail investors. However, restricting retail investors from investing in SPACs can be counterproductive to the SPAC investment framework and hence, it may be advantageous if such regulations are relaxed specifically for SPACs.

Moreover, the SEBI has recently released a discussion paper on Disclosures for 'Basis of Issue Price' in an offer document, where it suggests tightening disclosure requirements in relation to key performance indicators ("**KPIs**") of issuer companies for a period of three years prior to listing.[24] SEBI has further suggested that valuation of the issuer company may be done based on the transactions executed by the company during the last 18 months, prior to the filing of its offer document.[25] These changes have been suggested in response to the recent trend of listing of loss-making new age technology companies on the Indian stock exchanges. However, this can pose further challenges for listing of shell companies, which would have no historical basis for their valuation, and may prove to be a step backwards for the acceptance of SPACs in Indian capital markets, unless a separate carve-out is made for SPAC.

De-SPACing

Even in case of De-SPAC transactions, there are several foreign exchange regulatory concerns. India is a controlled economy, where foreign exchange is heavily regulated. For executing an outbound merger, a foreign SPAC will be required to comply with the requirement of determining FMV of securities of the entity, within the limit of USD 250,000 in accordance with the Liberalised Remittance Scheme in cases where Indian shareholders (who will be issued shares as consideration for the merger) are individuals, as given in the Foreign Exchange Management (Cross-Border Merger) Regulations, 2018. Similarly, the Foreign Exchange Management (Non-Debt Instruments) Rules, 2019 impose strict requirements on how Indian companies may hold foreign currency. The SPAC merger may also require prior approval from the National Company Law Tribunal.

The De-SPAC transaction may also adopt a structure whereby shares of the target are swapped against shares of the SPAC. Such an arrangement, however, needs to be analysed in detail as it is likely that such share-swap will require approval of the RBI, for the inbound as well as outbound leg of such transaction, depending on the residential status of the individuals involved in such share-swap. Additionally, such structures may also require consideration in terms of Press Note 3 of 2020[26] (which has now been subsumed into the Consolidated FDI Policy[27]) regarding investment from countries which share land border

24 https://economictimes.indiatimes.com/markets/ipos/fpos/sebi-plans-tougher-disclosure-norms-for-new-age-companies-ipos/articleshow/89677977.cms?from=mdr%20https://economictimes.indiatimes.com/?back=1.

25 https://www.sebi.gov.in/reports-and-statistics/reports/feb-2022/consultation-paper-on-disclosures-for-basis-of-issue-price-section-in-offer-document-under-sebi-issue-of-capital-and-disclosure-requirements-regulations-2018_56218.html.

26 https://dpiit.gov.in/sites/default/files/pn3_2020.pdf.

27 https://dpiit.gov.in/sites/default/files/FDI-PolicyCircular-2020-29October2020.pdf.

with India, and anti-trust approval under the Competition Act, 2002. Consideration of the listing requirements in the jurisdiction of the SPAC as well as in the jurisdiction where it is listed also needs to be considered and complied with when undertaking a De-SPAC transaction.

Another major hurdle in a De-SPAC transaction with an Indian target revolves around the prohibition on round tripping. The RBI does not permit a person resident in India to invest in an overseas entity which holds shares in India. Given that a De-SPAC transaction of an Indian target might involve its shareholders getting shares in the overseas listed SPAC (including a SPAC listed in an International Financial Services Centre) or an intermediate foreign holding structure, this may limit the ability to structure a number of De-SPAC transactions involving externalization of promoter's Indian holdings. On account of the round tripping concerns, the Indian resident shareholders would effectively be holding illiquid stocks of an unlisted entity and hence, the Indian resident shareholders may have to be accorded contractual protections to provide them benefits similar to those available to non-resident shareholders who may directly receive registered/ listed shares of the SPAC. However, these aspects require more in-depth analysis on a case-by-case basis.

Given the above, it may be said that the plethora of regulations aimed at protecting investors from unvetted shell companies as well as other regulatory complexities highlighted above make SPAC listings or undertaking De-SPAC transactions in India challenging and outline the need for further amendments to the regulations to provide a clear pathway for SPACs in India.

IFSC Listing Regulations for SPACs

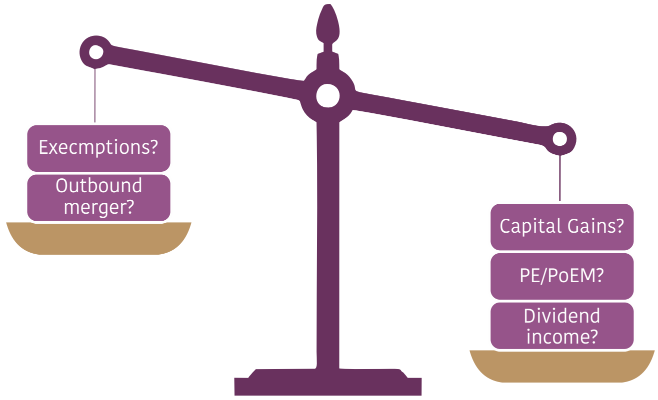
In July 2021, the International Financial Services Centre Authority ("**IFSCA**") notified the IFSCA (Issuance and Listing of Securities) Regulations, 2021, ("**IFSCA Regulations**") to provide for a framework for listing of SPACs in an IFSC.[28] Chapter VI of the IFSCA Regulations gives the eligibility criteria, filing procedure, obligations of the SPAC, and other compliance requirements for SPAC listings in an IFSC ("**IFSC SPAC**"). According to the IFSCA Regulations, the sponsor of a SPAC must have a 'good track record' in SPAC transactions or business combinations or fund management or merchant banking activities. However, what constitutes 'good track record' has not been defined. The minimum offer size for an IFSC SPAC is USD 50 Million. In contrast, the minimum market capitalisation for SPACs in Singapore is USD 150 Million. In the US, for listing on the Nasdaq, a minimum market capitalisation of USD 160 Million and total assets of USD 80 Million are required, for companies with no or insufficient earnings or cash flows.[29] Additionally, the IFSCA may consider SPAC listings on a case-by-case basis. However, the IFSCA Regulations do not prescribe any metrics that the IFSCA must use for such determination.

The SPAC is required to file a detailed prospectus with the stock exchange(s), regarding the identified target company, while seeking shareholders' approval for the De-SPAC transaction. No submissions to, or approvals from, the IFSCA are required at this stage. Further, non-sponsor shareholders who vote against the business combination may 'redeem' their securities. However, Indian law presently does not permit the conversion or redemption of equity shares. A company can buy-back issued shares or reduce its capital which may not necessarily be feasible. The CA, 2013 may need to be amended to permit the issuance of redeemable equity shares under the IFSCA Regulations. Currently, India has only one IFSC, the Gujarat International Finance Tec-City ("**GIFT-City**"). The two stock exchanges in GIFT-City have yet to add equity (or other convertibles) to their lists of products.[30] Additionally, neither the IFSCA nor the stock exchanges have prescribed delisting guidelines. Thus, additional clarifications and amendments are required before SPACs are able to list at GIFT-City.

Issues identified above, specifically around possible structuring issues and regulatory challenges in India (including reverse merger, round tripping and other exchange control implications) for listing through SPACs on foreign exchanges also apply to an IFSC SPAC.

Tax Implications in India

While the regulatory considerations have been briefly captured in the previous section, even if the same are eased through providing a separate framework for SPACs, there are important considerations from a tax perspective which can also pose a hindrance.



[28] https://ifsca.gov.in/Document/Legal/ifsca-issuance-and-listing-of-securities-regulations-202120072021054301.pdf.
[29] https://listingcenter.nasdaq.com/assets/initialguide.pdf.
[30] https://www.nseifsc.com/products/all-products.html.

Tax Implications during De-SPACing

As discussed, indirect listing of Indian companies, on a foreign stock exchange, through a De-SPAC transaction is presently permitted in India. This may be done by (i) the Indian company merging with a SPAC listed abroad by way of an outbound merger ("**Traditional De-SPAC**"); or (ii) the Indian company becoming a wholly-owned subsidiary of a SPAC listed abroad ("**Indirect De-SPAC**"). Indirect De-SPAC may also be done between the SPAC and a foreign holding company of the Indian target, wherein the foreign holding company becomes a subsidiary of the SPAC. The following tax implications may arise in such cases:

Capital Gains tax

Due to the regulatory hurdles involved in outbound mergers and outward remittance of foreign exchange, the De-SPAC transaction with an Indian target company often involves a share-swap. Such share swaps may attract capital gains tax for both resident and non-resident shareholders of the Indian target, since the shares of an Indian target would be considered 'capital assets situated in India', being shares of a company incorporated in India. Capital gains would be computed based on the difference between the FMV of the SPAC shares and the cost of acquisition of the Indian target company's shares. Similarly, capital gains tax may also be attracted where shares of the Indian target are sold for a cash consideration. Capital gains in such a scenario would be computed based on the difference between the consideration received from the SPAC and the cost of acquisition of the Indian target company's shares. Tax rates may vary from 10% to 40% (plus applicable surcharge and cess), depending upon factors such as the category of shareholder, period of holding of shares, etc.

Presently, a merger is only treated as tax neutral under the IT Act if certain conditions are met, which, *inter-ali*a, includes that the amalgamated company (i.e. the surviving entity) is an Indian company. However, this benefit is not extended to mergers where the amalgamated company is a foreign company. Accordingly, in a Traditional De-SPAC, there shall be tax consequences for the shareholders of Indian target as mentioned above. Even in an Indirect De-SPAC, where the foreign holding company of the Indian target becomes a subsidiary of the SPAC, the shares of foreign holding company or the SPAC may derive their value substantially from assets located in India and hence, such gains could be taxable in India as per the indirect transfer tax implications under section 9(1)(i) of the IT Act. However, two exemptions could be available if any of the following condition is met:

i) such shareholder would be considered a small shareholder (holding less than 5% directly or indirectly in the Indian target) and has no management control rights directly or indirectly in the Indian target; or

ii) such shareholder is not liable to tax in India in accordance with the benefit available under the applicable tax treaty. However, it may be noted that capital gains exemption is generally not available under the tax treaties of India, after the renegotiation of tax treaties with Singapore, Mauritius, Cyprus, etc.

Further, if the De-SPAC transaction involves exchanging of shares held by employees of the Indian target with the shares of the SPAC, this could also expose the employees to tax.

Tax obligations regarding withholding or collection of taxes may have to be analysed in each case to see if the payer/ payee is liable to withhold / collect taxes at source at the time of making/ receiving payment.

FMV of shares

Further, for charging capital gains under the IT Act, it is essential to determine the FMV of the shares as per valuation norms prescribed under section 50CA of the IT Act read with Rule 11UA of the Indian Income tax Rules, 1962. If shares of the Indian target are to be acquired, they would need to be acquired at least the FMV of such shares. In a share-swap, shares of the both the SPAC and the Indian target would need to be valued in accordance with the norms prescribed under the IT Act, to arrive at their FMV. Since the price at which shares are to be issued would be determined by the market forces in the respective jurisdiction in which the SPAC is situated, there may be a situation where the shares need to be issued at a price which is less than the FMV of the shares determined as per the scheme given under the IT Act, to be a commercially viable option for investors. This may lead to unnecessary questioning or litigation for the resident shareholders in case they receive shares at a price below the FMV, due to the application of section 56(2)(x) of the IT Act. The application of valuation norms will need to be amended, to account for such a possibility, in relation to SPAC deals.

Tax losses

In case the Indian target has brought forward tax losses and its voting rights at the time when the losses were incurred shall change by more than 49% at the end of financial year in which De-SPAC shall take place, the unabsorbed tax losses shall lapse. Hence, the Indian target shall not be eligible to carry forward the unabsorbed tax losses.

This may be relevant consideration for several Indian start-ups who have become giants like unicorns but have been operating on huge losses.

Tax Implications post De-SPACing

Capital Gains tax

Even after the De-SPAC transaction is complete, income earned from transfer of shares of a foreign SPAC would continue to be subject to capital gains tax in India, as these shares would be considered 'capital assets situated in India'. As mentioned above, it may be noted that shares of Indian companies are regarded as capital assets situated in India. Further, the shares of foreign companies, deriving substantial value from Indian assets are also deemed to be capital assets situated in India. Thus, under a Traditional De-SPAC, capital gains tax liability may be determined as follows:

i) Where the shareholders of the offshore merged entity are tax residents of India, they will be subject to taxes in India on its worldwide income. Hence, the gain on sale of shares of a foreign company shall also be taxable in India, at the rates mentioned above, i.e., 10% to 40%. However, in case the shareholders are also subject to tax in the country where the offshore merged entity is incorporated, relief from double taxation may be available to a tax-resident in India, subject to satisfaction of prescribed conditions.

ii) Where the shareholders of the offshore merged entity are not tax-residents of India, the indirect transfer tax provisions may get triggered. The sale of shares of a foreign company, which derives its value substantially from the assets located in India, could be subject to taxes in India, provided certain conditions are met. The gains on sale of shares of such foreign company shall be taxable in India at the rates mentioned above. Indirect transfer tax provisions may similarly apply in an Indirect De-SPAC, since if the SPAC derives its value substantially from the Indian subsidiary, the SPAC's shares would be deemed to be situated in India.

Under the IT Act, the transfer of GDRs and ADRs by a non-resident to another non-resident is treated as tax neutral. A similar amendment may need to be introduced to make equity shares of companies incorporated in India and listed on a foreign stock exchange exempt from capital gains tax in India.

Taxes of PE

In case of a Traditional De-SPAC, the Indian office of the merged entity will be treated as a branch office or PE of the SPAC in India. It would thus be liable to pay tax at a rate of 40% (plus applicable surcharge and cess) for that part of its income earned by the Indian branch office. Further, any transaction between the SPAC and the Indian PE would need to be carried out on arm's length basis in accordance with the applicable transfer pricing regulations in India. This would also be the case under an Indirect De-SPAC, where the foreign SPAC and the Indian target have a parent-subsidiary relationship.

Place of Effective Management ("PoEM")

A foreign company is treated as resident of India for tax purposes, if its PoEM is situated in India, in any financial year. PoEM is the place where key management and commercial decisions of the company are undertaken. There are extensive rules available under the PoEM regulations given by the Indian income tax authorities to determine whether an entity has a PoEM in India. The process, *inter-alia*, involves determination of whether or not the foreign company is engaged in 'active business' outside India. To meet the 'active business' test, its passive (non-business) income like royalty, etc. should not be more than 50% of its total income. Further, it should also meet certain prescribed criteria related to number of employees, value of assets and payroll expenditure. PoEM has much wider tax consequences than having a PE in India. Having a PE in India implies that only the income related to the PE is subject to tax in

India. However, having a PoEM in India implies that the company is a tax-resident of India and accordingly, the total income of the SPAC, including income earned outside India, could be taxable in India. Thus, under a Traditional De-SPAC, the merged entity could be subject to Indian taxes on its global income if the conditions given under the PoEM regulations are met.

Another implication would be that the merged entity would only be a *deemed* Indian resident in this scenario. Thus, concessional tax regimes available to domestic companies would not be applicable to it and it shall be taxed at 40%. If the Indian target were otherwise liable to a lower tax rate in Indian under such a regime, this might be a major deterrent against it accessing foreign markets through this route.

Under an Indirect De-SPAC, the SPAC could similarly be deemed a tax resident in India. However, the Indian subsidiary would continue to be an Indian domestic company and may continue to avail benefits under concessional tax regimes, if applicable.

Repatriation of funds and taxability of dividend income

In case of a Traditional De-SPAC, repatriation of income outside India of the Indian branch will not attract any further tax in India. However, in case of an Indirect De-SPAC, where the Indian target remains a subsidiary of the SPAC, repatriation of profits from the Indian target to shareholders of the SPAC may have tax implications in India in the hands of the SPAC, since the subsidiary would be treated as a separate legal entity in India. Further, any dividend income earned from the Indian subsidiary, will be subject to tax in India at the rate of 20% (plus applicable surcharge and cess) for non-residents and at 10% (plus applicable surcharge and cess) for residents, subject to any beneficial provisions available for non-residents in the respective tax treaties.

Tax Implications for IFSC SPAC

As discussed above, presently, a merger is only treated as tax neutral under the IT Act if certain conditions are met, which, *inter-alia*, includes that the amalgamated company is an Indian company. A company located in the IFSC, is considered a 'person resident outside of India' for the purposes of Indian foreign exchange control laws. However, it is considered an Indian resident for tax purposes (unless such company is a branch of a foreign company). Thus, where the merger is with a SPAC located in the IFSC, shareholders of the target company (whether Indian or foreign) may be able to claim the exemption given under section 47(vii) of the IT Act.

Further, section 47(viiab) of the IT Act provides that gains arising to a non-resident on transfer of a foreign currency denominated equity share of a company listed on a recognised stock exchange located in an IFSC is exempt from capital gains tax, provided the consideration for such transaction is paid or payable in foreign currency.[31] Accordingly, non-resident shareholders of a SPAC listed on recognized stock exchange of the IFSC would be eligible for such tax exemption under the Indian tax laws, provided that consideration for such transaction is paid or payable in foreign currency. However, resident shareholders can still be subject to capital gains tax. Further, no securities transaction tax is levied on the transfer of equity shares listed on a recognised stock exchange in an IFSC. Despite this, concessional rates of tax on capital gains, as given under sections 111A and 112A, are available for transactions undertaken on a recognised stock exchange in any IFSC provided that consideration for such transaction is paid or payable in foreign currency. Thus, long-term gains will be taxed at the rate of 10% (plus applicable surcharge and cess) and short-term gains will be taxed at rates ranging up to 30% (plus applicable surcharge and cess) for resident shareholders.

Developments so far

The SEBI, in 2018, came out with a report for listing of equity shares of companies incorporated in India on foreign stock exchanges and vice versa ("**SEBI Report**").[32] The SEBI Report listed several benefits to the Indian economy, if it were to adopt a more liberal tax and regulatory framework with regards to SPACs, *inter alia*, (i) increased competitive advantage to Indian companies; (ii) development of finance as a high-value added export; (iii) boost to growing technology sector; (iv) greater footprint of "India" as a global brand; (v) access to a broader, more developed, investor base for Indian capital markets; and (vi) increased diversification and participation in wealth created by global companies for Indian households. The SEBI Report further suggested several amendments to the foreign exchange, tax, corporate and securities laws of India, to enable a SPAC-friendly regime. To address the concerns of money laundering and tax evasion, the SEBI Report identified a list of ten 'permissible jurisdictions' with which such a regime could be implemented. These jurisdictions were selected based on the existence of a strong anti-avoidance regime and a strong capital market, similar to the criteria of determination used for listing of masala bonds. Subsequently, as per market reports, the Primary Market Advisory Committee of SEBI has been examining the possibility of introducing a framework for regulating SPACs

31 CBDT Notification No. 16/2020 dated March 5, 2020 issued by CBDT.

32 SEBI | Report of the Expert Committee for listing of equity shares of companies incorporated in India on Foreign Stock Exchanges and of companies incorporated outside India on Indian Stock Exchange dated December 4, 2018, available at https://www.sebi.gov.in/reports/reports/dec-2018/report-of-the-expert-committee-for-listing-of-equity-shares-of-companies-incorporated-in-india-on-foreign-stock-exchanges-and-of-companies-incorporated-outside-india-on-indian-stock-exchange_41219.html.

in India.[33] However, there has been no specific announcement on this front yet.

Moreover, on April 13, 2022, the Ministry of Corporate Affairs has invited suggestions from stakeholders on a recent report of the Company Law Committee ("**Committee**") dated March 21, 2022, which has, *inter-alia*, recommended the introduction of an enabling provision to recognise SPACs under the CA, 2013 so as to allow listing of SPACs incorporated in India on domestic and global exchanges. The Committee has further recommended that (i) strike-off provisions should be relaxed; (ii) procedure must be laid down to provide exit options to the dissenting shareholders of a SPAC; and (iii) necessary rules should be prescribed under amended section 23 of the CA, 2013.[34]

However, apart from the notification of the IFSCA Regulations, no changes have been made to the legal, tax and regulatory regime in India so far. The IFSCA Regulations also require further clarifications before they can be implemented.

Indian capital markets have been facing a historic outflow of foreign exchange as Foreign Portfolio Investors ("**FPIs**") have been withdrawing from the Indian markets at a never seen before pace.[35] This FPI selloff has been triggered by the Ukraine-Russia crisis, rising crude prices, depreciating rupee and overall market volatility. The Indian markets represent uncertainty in such trying times and FPIs are looking to park their capital in safer, more lucrative investments. This need may be fulfilled by SPACs. As per an estimate, India has 'approximately 50,000 start-ups and over 45 unicorns, so an estimated USD 150 to 200 Billion could be unlocked in the short to medium term should SPACs be open to Indian companies'.[36] Recently, a US-based SPAC was able to raise USD 200 Million from global investors for investing into Indian companies.[37] Thus, the SPAC, by enjoying investor receptivity during periods of market volatility, may enable India to retain some of its FPI investment.

The SEBI Report suggests that the groundwork has already been done, in relation to (i) identifying the key regulatory and tax concerns that have and (ii) proposing a modified scheme which takes into account the concerns of the regulatory and tax authorities as well as Indian and foreign investors. Despite this, reports suggest that the government of India currently does not plan to allow Indian firms to list overseas in an effort to bolster its own capital markets.[38]

Way Forward

While market volatility due to the Ukraine-Russia crisis may have brought back interest towards SPACs, some experts have been questioning the long-term viability of the pandemic-era SPAC boom due to several deals collapsing or underperforming.[39] A study published by Harvard Law School Forum on Corporate Governance suggests that the costs of a SPAC are less than IPO only because SPAC shareholders bear the cost, and hence the risks may actually outweigh its benefits.[40] However, given their potential to attract foreign investment, increasing governance and surveillance, and addressing such challenges through regulatory changes, may enable SPACs to become a more mature and better regulated investment instrument for public investors in the long run.

Since round tripping of funds and investor protection remains a pressing concern in the Indian context, the IFSC Regulations present a great starting point for India's foray into the adoption of SPAC IPOs. An IFSC may mitigate concerns regarding potential profit offshoring and tax avoidance since it is treated as an overseas location for exchange control purposes but is within the country's overall legal framework to monitor. Inspiration may be taken from the US and Singapore regime to bring further clarity under the IFSC Regulations to address concerns, *inter alia* (i) disclosure of selection criteria while determining a target; (ii) potential conflict of interest between the issuer, founding shareholder, directors, management team and their associates; (iii) auditor considerations; and (iv) key parameters to be looked at by the IFSC while considering the listing of a SPAC. Given the failure of SPACs to generate returns for their investors, both historically and consequent to the recent post-pandemic boom, the IFSCA may even highlight certain KPIs or other metrics that may be identified while choosing a target.

The successes or failures of the IFSC regime may subsequently be used as a template to amend the securities, tax, corporate, foreign exchange, and other laws of India, as required, towards the adoption of SPAC IPOs in India. Further, addressing the regulatory and tax-related challenges, as highlighted in this article, can also lead to a greater adoption of De-SPAC transactions in India and enable more Indian companies to access the SPAC route, whether domestically or in foreign markets.

33 https://economictimes.indiatimes.com/markets/stocks/news/sebi-exploring-framework-for-spacs-in-india-says-chairman-tyagi/articleshow/84820599.cms?from=mdr.
34 https://www.mca.gov.in/bin/dms/getdocument?mds=bwsK%252FBEAFTVdpdKuv5IR5w%253D%253D&type=open.
35 https://economictimes.indiatimes.com/markets/stocks/news/fpis-withdraw-over-rs-17000-cr-from-indian-markets-in-just-3-days/articleshow/90029048.cms; https://www.bloombergquint.com/markets/fpi-selloff-in-fy22-worst-on-record-two-key-sectors-bear-the-brunt.
36 https://economictimes.indiatimes.com/markets/stocks/news/indias-buoyant-startup-culture-shut-out-of-global-spac-hunt/articleshow/82226538.cms?from=mdr.
37 https://www.business-standard.com/article/markets/stonebridge-raises-200-mn-to-deploy-in-indian-apac-cos-lists-on-nasdaq-121071901195_1.html.
38 https://www.moneycontrol.com/news/economy/policy/government-freezes-plans-to-allow-local-firms-to-list-overseas-report-8266651.html.
39 https://www.forbes.com/sites/jemimamcevoy/2021/12/22/take-back-the-spac-more-and-more-companies-are-canceling-high-profile-deals-to-go-public/?sh=2526d5e11867; https://www.wsj.com/articles/the-spac-ship-is-sinking-investors-want-their-money-back-11642761012; https://www.livemint.com/market/stock-market-news/spac-startups-made-lofty-promises-they-aren-t-working-out-11645856910410.html.
40 https://corpgov.law.harvard.edu/2020/11/19/a-sober-look-at-spacs/.

Revisionary jurisdiction wide enough to rectify errors on the part of a taxpayer

In ***Hapag-Lloyd***,[41] the Bombay HC held that revisionary jurisdiction under section 264 of the IT Act is broad enough to include within its ambit the power to rectify any error on part of the taxpayer not claiming benefits under a DTAA.

Facts

Hapag-Lloyd, a private limited company incorporated in India and being its tax resident ("**Assessee**"), distributed dividends to its holding company, United Arab Shipping Company Limited-("**Holding Company**") a tax resident of Kuwait. The Assessee paid DDT at the rate of 16.91% (inclusive of applicable surcharge and cess) on dividends distributed, and inadvertently, did not claim the benefit of the beneficial rate of 10% available under the India-Kuwait DTAA. Curiously, the Assessee did not claim this beneficial rate even while filing a revised return of income at later date.

The Assessee subsequently filed an application under section 264 of the IT Act seeking revision of the assessments and refund of the excess taxes paid. The PCIT refused to reconsider the assessment and held that revision petition to be inadmissible on grounds that a) the Assessee had failed to claim a refund of excess taxes paid at the time of filing the original return or the revised return; and b) section 264 did not empower the PCIT to rectify an error made by the Assessee when there was no 'error apparent on the face of the record' in the assessment order to justify a revision under section 264. Aggrieved by the order, the Assessee filed a writ petition before the Bombay HC.

Issue

Whether PCIT was justified in holding that the revisionary jurisdiction under section 264 of the IT Act did not empower him to rectify inadvertent errors committed by the Assessee.

Arguments

The Assessee argued that the scope of section 264 of the IT Act was not simply limited to correction of errors committed by subordinate tax authority, which were 'apparent from the fact of the record'. To back this argument, the Assessee relied on the Bombay HC decision in the case of *Geekay Security Services*,[42] wherein the HC, while dealing with identical facts, had held that the revision jurisdiction under section 264 is not limited to correction of errors committed by subordinate authorities.

The IRA submitted that since the Assessee had failed to claim refund while filing the original and revised returns, the assessment order, which was sought to be revised, could not be said to be against the interest of the Assessee. The IRA further argued that the revisional jurisdiction under section 264 could have been invoked in case a refund of excess tax paid was claimed by the Assessee and thereafter rejected during assessment. When no refund was claimed, there was no mistake in the assessment order and the revision petition was not maintainable.

Judgment

The Bombay HC held that the PCIT had erred in constricting the scope of its revisional jurisdiction by relying on the Assessee's

[41] Hapag Lloyd India Private Limited v. Principal Commissioner of Income Tax, Mumbai, WP No. 2322 of 2021.
[42] Geekay Security Services (P) Ltd. v. Deputy Commissioner of Income Tax, [2019] 101 taxmann.com 192 (Bombay).

failure to claim refund of excess taxes paid by it. It was noted that the foundation of the application filed by the Assessee was that it failed to claim the benefit of Article 10 under the India-Kuwait DTAA. The Bombay HC clarified that the PCIT's order erroneously confused the standard of review for falling within the revisionary jurisdiction with that for review jurisdiction. While the standard to be satisfied under revision jurisdiction was not as broad as that at the stage of appeal, it was certainly broader than that under review jurisdiction (which requires that there should be an error apparent on the face of the record).

The Bombay HC further held the PCIT's reading of section 264 as having limited scope is neither supported by the text of section 264, nor by any precedents. Further, the HC noted that section 264 was silent about a need for the revision to be justified by an error apparent from the face of the record committed by the subordinate tax officer. Accordingly, it held that by imputing such extraneous considerations, the PCIT's order erroneously limited the revisional jurisdiction under section 264. The Bombay HC held that powers available with the PCIT under section 264 is not limited to correcting errors committed by subordinate tax authorities but also empowers him to provide relief when there are mistakes apparent from records.

With the above observations, the Bombay HC remitted the matter back to the PCIT, asking him to decide on the revision filed by the Assessee. The HC also clarified that it has not made any comments about the merits of the application filed by the Assessee.

Significant Takeaways

The Bombay HC's decision confirms the broad ambit of revisional powers under section 264 while also clarifying that the standard to be deployed while invoking revisionary jurisdiction is relatively lower. The ruling is also relevant since it clarifies that even errors committed by taxpayers can be covered under the revisional jurisdiction in section 264 of the IT Act.

It is relevant to note that various High Courts[43] have previously interpreted section 264 to include within its ambit the power to rectify errors on the part of the taxpayer. It has been consistently held that the power under section 264 is very wide and allows the Commissioner to apply his mind to the correctness of assessment sought to be revised.[44] As a matter of interpretation of statutes, it is difficult to accept that the tax authorities would be allowed to deny a legitimate claim of a taxpayer. Even the CBDT has previously clarified that revenue officers must not take advantage of a taxpayer's ignorance of their own rights.[45]

Thus, the Bombay HC's decision in *Hapag Lloyd* falls in line with previous decisions and settled principles of law, pointing to the conclusion that taxpayers should not be prejudiced either due to their ignorance or errors.

“ Revisionary jurisdiction broad enough to rectify any error on part of a taxpayer. ”

[43] Geekay Security Services (P) Ltd. v. Deputy Commissioner of Income Tax, [2019] 101 taxmann.com 192 (Bombay); C. Parekh Bros. v. CIT [1984] 150 ITR 105/[1983] 15 Taxman 539; Vijay Gupta v. CIT [2016] 386 ITR 643/238 Taxman 505/68 taxmann.com 131; Sri Selvamuthukumar v. CIT [2017] 394 ITR 247/246 Taxman 185/79 taxmann.com 113.
[44] Vijay Gupta v. CIT [2016] 386 ITR 643/238 Taxman 505/68 taxmann.com 131.
[45] CBDT Circular No.14 of 1955 (Dated 11 March 1955).

MFN clause can be invoked despite the beneficial rates/ scope not being notified by the Central Government

In the case of ***GRI Renewable***[46], the ITAT-Pune held that the MFN clause in the India-Spain DTAA can be applied to import beneficial treaty provisions under the India-Portugal DTAA even though a separate notification has not been issued by the Central Government.

Facts

GRI Renewable Industries S. L. ("**Assessee**"), a company incorporated in Spain, received a specified amount from M/s. Shrenik Industries Pvt. Ltd. towards providing certain software and support services. These incomes were declared in the returns filed by the Assessee as royalties and FTS respectively. Relying on the MFN clause along with Article 12 of the India-Portugal DTAA, the Assessee claimed that the aforementioned receipts were taxable at the rate of 10% instead of the 20% rate provided in the India-Spain DTAA. The AO, however, held that the 10% rate under the India-Portugal DTAA could not be applied since the necessary notification making the rate applicable under the India-Spain DTAA had not been issued by the Central Government.

The AO relied on the CBDT Circular No. 3/2022 ("**Circular No. 3**") to hold that the issuance of a separate notification importing the benefits of the India-Portugal DTAA into the India-Spain DTAA, was necessary for the beneficial rates to become applicable and proceeded to tax the FTS and royalties at the rate of 10% (plus applicable surcharge and cess) in terms of section 115A of the IT Act (since this was more beneficial in comparison to the 20% rate prescribed in the DTAA). The DRP concurred with the AO and the aggrieved Assessee preferred an appeal with the ITAT.

Issue

Whether the Assessee can claim benefit of the MFN clause in the India-Spain DTAA even though the extension of benefits has not been separately notified by the Central Government.

Arguments

The Assessee argued that the Protocol under the India-Spain DTAA contained an MFN Clause, the conditions under which were duly satisfied to import the beneficial provisions of the India-Portugal DTAA. It was further argued that the Circular No. 3 could not have a retrospective application to deny MFN benefits to a transaction, which had been completed prior to the issuance of the Circular.

The IRA relied on Circular No. 3 to argue that the benefits of the MFN Clause could not be claimed unless the conditions mentioned therein are satisfied. It was argued that one of the conditions in Circular No. 3 which provides that an MFN clause can only be invoked when a separate notification has been issued, was not satisfied in the instant case.

Judgement

The ITAT noted that the Protocol to the India-Spain DTAA included an MFN clause which provided that if India enters into a DTAA with a third country after January 1, 1990, which is a member of the OECD and agrees to a lower tax rate or a more beneficial provision therein, then such lower rate or beneficial provision would also be applicable under the India-Spain DTAA. Further, the Protocol to the India-Spain DTAA was signed and treated as an integral part of the India-Spain DTAA at the time of signing of the India-Spain DTAA. Thus, under the terms of the India-Spain DTAA, India had agreed for the automatic importation of benefits of any DTAA entered into by India with an OECD country after January 1, 1990, into the India-Spain DTAA, at the time of the signing of the India-Spain DTAA. Thus, the ITAT held that no separate notification was required within the scheme of the India-Spain DTAA to import the benefits of the India-Portugal DTAA.

The ITAT observed that section 90(1)(a) of the IT Act provides that the Central Government "may, by notification in the Official Gazette, make such provisions as may be necessary for implementing the agreement". Accordingly, the ITAT held that as per the plain language of section 90(1), on notification of a DTAA, all its integral parts get automatically notified. Neither the India-Spain DTAA nor section 90(1) of the IT Act provides for the piecemeal issuance of notifications in a truncated manner. Therefore, the requirement for issuance of a separate notification under the CBDT Circular transgresses the requirements under section 90(1) of the IT Act.

Further, the ITAT clarified that in any event, a Circular issued by the CBDT is only binding on the IRA and not on the Assessee. The ITAT held that by attaching a new disability under section 90(2) of the IT Act, CBDT Circular No. 3 attempted to amend the IT Act and thus, could only be applied prospectively. It could not have retrospective effect on any transactions taking place prior to its issuance.

46 GRI Renewable Industries S.L. v. ACIT (IT) Circle-1, Pune, ITAT Pune Bench-C, ITA No.202/Pun/2021.

Significant Takeaways

Circular No. 3 has been particularly controversial and is already a subject of litigation. It would be relevant to note that the said Circular was issued after certain High Courts had allowed taxpayers from countries like the Netherlands and France to invoke the MFN clause and import the beneficial 5% rate from the DTAAs with countries like Slovenia, Lithuania and Colombia, even though such countries became members of the OECD after signing their relevant DTAAs with India.[47] Some of these European countries even issued unilateral decrees stating that the tax rate on dividends under their respective DTAAs with India now stands modified and the lower rates of taxation, as given under India's DTAAs with Slovenia, Colombia and Lithuania, would apply. Thus, in response to these decisions and the unilateral decrees, the CBDT issued Circular No. 3, which stipulates conditions to be satisfied in order to claim the benefit of the MFN clause, including prescribing the requirement for a separate Notification to be issued by the Central Government.

The ITAT, in the instant case, has followed suit with previous rulings where the MFN clause entered through Protocols have been considered an integral part of the DTAA itself[48]. The ruling brings some relief to taxpayers who intend to rely on the MFN clause under respective DTAAs. As per the legal jurisprudence, a circular issued by the CBDT is not binding on the taxpayers or adjudicatory authorities and hence, the taxpayers have the option to challenge the denial of any such treaty benefits before an appropriate authority. This decision has further buttressed the position of such taxpayers. In this context, it is relevant to note that a writ petition challenging the Circular No. 3's constitutional validity has been admitted before the Karnataka HC.[49] This decision is eagerly awaited, considering the significance of this issue for cross-border M&A transactions. The availability of such treaty benefits would be a relevant consideration for foreign investors looking to invest in India.

> **"MFN clause in the India-Portugal DTAA can be imported into India-Spain DTAA without any notification."**

[48] Concentrix Services Netherlands B.V. v. Income Tax Officer (TDS), Delhi, High Court. W.P(C)9051/2020; M/S Nestle SA v. Assessing Officer Circle (International Taxation)-2(2)(2), New Delhi, Delhi, High Court W.P.(C) 3243/2021.

[49] Steria (India) Ltd. v. CIT [2016] 72 Taxmann.Com 1/241 Taxman 268/386 ITR 390.

[49] M/s DXC Gatriam Holding BV v. Deputy Commissioner of Income Tax, Writ Petition 6595/2022 (daily order dated 25th March 2022).

TDS on cloud service-related consideration restricted to 8%, 2% EL already paid by the Assessee taken into account

In the case of ***Google Asia Pacific Pte. Ltd.***[50] the HC held, as an interim measure, withholding of 8% tax on cloud services should be applied in lieu of 2% EL already paid by the Assessee.

Facts

Singapore-based Google Asia Pacific Pte. Ltd. ("**Assessee**"), engaged in the business of providing cloud services in India under the Google Cloud Services Reseller Agreement ("**Agreement**"). In FY 2021-22, the AO issued a tax deduction certificate under section 195(2) of the IT Act directing Google Cloud India Private Limited ("**GCI**") to deduct tax at source at the rate of 10% at the time of making payment to the Assessee. The Assessee filed a writ petition before the HC challenging the higher withholding tax certificate issued by the AO.

Issue

Whether 10% withholding of tax was permissible where the Assessee had already paid EL on the consideration received from cloud services.

Arguments

The Assessee argued that it had already subjected itself to EL of 2% on the payments under consideration and to levy a tax withholding of 10% would be a double whammy. Alternatively, the Assessee argued, if prejudice towards its rights and contentions are eliminated, it may be permitted to receive the payments under consideration after suffering a withholding of only 8%. Accordingly, the same would also protect the interests of IRA since 2% EL had already been paid. The Assessee also argued against the additional levy of surcharge and cess by the IRA on 10% withholding tax rate, assessed/derived by relying on *Epcos Electronic Components*[51] which had held that the rate prescribed under the DTAA is the final rate. Therefore, 10% rate of tax withholding was the maximum that could have been imposed on the payments.

On the other hand, the IRA argued that in accordance with section 115A of the IT Act read with India Singapore DTAA, the tax withholding is required to be done at the rate of 10%.

Judgment

The ITAT rejected the Assessee's contentions that services under The HC upheld the argument of the Assessee on the levy of additional surcharge and cess and held that the maximum levy that could be made in the case of payments under consideration has to be limited to 10%. Further, the HC also directed, purely as an interim measure, that the Assessee would be entitled to receive its payment from GCI after deduction of tax at the rate of only 8%, taking into account the deposit of EL of 2%.

Significant Takeaways

FA, 2020 introduced an EL of 2% on the consideration received or receivable by an e-commerce operator from e-commerce supply or services. This raised an important issue of taxability of services under royalty/ FTS versus taxability under the EL provisions. In this regard, FA, 2021 had clarified that EL will not be applicable if consideration was taxable as Royalty/FTS under the IT Act read with relevant provisions of DTAA. Where the amount was not taxable as royalty/ FTS, the same may be subject to EL.

However, in the instant case, the Assessee had already paid EL pursuant to which the IRA wanted to tax it as royalty. Given the same, the HC, just as interim measure, has supported Assessee in directing the payer not to withhold more than 8%, as pleaded by the Assessee.

Having said that, it may be interesting to observe the arguments on this issue of cloud services over the course of time and how they are classified by the courts finally. Previously, payments for cloud computing services, depending on use or right to use being provided, have been characterised as Royalty[52].

> **"Delhi HC restricts withholding tax at 8% for cloud services in light of 2% EL already paid."**

[50] Google Asia Pacific Pte. Ltd. v CIT (WP(c) 215/2022).
[51] Epcos Electronic Components SA v. UOI (2020) 316 CTR 126.
[52] Infosys Limited v DCIT, IT (IT) A Nos 105 to 115/ BANG/ 2021; Urban Ladder Home Décor Solutions Pvt. Ltd (ITA No. 615 to 620/ Bang/ 2020).

Business support services not taxable as FTS on account of MFN clause under Indian-Belgium DTAA

In the case of ***Magotteaux International SA***[53], the Delhi ITAT held that business support services are not taxable as FTS on the basis of its restricted definition borrowed from the India-Portugal DTAA on account of MFN clause present under India-Belgium DTAA.

Facts

Magotteaux International SA ("**Assessee**"), is a resident of Belgium and is engaged in providing operational consultancy and other management services to various group entities. The Assessee had entered into an agreement with an Indian company to provide business support services, such as marketing, sales, finance, administration and other services, from outside India.

During AY 2011-12, the Assessee received income in the nature of group management fees from the Indian company. The AO observed that the support services provided by the Assessee included both managerial and consultancy services. The AO referred to Article 12 of India-Belgium DTAA and observed that the group management fee received by the Assessee was taxable as FTS under section 9(1)(vii) of the IT Act as well as under the DTAA.

The Assessee relied on the MFN clause in the India-Portugal DTAA and borrowed the definition of FTS to contend that given its restricted scope, the group management fee received by it shall not qualify as FTS. The AO dismissed the contention of the Assessee and treated the services as FTS.

The DRP concurred with the order of AO. The Assessee, thereafter, preferred an appeal before the ITAT.

Issue

Whether the restricted definition of FTS can be borrowed from India-Portugal DTAA on account of MFN clause under India-Belgium DTAA.

Arguments

The Assessee contended that in accordance with Article 12 of the India-Belgium tax treaty, for any services to qualify as FTS, such services needed to be managerial, technical or consultancy, in nature. The Protocol to the India-Belgium tax treaty provides for taxation of FTS in accordance with the provisions of DTAA between India and a member of OECD entered into after January 1, 1990, where such provisions provide for a lower rate or restrictive scope of taxation on Royalties/FTS.

In view of this Protocol, the Assessee placed reliance on the restricted scope/rate mentioned in the India-Portugal DTAA, according to which, the services provided by the Assessee may qualify as technical services only where they handed out technology, know-how, skills, processes, experience, etc. to the India group company. It was brought to the notice of the IRA that the services rendered by the Assessee were routine business support services and no technology, skill or know-how were made available to the Indian company.

Against this, the IRA argued that the services rendered by the Assessee did make available knowledge, experience, know-how to the recipient and the same was clearly visible when one examined the nature of services rendered and the consequential benefits received by the Assessee.

Judgment

On the basis of review of the service agreement, the ITAT observed that the services rendered were routine in nature and did not make available any experience or know-how to the recipient Indian company.

The ITAT further observed that while considering the Protocol to the India Belgium DTAA India and Portugal DTAA had to be considered for MFN clause. Under the India Portugal DTAA, fees for included services ("**FIS**") is defined as consideration for rendering of any technical or consultancy services if such services (a) are ancillary and subsidiary to the application or enjoyment of the right, property or information of which royalty payment, as defined under Article 12(b) is received; or (b) make available technical knowledge, experience, skill, know how or processes or consist of the development and transfer of a technical plan or technical design which enables the person acquiring the services to apply the technology contained therein.

Given the same, ITAT opined that since technology, skill, technical know-how, etc. were not made available through the services received by the Indian company, such services cannot be categorised as FTS.

Significant Takeaway

The usage of MFN clause for benefitting from the restricted scope of 'make available' clause has been a subject of several back-and-forth litigations.

[53] Magotteaux International SA v DCIT (ITA No 1358/DEL/2015) [TS-91-ITAT-2022(DEL)].

The Karnataka HC in the case of *De Beers India*[54] had applied the MFN clause under the India-Netherlands DTAA for borrowing the 'make available' clause to use under the India–Singapore DTAA.

On the contrary, the AAR, in the case of *Steria (India) Ltd*[55] had denied the benefit of MFN clause under the India–France DTAA and held that payment for management services would be taxable as FTS since the Protocol to the DTAA could be treated at par with the provisions of the DTAA itself, and may even be considered as an integral part of the DTAA. Further, AAR in the case of *Mersen India Private Limited*[56], while denying the benefit of MFN clause under the India-France DTAA, held that the 'make available' concept is applicable only to technical and consultancy services and not to the 'managerial services' since the comparative DTAA (i.e. India-USA DTAA) does not include managerial services.

Having stated the above, it may also be pertinent to note that the CBDT's Circular No. 3[57] attempted to clarify the position of IRA on MFN clause. In the said circular, CBDT had clarified that a government notification under section 90 of IT Act shall be required to import provisions of any third world country in the concerned DTAA by virtue of the MFN clause. The provisions are, thus, not applicable automatically.

However, the binding effect of the CBDT circular has already been challenged in the Indian courts. Pune ITAT in the case of *GRI Renewable*[58] has already held that the provisions of the CBDT circular were neither binding nor applicable retrospectively. Further, the constitutional validity of the said Circular has also been challenged before the Karnataka HC in the case of *DXC Gatriam*[59].

"Business support services not taxable as FTS on account of MFN clause under the India Belgium DTAA."

54 CIT vs. De Beers India Minerals (P) Ltd. (2012) 346 ITR 467 (Kar).
55 Steria (India) Ltd [2014] 364 ITR 361 (AAR).
56 Mersen India Private Limited [2013] 353 ITR 628 (AAR).
57 Circular No. 3 issued by CBDT dated 3 February 2022.
58 supra.
59 M/s DXC Gatriam Holding BV v. Deputy Commissioner of Income Tax, Writ Petition 6595/2022 (daily order dated 25 March 2022).

Losses on investment made in subsidiary can be claimed as business expenditure

In the case of ***M/s Vaibhav Global Limited***[60], Rajasthan HC held that investments made by the Assessee for the purpose of expansion of business to earn higher profits should be considered as made out of business expediency. Therefore, any loss incurred as a result of such investments falls within the scope of business expenditure, and hence, allowable as deduction under section 37 of IT Act.

Facts

M/s Vaibhav Global Limited ("**Assessee**") had investment in equity shares of its Mexican subsidiary i.e. Indo Medico Co. S. De. R.L. De. V.V.s ("**Subsidiary**"). During the course of assessment proceedings, several adjustments were made by the AO which *inter-alia*, included the disallowance on account of loss claimed by the Assessee for permanent diminution in the value of investment made by it in its Subsidiary. In respect of such issues, against the order already passed by the ITAT, an appeal was filed by the IRA on the following issues adjudicated upon by the ITAT

i) Allowability of write-off of loss claimed by the Assessee on account of investment made in equity shares of one of its foreign subsidiaries; and

ii) Allowability of write-off of loss claimed by the Assessee on account of investment made in equity shares of one of its subsidiaries for the purpose of computing book profits under section 115JB of IT Act.

Issue

Whether permanent diminution in value of investment made by the Assessee in its subsidiary was deductible as a business expenditure?

Arguments

The IRA contended that the loss on account of permanent diminution in value of the Assessee's investment in its subsidiary company was not in the nature of any expenditure, loan or advance that was debited from its profit and loss ("**P&L**") account. Even at the time such investment was made, it was never debited to the P&L account. Therefore, the IRA contended that loss on account of permanent diminution in value of investment was in the nature of a capital loss and not deductible as an expenditure under section 37 of the IT Act.

The Rajasthan HC had issued a favourable order dated December 15, 2021[61] for another year for the Assessee on this issue saying that the Assessee had set-up subsidiaries in other countries for expansion of its business and, therefore, such loss constituted its revenue expenditure and was deductible as a business expenditure under section 37 of IT Act.

To compute book profits under section 115JB of IT Act by deducting the losses arising on account of investments in the Assessee's subsidiary, the IRA contended that clause (i) of Explanation 1 to section 115JB of IT Act would become applicable and, therefore, the amount set aside to provide for diminution in asset value should be added back while computing the

60 Pr. Commissioner of Income Tax, Jaipur -II, Jaipur v. M/s Vaibhav Global Limited, formerly known as Vaibhav Gems Limited, D.B. ITA No. 291/2017 (Rajasthan HC).

61 ITA No. 53/2021.

Assessee's book profits. As per clause (i) of Explanation 1 to section 115JB of IT Act, any amounts set aside as provision for diminution in the value of any asset would be added to the profits as shown in the P&L account of an assessee for the purpose of computing book profits under the MAT provisions i.e. section 115JB of IT Act.

On the other hand, the Assessee contended that it had claimed the losses were arising due to an actual write-off and not merely on account of a provision made in its books and, therefore, clause (i) of Explanation 1 to section 115JB of IT Act was not applicable. In this regard the Assessee placed reliance on a ruling of the Gujarat HC in the case of *Vodafone Essar Gujarat Ltd*[62].

Judgement

The Rajasthan HC observed that it had already heard and adjudicated such an issue in the case of the Assessee *vide* its order dated December 15, 2021[63]. The HC had already allowed the Assessee's earlier claim for deduction of INR 50.72 crore as a business expenditure under section 37 of IT Act on account of permanent diminution in the value of its investment in the equity shares of one of its US subsidiary companies. In its said judgment, the Rajasthan HC had held that the Assessee had set up subsidiaries in other countries for expansion of its business and since such investment in equity shares of subsidiaries was for the purpose of earning higher profits and driven by business expediency, any write-off of such investment was in the nature of revenue expenditure. Accordingly, the HC had dismissed the appeal filed by the IRA in that year on this issue. Therefore, relying on its earlier decision in case of the Assessee on this issue, Rajasthan HC dismissed the appeal of the IRA in this regard in the present year as well.

With respect to deduction of loss claimed by the Assessee on account of its investment in its subsidiary, for the purpose of computing book profits under section 115JB of IT Act, the HC borrowed heavily from the larger bench of the Gujarat HC in the case of *Vodafone Essar Gujarat Ltd (supra)*[64].

In the case of Vodafone, the Gujarat HC relied on the SC's ruling in the case of *Southern Technologies Ltd.* and *Vijaya Bank*[65] wherein the Apex Court had held that there was a clear distinction between a provision being booked by an Assessee (by debiting the P&L account and creating a provision on the liability side of balance sheet) and a case where an assessee had actually written off such provision in P&L account and balance sheet. The Gujarat HC further observed that the specific facts in the case of *Deepak Nitrite Ltd.*[66] were similar to *Southern Technologies Ltd.(supra)* whereas the facts in the case of *Indian Petrochemicals Corpn. Ltd.*[67] were similar to *Vijaya Bank (supra)* and observed that these judgments were not conflicting, rather upheld similar principles.

62 CIT v. Vodafone Essar Gujarat Ltd., [2017] 397 ITR 55 (Gujarat HC).
63 ITA No. 53/ 2021.
64 Southern Technologies Ltd. v. Jt. CIT [2010] 320 ITR 577/187 Taxman 346 (SC).
65 Vijaya Bank v. CIT [2010] 323 ITR 166/190 Taxman 257(SC).
66 CIT v. Deepak Nitrite Ltd. (Tax Appeal No.1918/2009, order dated 17.8.2011) (Gujarat HC).
67 CIT v. Indian Petrochemicals Corpn. Ltd. [2016] 74 taxmann.com 163 (Gujarat HC).

Relying on the case of *Yokogawa India Ltd.*[68] and *Kirloskar Systems Ltd.*[69], which held that there was a difference between mere debit to P&L account due to creation of a provision for doubtful debt versus an actual write-off of loans or advances from the books as the latter is not covered in clause (i) of Explanation 1 to section 115JB of IT Act and hence, no adjustment will be required while computing book profits for ascertaining MAT liability under section 115JB of IT Act, the Rajasthan HC dismissed the appeal filed by the IRA.

Significant Takeaways

With respect to the significant issue forming part of aforesaid appeal i.e., allowability of business loss on account of investments made by any taxpayer in its 100% subsidiaries for business purposes, reference may also be drawn to the ruling of the Bombay HC in the case of *Colgate Palmolive (India) Ltd.*[70]. It is pertinent to note that the SLP[71] filed by the IRA against the decision of the Bombay HC was dismissed by the SC and, therefore, the said decision has attained finality on this issue.

Further, relying on the said ruling, Karnataka HC upheld the same principles in the case of *ACE Designers Ltd.*[72] to rule that investment made in a wholly-owned subsidiary for business purposes can be claimed as a business loss.

The rationale of these decisions is that if the investments are made in furtherance of business interests of the taxpayer and are made of commercial expediencies i.e. to boost the sales of the taxpayer company, then the losses should be considered as revenue loss and should be allowed under section 37 of the IT Act. In cases where the investments were made to acquire any asset in a capital field (viz. investment in an unrelated new business which does not benefit the business of the taxpayer), then the losses of such business cannot be claimed as business loss by the taxpayer company.

In the instant case, the Rajasthan HC followed this principle on revenue expenditure vis-à-vis capital expenditure and held that the Assessee's purpose of investment was expansion of its business and thus, the expenses incurred were out of business expediency.

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“ Loss on account of permanent diminution in the value of an investment in a foreign subsidiary deductible as business expenditure. ”

68 CIT v. Yokogawa India Ltd. [2012] 17 taxmann.com 15/204 Taxman 305 (Karnataka HC).
69 CIT v. Kirloskar Systems Ltd. [2013] 40 taxmann.com 124 [2014] 220 Taxman 1 (Karnataka HC).
70 CIT v. Colgate Palm Olive (India) Ltd. [2015] 59 taxmann.com 139/370 ITR 728 (Bombay HC).
71 CIT v. Colgate Palmolive (India) Ltd. [2017] SLP No.25987/2015 (SC).
72 ACE Designers Ltd. v. ACIT [2020] 120 Taxmann.com 321 (Karnataka HC).

ITAT disallows depreciation on enhanced goodwill for revaluations post completion of slump sale

In the case of ***Middleby Celfrost Innovations Pvt. Ltd.***[73] the ITAT disallowed the depreciation claimed on enhanced goodwill after revaluation of debtors and inventory.

Facts

Middleby Celfrost Innovations Private Limited ("**Assessee**") had acquired the assets and liabilities of the refrigeration business of Celfrost Innovations Private Limited ("**Celfrost**") as going concern under a slump sale through a Business Transfer Agreement ("**BTA**") in FY 2013-14.

On conclusion of the slump sale, the Assessee obtained a valuation report from an independent valuer for the allocation of purchase price towards various assets. As per this purchase price allocation report ("**PPA report**"), all assets were recorded at a fair value including an allocation towards brand value. The resultant excess purchase consideration was recognised towards goodwill.

The Assessee carried out the adjustments to the value of sundry debtors and inventory taken over from Celfrost at the year-end. Apart from this, adjustments were also made to certain liabilities and purchase consideration. Accordingly, the value of goodwill was revised in the books of the Assessee.

During AY 2014-15, the Assessee claimed depreciation on the said revalued goodwill. The Assessee also claimed deductions with respect to inventory and debtor's adjustment from the business profits.

The AO accepted that the difference between purchase consideration and the net value of the assets was goodwill and hence, entitled for depreciation under section 32 of IT Act. However, the AO observed mismatch in amount which had arisen on account of adjustments to debtors and inventory, and the valuation report. The AO was also of the view that by revaluing the debtors and inventory, the Assessee was indirectly trying to claim depreciation on non-depreciable assets, amounting to double depreciation. Accordingly, the AO restricted the allowance of depreciation to the adjustments made to the goodwill.

The CIT(A) upheld the order of the AO and the Assessee appealed before the ITAT.

Issue

Whether Assessee could claim depreciation on enhanced goodwill after revaluation of debtors and inventories acquired in a slump sale transaction.

Arguments

The Assessee submitted the fair value adjustments to its debtors and inventory to the ITAT, that were made at the end of FY.

With respect to revaluation of debtors, the Assessee argued that subsequent to slump sale, the management identified certain debtors taken over from Celfrost were not stated at their realisable value at the time of transfer and accordingly a provision on this account was recorded. The analysis of each debtor was made on a scientific basis individually, which was possible only after taking over them. Further, since the adjustment pertained to the debtors taken over, it was fair and logical that the goodwill was adjusted for the said amount, since no adjustments to the purchase consideration was possible. The said adjustment was also found reasonable by the auditors in the audited financial statements of the Assessee, without any adverse qualification.

Further, the Assessee also argued that in a span of four years from the acquisition of business, it realised only 20% of the debtors. Therefore, had the Assessee not claimed adjustment in goodwill and taken over the debts, which could not be recovered, as bad debts in the year of write-off, it would have been in a position to ask for more deduction than what it had claimed in the form of depreciation on enhanced goodwill. Thus, the adjustment towards the value of goodwill was not prejudicial to the interest of IRA, nor did the Assessee gain anything.

With respect to adjustments made to inventories, the management identified that certain inventories taken over from Celfrost were not stated at their realisable value at the time of transfer owing to a number of factors such as market acceptance, discontinued products, usage of products, ageing, physical conditions, etc. Upon evaluation of the inventory post acquisition, the Assessee ascertained the many adjustments towards its value and accordingly, were written down. The Assessee argued that this exercise was possible only after taking over of the inventories. Further, since the adjustments pertained to the inventories taken over, it was fair and logical that the goodwill was adjusted for the said amount since no adjustment to purchase consideration was possible.

[73] Middleby Celfrost Innovations Pvt. Ltd. v. DCIT (ITA Nos 953 to 955/ Bang/ 2019) – Taxsutra.com.

Judgment

The ITAT held that there was no provision in the IT Act that provides a method on how the purchaser in a slump sale must record the value of assets/ rights acquired since their value is determined and agreed by the parties. As per the BTA, the Assessee had acquired the refrigeration business on a slump sale basis for a lumpsum consideration. In terms of the BTA, the cost/ consideration allocated to various assets had to be recorded as bargained between the Assessee and Celfrost.

In the present case, the Assessee got the valuation done by an independent valuer. The ITAT observed that the debtor's account and inventory were valued higher at the time of slump sale. In accordance with the decision of the SC in *Smifs Securities*[74], the Assessee could claim goodwill only on the difference between the consideration paid at the time of slump sale and net value of assets that the taxpayer acquired by virtue of a slump sale.

Thus, the Assessee could not vary the quantum of goodwill based on an exercise carried out subsequent to the slump sale and by passing entries in the books of accounts towards the end of the FY, even though there were valid reasons to do so. Hence, the IRA was justified in rejecting the Assessee's claim for depreciation on the enhanced goodwill value.

Further, the ITAT also observed that since the quantum of consideration attributable to various assets in a slump sale was sought to be varied from what was bargained between the parties, like in the present case towards unrealisable debts/ bad debts or reduction in the value of inventory, the claim can either be made through write-off of bad debts under section 36(1)(vii) or diminution of the value of inventory by necessary entries in the books of account.

Significant Takeaway

The allowability of depreciation on goodwill has been a subject matter of debate before the courts. The SC in the case of *Smifs*

Securities had held that the goodwill of business is an intangible asset eligible for depreciation. Subsequently, some of the Courts/ Tribunals have allowed depreciation on goodwill.

In the instant case, the issue was whether depreciation can be claimed on the increased amount of goodwill due to revaluation of debtors and inventory after the slump sale. The ITAT had held that the Assessee was not eligible for depreciation on goodwill that was arrived at after the fair value adjustments were made towards debtors and inventory, and allowed claiming goodwill only on the difference between purchase consideration and net value of assets acquired during slump sale. However, it is surprising to note that this decision could actually favour the taxpayer, who shall be entitled to book such expenses as legitimate business expenses and claim full deduction of the same!

Having stated the above, IT Act has been amended with effect from April 1, 2021, to exclude goodwill of a business or profession from being classified as a depreciable asset.

> **" Enhanced goodwill recognised due to revaluation of debtors and inventory post slump sale not eligible for depreciation. "**

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

CASE LAW UPDATES- DIRECT TAX

ROUTINE

Stay application should be decided by the AO in a fair and judicious manner

In the case of ***Harsh Dipak Shah***[75], the Gujarat HC held that HCs have the power to set aside an order to stay demand proceedings, passed by the AO through arbitrary use of his discretionary power, and directed him to pass a reasonable and speaking order based on facts and circumstances of a particular case.

Facts

Harsh Dipak Shah ("**Assessee**") was director of entities falling under Avani group of companies. After initiating search proceedings in the case of the Assessee, and assessment orders were passed for AYs 2010-11 till 2020-21 and an aggregate demand to the tune of INR 373 crores (approximately) were raised for these years. The Assessee challenged the orders by way of an appeal before the CIT(A). In the interim, the Assessee also filed a stay application requesting the AO to stay the entire demand on various grounds including a high-pitched assessment order.

Taking into account the CBDT Instruction dated March 21, 1996[76] (as modified by CBDT Instruction dated March 31, 2017) ("**CBDT Instruction**"), the AO denied the request for a stay. The CBDT Instruction lays down three illustrative situations where stay could be granted:- a) issues relating to the disputed demand have been decided in favour of the Assessee by courts or appellate authorities previously; b) the AO has adopted an interpretation of law on which there were contrary rulings of one or more HCs; and c) the jurisdictional HC has adopted a contrary interpretation which the tax authorities have not accepted. Therefore, although the AO denied the request for a stay citing the aforesaid CBDT Instruction, he agreed to grant the request if the Assessee paid 20% of the total demand.

Being aggrieved by the AO's order, the Assessee approached the PCIT requesting for complete stay of the entire demand since it was a high-pitched assessment order passed in a stereotypical manner. The Assessee further submitted that he only derived income as a director from his company that had a turnover of INR 125 crore whereas the aggregate of income addition in his case was INR 408 crore i.e. four times higher than the annual turnover of the company. The Assessee further submitted that it was difficult to deposit such huge tax demand as there was an adverse impact on his business affairs due to the protracted effects of the COVID-19 pandemic.

The PCIT rejected this application stating that no evidence of financial crunch was placed on record by the Assessee and he failed to meet any of the conditions as specified in the CBDT Instruction. Accordingly, the Assessee filed a writ petition with the Hon'ble Gujarat HC.

Issues

Whether the HC had powers to intervene in a stay application filed by the Assessee and to decide quantum of tax demand required to be paid for a grant of stay by the AO, as per the provisions of section 220(6) of IT Act read with circulars and guidelines issued by the CBDT.

[75] Harsh Dipak Shah v. Union of India, Civil Application No. 19804, 19808 & 19815 of 2021 (Gujarat HC).
[76] CBDT Instruction No. 1914 F No. 404/72/93 ITCC dated March 21, 1996.

Arguments

The Assessee contended that the AO had mechanically passed the stay order directing him to pay 20% of the tax demand amounting to INR 74 crore (approximately). It was a high-pitched assessment order and the income assessed was approximately 100 times the returned income. The Assessee also submitted that such a huge quantum of tax demand could lead to insolvency or closure of the business of the Assessee.

The Assessee further argued that the AO had failed to take into consideration certain crucial factors relevant for grant of interim stay as has been explained in several precedents. The factors being: a) existence of a prima facie case; b) financial stringency duly considering the factor of "irreparable injury" and "undue hardship" on assessee; and c) balance of convenience.

On the other hand, the IRA argued that the HC under its writ jurisdiction cannot interfere with the discretionary powers bestowed upon the AO. The IRA also contended that the high quantum of assessed income does not per se imply that it was a case of high-pitched assessment, if the additions were based on substantive material relied upon by the AO obtained during the course of search operations. Further, the IRA contended that the CIT(A) also had inherent powers for grant of a stay and the Assessee should have approached the appellate authority instead for reaching out to the AO.

Judgment

The HC referring to section 220(6) of IT Act held that the AO has the *"discretion"* to grant stay, subject to such conditions as he may deem fit to impose. The HC agreed that for grant of stay the four basic parameters that need to be kept in mind are: (i) a prima facie case in favour of assessee; (ii) balance of convenience; (iii) irreparable injury that may be caused to the assessee which cannot be compensated in terms of money; and (iv) whether the assessee has come before the authority with clean hands. Further, HC held that this discretion needs to be exercised judiciously, on relevant grounds and not in an arbitrary or mechanical manner and that while exercising this discretion, the AO should not act as a tax gatherer.

The HC referred to the Andhra Pradesh HC decision in the case of *Vetcha Sreemmamurthy*[77] where it was held that the Legislature did not intend to grant an absolute, uncontrolled or arbitrary discretion to an income tax officer in granting stay, but rather, imposed a duty upon him to arrive at an honest judgment as to whether to exercise the discretion in a matter or not.

The HC further observed that the instant case had not been considered by the AO in its proper perspective. Placing reliance on the Madras HC ruling in the case of *N. Jegatheesan*[78], the HC observed that a high-pitched assessment implied that the assessed income is substantially higher than the returned income. Further, the HC placed reliance on Delhi HC ruling in the case of Soul[79] wherein it referred to para B of the CBDT Instruction and held that a superior authority can interfere with the decision of the AO for stay of demand in exceptional circumstances, including in cases of high-pitched assessments.

The HC further relied on the Madras HC ruling in *Mrs. Kannammal*[80] and observed that the AO was required to pass a speaking order and even if the stay application filed by an assessee did not make a mention of the relevant parameters (i.e. a prima facie case, financial stringency and balance of convenience), it was still incumbent upon the AO to assist the taxpayer and take into account these considerations while passing the order.

To elaborate on the legal principles governing the exercise of discretion by an officer, the HC placed reliance on SC ruling in the case of *Sant Raj*[81] and *Reliance Airport Developers (P) Ltd.*[82] wherein the SC held that administrative discretion must be exercised according to the rules of reason and justice and not as per private opinion. Further, in *U.P. State Road Transport Corporation*[83], the SC observed that Courts cannot go beyond its jurisdiction and dictate the manner in which a statutory authority should exercise its discretion. Instead, the SC held that Courts can only command the authority to exercise the discretion as per law. The SC also clarified that such discretion needs to be exercised faithfully and impartially. Further reliance was placed on SC ruling in the case of *Glaxo Smith Kline Consumer Health Care Limited*[84] which held that constitutional courts, even while exercising their wide jurisdiction, cannot disregard statutory provisions.

The Gujarat HC held that section 220(6) of IT Act required that the AO should wait for the outcome of the appeal filed by an assessee before the CIT(A) and provided discretion in the hands

77 Vetcha Sreemmamurthy v. ITO [1956] 30 ITR 252 (Andhra Pradesh HC).
78 N. Jegatheesan v. Deputy Commissioner of Income Tax, Non Corporate Circule-2, reported in (2016) 388 ITR 410 (Madras HC).
79 Soul v. Deputy Commissioner of Income Tax (2010) 323 ITR 305 (Delhi HC).
80 Mrs. Kannammal v. Income-tax Officer-Ward-1(1), Tripura (2019) 103 taxmann.com 364 (Madras HC).
81 Sant Raj and Anr v. O.P Singla and Anr., 1985 2 SCC 349 (SC).
82 Reliance Airport Developers (P) Ltd. v. Airports Authority of India and Ors., (2006) 10 SCC 1 (SC).
83 U.P. State Road Transport Corporation and Anr. v. Mohd. Ismail and Ors., (1991) 3 SCC 239 (SC).
84 Assistant Commissioner (CT) LTU, Kakinada and Ors. v. Glaxo Smith Kline Consumer Health Care Limited, 2020 SCC Online SC 440 (SC).

of the AO for grant of stay, such discretion should ordinarily be exercised in favour of the assessee unless there are overwhelming reasons to reject an application for stay of demand.

The HC placed further reliance on Bombay HC ruling in the case of *KEC International Ltd.*[85] wherein the HC laid down certain parameters relevant for deciding a stay application i.e. a) the concerned authority should briefly describe the Assessee's case; b) where the assessed income is far in excess of returned income, an unconditional stay may be considered or short prima facie reasons may be given for deposit of a partial amount; c) where the authorities counter the Assessee's claims of financial difficulty and indicate if he/she was financially sound to deposit an amount. The Gujarat HC also referred to a ruling of the SC in the case of *M. Damodar Bhat*[86] wherein the SC held that where the Assessee itself had failed to specify any particulars as to how the concerned officer had acted arbitrarily, the Court should not go into the said question.

Applying the position of law discussed to the facts of the instant case, the Gujarat HC set aside the rejection order and directed the AO to reconsider the stay application of Assessee in accordance with the CBDT guidelines and the jurisprudence laid down by the various Courts.

Significant Takeways

Stay of demand subject to payment of a certain sums has always been a bone of contention between Assessees and tax authorities. Tax authorities are usually keen to recover the tax demand up to the maximum extent possible once an assessment order is passed even though the circulars and other guidelines issued by the CBDT expect the AO to appreciate the facts and circumstances of each case.

Taxpayers face immense hardships in depositing huge sums of tax demand at a short notice especially in case of high-pitched assessments. Deposit of a huge sum of money, merely pursuant to an assessment order, disrupts business operations of taxpayers and are highly unjustified especially considering that a large number of these cases get overruled at higher appellate levels. Courts have time and again stressed that ample discretion has been provided to the AO to decide on the stay of applications in each case in a judicious manner.

The law under section 220(6) and the power of the High Court under its writ jurisdiction is fairly settled. Usually, Courts deciding the legality of the AO's decision under section 220(6) does not sit in appeal over the *correctness* of the decision by replacing the AO's judgment by its own. As stated by the Gujarat

[85] KEC International Limited v. B.R. Balakrishnan (2001) 251 ITR 158 / 119 Taxman 974 (Bombay HC).
[86] The Income Tax Officer, III Mangalore v. M. Damodar Bhat (SC).
[87] Queen Agencies vs. ACIT, [2021] 128 taxmann.com 107 (Madras).

HC in the instant case, if it is found that the AO has exercised his discretion improperly, then the HC may remand the matter back to the AO for fresh consideration. This has been done by other High Courts in the following situations (i) if the AO dismisses the section 220(6) application by a non-speaking order[87]; (ii) stay is granted only subject to a high sum being deposited with the tax authorities[88]; (iii) failed to take into account the relevant factors for grant of stay[89] etc., then the HC may set aside the AO's decision and remit the matter back to the AO for fresh consideration. If the HC finds that the AO has considered all the relevant factors in arriving at the decision, the grant of stay subject to the payment of a portion of the demand, the decision cannot be interfered with.[90] However, as held by the Gujarat HC, Courts should not order the stay itself.

However, in a 2020 case of *Suresh Anuradha*[91], the Madras HC decided to take matters into its own hands while holding that the requisite deposit ordered by the AO while granting stay under section 220(6) was excessive. The HC ordered that stay be granted subject to the payment of a reduced amount of deposit. This goes contrary to the Gujarat HC's exposition that as per administrative law principles, the HC cannot replace the AO's judgment by its own. Regardless, we can assume that the Gujarat HC's decision follows the correct position in law by not replacing the AO's judgment as is consistent with earlier precedents.

In other situations, the tax authorities may also initiate recovery proceedings under the demand notice during the pendency of the stay application under section 220(6) of the IT Act – in these situations, Writ Courts have stayed coercive proceedings until the AO decides such application on merits.[92]

The Gujarat HC in the present case has discussed at length the scope of the discretionary powers available to the AO for deciding stay application and has also clarified that it is not up to Courts to encroach upon these discretionary powers. However, if there is a clear abuse of these powers by the AO, Courts have to intervene and set aside any such orders for reconsideration, in keeping with the applicable law and guidelines of the CBDT.

“ The power to grant stay should be utilised judiciously. ”

88 Sushil Bhatia v. ACIT, [2018] 94 taxmann.com 30 (Bombay).
89 Chetan Kothari v. PCIT, [2020] 121 taxmann.com 279 (Madras).
90 Gorlas Infrastructure (P.) Ltd. v. PCIT, [2021] 130 taxmann.com 378 (Telangana).
91 Suresh Anuradha v. CIT, [2020] 115 taxmann.com 73 (Madras).
92 Vimal Tyagi v. ITO [2021] 133 taxmann.com 291 (SC); M.D. Infra Developers v. DCIT [2016] 70 taxmann.com 270 (Gujarat).

Delhi HC quashes reopening of assessment proceedings due to contradictory reasons furnished by the IRA

In ***Vodafone Luxembourg 5 S A R L***[93], the Delhi HC quashed the reassessment notices issued against the Assessee by holding that the IRA cannot state one reason for reopening of assessment proceeding and another at the time of hearing before it. As per the notice(s) issued to the Assessee, it was stated that the case of the Assessee was selected for reassessment because its case was flagged in the Non-filers Monitoring System ("**NMS**") due to non-filing of return of income. However, during the course of hearing, it was contended that reassessment notices were issued for verification of the nature of loans.

Facts

Vodafone Luxembourg 5 S A R L ("**Assessee**") is a non-resident in India for the purposes of IT Act. It filed a writ petition against an order dated March 10, 2022 ("**Impugned order**"), reassessment notice dated March 30, 2021 under section 148 of IT Act and a notice for re-assessment proceedings dated February 3, 2022 issued under section 143(2) and 142(1) of IT Act read with section 147 of IT Act for the AY 2016-17 ("**Impugned notices**") by the AO.

During the year, the Assessee had earned interest income on rupee denominated bonds issued by an Indian company. As specified under section 194LD of IT Act, tax was deducted at source on such interest income at the rate of 5%.

However, despite the abovesaid provisions, a re-assessment notice was issued for the relevant AY. Being aggrieved, the Assessee filed a writ petition before the Hon'ble Delhi HC.

Issue

Whether reassessment notice issued by the IRA was maintainable in view of the reasons for reopening as per the reassessment notice were contradictory to the reasons furnished by the IRA during the course of the hearing before the Hon'ble HC?

Arguments

It was contended by the Assessee that the aforesaid order and notices were erroneously issued to it as the interest income earned by it during the relevant AY on rupee denominated bonds issued by an Indian company, as referred to in section 194LD of IT Act, was taxable at a concessional rate of 5%. It further contended that being a non-resident in India, it was exempted from filing separate return of Income in India on account of section 115A(5) of IT Act which provides that a non-resident assessee having income on which TDS has already been deducted as per section 194LD of IT Act, shall not be required to separately file a return of income in India. In this regard, the Assessee also placed reliance on a ruling of the Delhi HC in the case of *Nestle SA*[94] wherein the reassessment notice along with order passed by the IRA (rejecting the objections raised by the Assessee against such notice as the Assessee in said case was specifically exempted from filing a return of income under section 115A(5) of IT Act and had duly pointed this out in its objections filed against the reassessment notice issued by the IRA) were quashed.

The IRA submitted that the Assessee's case was selected for re-assessment as it was yet to furnish relevant documents or agreement pertaining to debenture subscription, residency certificates, etc. Therefore, the IRA argued that it had issued the reassessment notice to ascertain whether the Assesssee received interest on rupee denominated bonds or dollar denominated bonds that were issued by an Indian company.

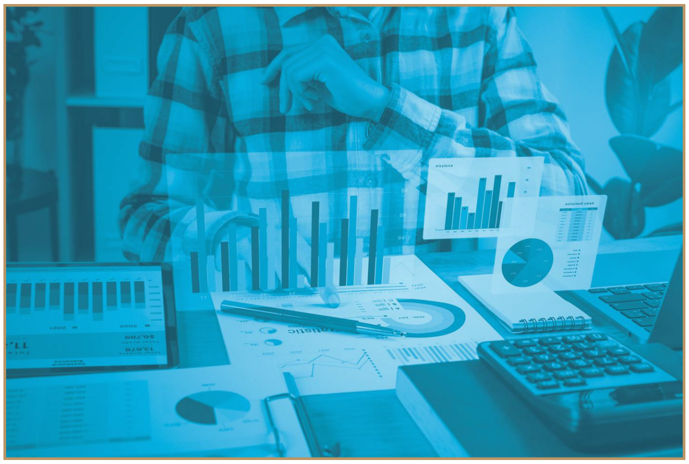
Judgment

The Hon'ble HC observed that during the course of the hearing, the IRA submitted that the Assessee's case selected for re-assessment to check whether interest was received by the Assessee on rupee denominated bonds of an Indian company so as to verify whether provisions of section 194LD of IT Act were applicable in the case of the Assessee.

However, on a perusal of the records of the case as filed before the Delhi HC, the Hon'ble Court observed that the Assessee was issued the reassessment notice after its case was flagged in the Non-filers Monitoring System due to non-filing of return of income.

Therefore, basis the above, it was held by the Hon'ble Court that there is a contradiction in the stand taken by the IRA before the Hon'ble Court as opposed to the documents furnished before it By calling out this glaring dichotomy, Delhi HC quashed the Impugned order and Impugned notices giving IRA the liberty to issue fresh reassessment notices in accordance with law.

[93] Vodafone Luxembourg 5 S A R L v. Income Tax Department, Circle International - Tax 3(1)(1), Delhi and Anr, W.P.(C) No. 4548/2022 (Delhi HC).
[94] Nestle SA v. ACIT (IT), Circle (2)(2), New Delhi (2019) 417 ITR 213 (Delhi HC).



Significant Takeaways

The Courts have time and again held that re-opening of assessment proceedings should be on sound legal basis. Thus, to initiate reassessment proceedings against any Assessee, the reason recorded by the AO is a *sine qua non* and failure to record proper reason such that it is not on sound legal footing or that the AO has not applied his mind - can vitiate the entire reassessment proceedings. The requirement of recording reasons is a check against arbitrary exercise of power by the IRA because basis the reasons recorded, the validity of the reopening of the assessment is decided. The Court was right in holding that the reasons recorded while reopening the assessment cannot be allowed to grow with age and ingenuity, by devising new grounds in replies and affidavits not envisaged when the reasons were initially recorded.

The Hon'ble Delhi ITAT in the case of *Balbir Investment (P.) Ltd.*[95] held that where in the reasons for reopening the AO had recorded that the Assessee had invested in shares of a shell company as per the information obtained from Investigation Wing, but as per the assessment order passed by the AO the Assessee had received share capital from a shell company; there was a contradiction in the reasons recorded and subsequent assessment made showed complete non-application of mind by the AO and, therefore the reassessment proceedings ought to be quashed. Further, the Hon'ble Bombay HC in the case of *Godrej Industries Ltd.*[96] held that the reasons recorded at the time of issuing notice being the only evidence of the AO's reason to believe that income chargeable to tax has escaped assessment, other reasons cannot be added to, deleted from or supplemented.

Therefore, the reasons for reopening assessment being sacrosanct, if there is any contradiction in the stance subsequently adopted by the ITA, such reassessment proceedings ought to be quashed.

> **"Reassessment notice quashed due to contradictory reasons furnished by the IRA at the time of recording reasons for reopening and subsequently to justify its action before the Hon'ble HC."**

[95] Balbir Investment (P.) Ltd. v. Income-tax Officer, Ward-4(2), New Delhi [ITA No. 1954/ 2019 (Delhi ITAT)].
[96] Godrej Industries Ltd. v. B.B. Singh DCIT & others (2015) 377 ITR 1 (Bombay HC).

CASE LAW UPDATES- INDIRECT TAX

OTHER JUDICIAL PRONOUNCEMENTS

Blocking of Electronic Credit Ledger ("ECL") cannot be compared with provisional attachment of property

In the case of ***Dee Vee Projects Ltd.***[97], the Hon'ble Bombay HC held that the law permits blocking of ECL for the amount that is found to be fraudulently or wrongfully availed. It also held that a post-decisional hearing must be granted within two weeks from the date of the order blocking ECL.

Facts

Dee Vee Projects Ltd. ("**Petitioner**") was engaged in infrastructure development service and was present in multiple states in India. The Petitioner had availed ITC of INR 48.7 Crore. A criminal case was initiated against the Petitioner, who challenged it by filing a criminal writ petition. Subsequently, his ECL was blocked by the deputy commissioner. The Petitioner was unable to update ECL or use it to discharge its output GST liability.

Aggrieved by the same, the Petitioner approached the HC by filing a Writ Petition.

Issue

i) Whether the writ petition before Bombay HC was maintainable;

ii) Whether blocking ECL under Rule 86-A of the CGST Rules amounts to provisional attachment of property under section 83 of the CGST Act;

iii) Whether rule 86-A of CGST Rules permits blocking of the ECL, and if yes, to what extent?

iv) Whether the order of blocking of ECL is arbitrary and illegal.

Arguments

The Petitioner asserted that no alternative remedy was available as no order was passed by an adjudicating authority which was appealable under section 107 of the CGST Act.

On merits, the Petitioner argued that it has been compliant with GST legislation and had filed timely returns. The ITC availed in the ECL was on a property of the Petitioner and blocking of ITC amounted to provisional attachment of its personal/private property. The GST legislation permits provisional attachment under section 83 of the CGST subject to fulfilment of prescribed conditions that a proceeding was pending before the authority in relation to assessment, inspection, search, seizure and demand of unpaid taxes or short paid taxes. As no proceeding was pending under such provision against the Petitioner, the attachment was without the authority of law.

The Petitioner also contended that the power to block ITC under Rule 86A of the CGST Rules could not be exercised without quantifying the amount of ITC availed wrongfully or fraudulently. The Petitioner argued that no order was passed recording the reasons for blocking the availed ITC and there was no clarity if the facts were considered by the officer blocking the credit (as the officer merely followed the instruction of superior order belonging to different wing). It also requested that direction must be issued to Government to issue guidelines for exercising power under Rule 86A of the CGST Rules, as any misuse could result in large scale impact on business of various taxpayers.

On the other hand, the Respondent asserted that a detailed investigation revealed that the Petitioner neither had presence nor carried out any business from Maharashtra. The registration has been obtained by submitting a rental agreement, which did not clearly state about the owner of the property. Thus, it has fraudulently availed the ITC.

[97] Dee Vee Projects Ltd. v. Government of Maharashtra – 2022 TIOL 238 HC MUM GST.

The power of blocking ITC under Rule 86A of the CGST Rules cannot be compared to provisional attachment under section 83 of the CGST Act, as it was temporary blocking for a period upto 1 year. There was no attachment and it was merely imposing a restriction to utilise blocked ITC. It argued that there was no requirement of hearing before blocking of ITC under Rule 86A of the CGST Rules and it only required that the authority was satisfied regarding blocking of ITC. The Respondent further mentioned that Rule 86A of the CGST Rules allowed delegation of power by the Commissioner and necessary material was provided to the officer to satisfy himself regarding the blocking of ITC. It also mentioned that Rule 86A of the CGST Rules provided for specific conditions, thus there was no requirement of separate guidelines.

Judgment

The HC held that the petition was maintainable as section 107 pertains to appeal from decision of an adjudicating authority, which was not applicable to instant case as no order was passed by adjudicating authority. Hence, the Petitioner has no alternate remedy available.

With respect to Rule 86A of the CGST Rules, it observed that the commissioner or delegated sub-ordinate had power to put an embargo upon the utilisation of the amount of ITC or refund of the unutilised ITC. The HC then differentiated between blocking of ITC vis-à-vis provisional attachment. It observed that blocking of ITC was not akin to seizure of the ITC amount for appropriation towards realisation of GST dues, which occurs in the case of attachment of property. The ITC remains in possession of the taxpayer and only the power/ capacity to utilise it for temporary period was disabled. There was no requirement under Rule 86A of the CGST Rules for any pending proceeding in relation to assessment, inspection, search & seizure and demand of unpaid or short paid tax as required for provisional attachment. Thus, the conditions stated for provisional attachment were not required to be satisfied. The only condition needed here was to ascertain that, as per Rule 86A of the CGST Rules, the competent authority has been satisfied, based on material available to him, to conclude that blocking was necessary. The other requirement is that the reasons must be recorded in writing by the competent authority. In this regard, as the provision read "may", the HC was of the opinion that it must be interpreted as conveying an authoritative command as the taxpayer had to bear adverse consequences on account of blocking of ITC by relying on earlier precedents[98].

As the blocking of ITC has civil consequences, such administrative power must be exercised cautiously by the department and it must satisfy the test of reasonableness by undertaking subjective satisfaction on the basis of material available. The HC also stated that while there was no requirement of providing a hearing under the provision, as the blocking has civil consequences, thus, a post-decisional hearing may be granted within a reasonable period of time (of two weeks) from the date of the order of blocking.

The HC also observed that ECL cannot be blocked for amount of ITC which was more than what was found to be fraudulently or wrongfully availed. On the above principles, the HC concluded that the order did not record any reason how the ITC was fraudulently or wrongfully availed and merely relied on instruction of superior. Concluding it was incorrect, the HC directed the ITC to be released but allowed the department to invoke Rule 86 A of CGST Rules in accordance with observations of the Court.

Significant Takeaways

The aforementioned decision is breakthrough decision as HC has held that even power under Rule 86A of CGST Rules for blocking of ITC must be exercised fairly and reasonably by following the principles of natural justice. The decision provides a relevant guideline for providing a post-decisional hearing. The same view has recently been reiterated by Gujarat HC in *New Nalbandh Traders v. State of Gujarat & Ors*[99]. In another decision, the HC held that prior to blocking of ITC under Rule 86-A, the department must communicate the rationale so as to enable the taxpayer to put forth objections[100].

Some states like Kerala have issued guidelines for using the power under Rule 86A of CGST Rules. Hopefully, other states would also come up with similar guidelines to prevent misuse of power.

> **"The competent authority must mandatorily record reason in writing before creating a lien on ITC."**

[98] Andhra bank v. Official Liquidator, 2005 (3) SCJ 762.
[99] TS-107-HC(GUJ)-2022-GST.
[100] HEC India v. CGST [TS-513-HC(MAD)-2021-GST]; Aryan Tradelink v. UOI [TS-1143-HC-2020(KAR)-NT].

Tax recovered during investigation at odd hours are involuntary payment

In the case of ***Bundl Technologies Private Limited***[101], the Hon'ble Karnataka HC held that the GST amount deposited with the department at night time during the course of investigation was illicit collection of money and cannot be considered as voluntary payment under section 74(5) of the CGST Act.

Facts

Bundl Technologies Private Limited ("**Respondent**") was engaged in the business of operating a food-delivery e-commerce platform under the brand name of 'Swiggy'. The Respondent utilises delivery partners who are either directly engaged or are hired temporarily through third party service providers. One of the third-party service providers was Green Finch Team Management (P) Ltd. ("**Green Finch**") who charged the Respondent on a cost-plus mark-up basis. The Respondent was availing ITC on the GST paid to Green Finch.

While investigating the Respondent for the services provided by Green Finch, the DGGI found that it was a non-existent entity. Accordingly, the Respondent was questioned about the ITC availed by it against the invoices raised by Green Finch which were regarded as fraudulent. The IRA entered the premises of the Company on 28.11.2019 at 10.30 a.m. During the course of the investigation, a sum of INR 15 Crore was deposited by the Company at 4 am under the GST cash ledger. Further, during the summon proceedings, a sum of INR 12.5 Crore was deposited at about 1 a.m. to secure the release of three directors. No SCN was issued for the next 10 months nor any refund was granted to the Respondent. Aggrieved by the same, the Respondent filed a writ petition before the HC seeking direction for refund along with interest.

The learned Single Judge of the HC passed an order holding that the payment made by the Respondent during the course of investigation was involuntary. However, the Respondent was required to undergo refund procedure as the process of investigation was separate and cannot be merged with investigation. Aggrieved by the same, the department ("**Appellant**") filed an appeal challenging the order.

Issue

i) Whether the GST paid during the investigation was voluntary?

ii) Whether the amount was recovered under the coercion and threat of arrest?

iii) Whether the DGGI officers conducted investigation in a high handled and arbitrary manner?

iv) Whether writ petition filed by the Respondent suffered from delay or laches?

Arguments

The Appellant contended that a tip was received that Green Finch was a non-existing company and large amount of ITC was being availed by the Respondent. The Respondent had not received any services from Green Finch or its inward suppliers and was not entitled to claim ITC on the same. The Respondent had failed to disclose that it has also deposited an amount of INR 4.74 Crores during investigation in respect of a different issue which was not claimed as refund. It argued that the Respondent has self-ascertained his GST liability of INR 27.5 Crores and voluntarily paid it in terms of section 74(5) of CGST Act. It was further urged that the summon issued pertained to submission of evidence and there was no threat and coercion by the DGGI Officers. It also argued that being questions of fact, these issues cannot be examined under writ jurisdiction.

It was also submitted that there was delay in filing of writ petition as it was filed after a period of 15 months. Thus, it can be identified that allegations of threat and coercion were an after-thought.

Whereas the Respondent submitted that Green Finch was an existing entity as per information available on the official website of the ministry of corporate affairs. The Respondent had terminated availing services from Green Finch from December 2018. An arbitration proceeding was pending in that regard. The Respondent contended that Green Finch had periodically filed returns till September 2019. The Respondent had received services and valid tax invoices charging applicable GST.

The Respondent argued that it was compelled to deposit GST at unreasonable hours under the threat of arrest and imprisonment. It contended that the recovery of tax during the investigation was illegal and unconstitutional and, therefore, it was entitled to refund of the amount. The Respondent's correspondence to the DGGI also stated that it reserved its rights to claim the refund and the same was not to be treated as admission of liability. The Respondent had initiated the refund proceeding within two years from the date of depositing GST. As

[101] UOI v. Bundl Technologies Private Limited 2022 (3) TMI 625- Karnataka HC.

attempts failed to evoke any response from the department, the Respondent had to take recourse of a writ petition.

Judgment

The HC reviewed the provision under section 74(5) of the CGST Act to determine if the payment made was voluntary. It also took note of interim order passed by the Gujarat HC decision in *M/S Bhumi Associate v. UOI*[102], wherein CBIC was directed to enforce following guidelines:

a) no recovery in any mode by cheque, cash or adjustment of ITC should be made at the time of search / inspection proceedings under any circumstances;

b) Where the taxpayer intends to make voluntary payment, it should be advised to wait until the next day when search proceedings have ended;

c) Facility of filing complaint / grievance after the end of search proceedings should be made available to the taxpayer;

d) If complaint / grievance was filed and an officer was found to have acted in defiance, disciplinary action should be initiated against the concerned officer.

In the present case, the amount was paid at unreasonable hours. The HC also relied on Article 265 of the Constitution which mandates that collection of tax has to be by the authority of law. Where tax was collected without any authority of law, it would deprive a person of his property and would infringe his right under Article 300A of the Constitution. Section 74(5) of CGST Act permits deposit of an amount during pendency of an investigation as there was no communication from the Respondent regarding self-ascertainment or admission of liability. Rather it reserved the right to refund and stated that the amount must not be considered as admission of liability. The HC also observed that the Respondent was filing regular GST returns and no amount was due as no document was submitted by Appellant stating otherwise. Thus, it held that amount was not paid voluntarily.

However, the HC did not answer over the issue of threat/ coercion as it was not appropriate to decide it in a writ proceeding. Before departing, the HC emphasised that a statutory power must be exercised within a system of controls and not in the manner to instil fear in the mind of a person.

With respect to delay in filing writ petition, it stated that the Respondent approached the HC only after its attempts to seek refund from the IRA did not yield any result and the petition was filed within two years. Hence, there was no delay or laches in filing the writ petition.

Significant Takeaway

The aforementioned decision is clearly a positive outcome, which intends to protect the genuine taxpayers from the impact of power-misuse by the IRA. The decision reiterates that the taxpayer cannot be put in a jeopardy and that any illicit collection of money during investigation would be liable for refund. The ruling is clear about the perils of collection of GST under threat or coercion by the IRA as it would disrupt the business of a taxpayer.

The HC has reiterated the IRA must strictly adhere to the relevant guidelines at the time of voluntary payment of GST. It can only be hoped that the IRA would abide by the guidelines in order to preserve the interests of genuine taxpayers.

“ Involuntary payment of GST violates Article 265 of the Constitution. ”

102 M/s Bhumi Associate v. UOI, Matter No. SCA/3196/2021, Gujarat HC.

GST not applicable on Notice Pay

In the case of ***Syngenta India Limited***[103], the AAR Maharashtra has interpreted that recovery of notice pay from dues of the employee for not serving the notice period as per contractual agreement / appointment letter does not amount to supply of services under GST.

Facts

Syngenta India Ltd. ("**Applicant**"), is a manufacturer of crop safety products like pesticides, herbicides and sells various seeds. The Applicant offered incentives to its employees such as Parental Insurance Policy, group policy, etc. and recovered premium amount from them without any profit.

However, if the employees leave without serving notice period as per their employment agreement, the Applicant also recovered notice pay from them. In order to determine the taxability of money recovered from employees, the Applicant approached the AAR.

Issue

i) Whether payment by employees for parental insurance subject to GST;

ii) Whether the notice pay recovered from employee subject to GST.

Arguments

The Applicant asserted that parental insurance was provided by a third-party service provider. The Applicant paid the invoice (charging GST) raised by the third party and recovered the amount from its employees. Neither it was part of the Applicant's business activity, nor was it holding a licence to carry out insurance activity. It was not incidental and ancillary to the main business. It relied on various decisions where taxpayers were engaged in a particular business but had sold other items, and it was held that taxpayer was not engaged in business of the latter product.

The Applicant also contended that the amount of parental insurance recovered from the employees was in accordance with the employment contract. It was clarified by the Ministry of Finance *vide* press release dated July 10, 2017 that, any services provided by the employer to the employees in terms of the contractual agreement entered into between the employer and employee would not be subjected to GST. It also relied on Schedule III of CGST Act, which provided list of activities that were not treated as supplies under the GST legislation (it included entry dealing services provided by employees to employer). Therefore, Applicant contended that the parental insurance it provided to its employees was not in the nature of 'supply of services'.

The Applicant also argued that the notice pay was not a consideration towards any of its activities. Not serving the notice period post submission of letter for termination of employment was mere non-compliance of the concerned employment agreement. It was recovery of reasonable estimate of the loss suffered by the Applicant, i.e. damage on account of unforeseen action of an employee. The amount recovered was compensation for damage. It relied on section 73 and section 74 of the Contract Act, 1872 which deals with compensation for breach of contract.

The Applicant also relied on Para 2.3.1. of Education Guide issued by CBIC for erstwhile service tax law, which clarified that fines and penalties as legal consequences of a person's actions were not in the nature of 'consideration'. It also relied on service tax jurisprudence wherein it was held that notice pay recovery was not liable to service tax[104]. The Applicant also submitted that since it did not agree to an obligation to tolerate an act, the entry pertaining to acceptance of such obligations as to refrain from or tolerate an act or a situation, or to do an act was not applicable.

The IRA asserted GST was liable on recoveries made from the employees for not serving the full notice period as it was mutually agreed between them for breach of contract. It was consideration to the employer for tolerating the act of the employee for not serving the notice period and covered under clause 5 (e) to Schedule II of CGST.

However, with respect to amount recovered for parental insurance, the IRA agreed with the Applicant that the same was not subject to GST.

Judgment

The AAR held that recovery of Parental Health Insurance Premium from employees did not amount to supply of service. It relied upon its earlier decisions in the cases of in re *M/s Jotun India Private Limited*[105] and in re *M/s POSCO India Pune Processing Centre Private Limited*[106].

[103] In Re: M/S. Syngenta India Limited, 2022 (1) TMI 903 AAR Maharashtra.
[104] HCL Learning Ltd.v. Commissioner of CGST 2019 (12) TMI 558, CESTAT Allahabad.
[105] In re M/s Jotun India Private Limited, 2019-TIOL-312-AAR-GST.
[106] In re M/s POSCO India Pune Processing Centre Private Limited, 2019 (2) TMI 63.

With respect to notice pay, the AAR observed that in order to be treated as supply of service under Clause 5(e) of Schedule II, there must be an act of forbearance or tolerating an act or situation, one of the party must have an obligation to forbear, refrain or tolerate an act or situation for a consideration.

It observed that an employee may opt for resignation by paying certain amount in lieu of notice period as per the contract. There was no forbearance or tolerance by any party. The resignation, as per the agreement, was not subject to acceptance or approval. The employees were free to tender their resignations. Thus, there was neither any activity nor any passive role played by the employer. No consideration was paid for act of forbearance as there was no breach of contract.

The AAR also relied upon jurisprudence under erstwhile service tax regime, where the Hon'ble Madras HC held that imposition of cost on the employee on his/her sudden termination and exit was not a service[107]. It was mere facilitating the exit. The employer has not 'tolerated' any act of the employee but has permitted pre-mature termination. Imposition of such cost on employee would not lead to rendition of service either by the employer or the employee.

A similar view was also taken in an advance ruling under the GST, and it was held that GST was not applicable on recovery of notice pay.[108]

Thus, the AAR held that GST was not applicable on notice pay recovered from an employee leaving the organisation without serving the notice period.

Significant Takeaways

The aforementioned decision clarifies the scope of GST levy on notice pay. While several taxpayers are approaching the advance ruling authority for seeking clarification on this aspect, the aforesaid judgment comes out as lucid.

Unfortunately, recently in another matter, the Gujarat Appellate AAR in the matter of *In Re: M/S. Amneal Pharmaceuticals Pvt. Ltd.*[109] failed to provide any ruling on this aspect as both the members had difference of opinion. The member providing the contrary view stated that the transaction was tolerating non-performance/ breach of contract which is in the nature of rendering of service. The member was of the view that Schedule III to the CGST Act (which dealt supply which were not subject to GST as they were neither to be treated as supply of goods nor services) was inapplicable in present case. The reasoning stated by the member was that the Schedule covers services provided by an employee during the course of employment and that wasn't the scenario in case of notice pay as the employer was the service provider. Whereas the other member was of the view that it was not subject to GST and had a reasoning similar to that provided in Syngenta case. However, do note that Madhya Pradesh Appellate AAR had held that GST was not applicable on notice pay recovered from employee leaving the organisation without serving the notice period.[110] Thus, it is evident that there is still no conformity in advance ruling issued by different state Appellate AAR.

Thus, it is essential that CBIC comes up with clarification as early as possible to avoid contrary stands taken by GST officers at various jurisdictions.

“ Notice pay is not a consideration for any activity of employer. ”

[107] GE T&D India Ltd v. Deputy Commr of Central Excise, LTU, Chennai, 2020-VIL-39-MAD-ST.
[108] In re: Emcure Pharmaceuticals Ltd., 2022 (1) TMI 186 AAR- Maharashtra.
[109] In Re: M/S. Amneal Pharmaceuticals Pvt. Ltd., 2022 (3) TMI 1143 - AAAR, GUJARAT.
[110] In Re M/s. Bharat Oman Refineries Limited, MP AAAR dated November 08, 2021.

Manpower supply or job-worker service to be determined on the basis of contractual arrangement

In the case of ***Adiraj Manpower Services (P.) Ltd***[111]**,** the SC held that exemption available under erstwhile service tax for job-worker services was not available where the crucial terms representing that the services were in the nature of job work were missing.

Facts

Adiraj Manpower Services P. Ltd. ("**Appellant**") was engaged in the business of providing personnel for activities such as felting, material handling, pouring and supply of material to furnace. It entered into a contract with Sigma Electric Manufacturing Corporation Pvt. Ltd. ("**Sigma**"). A Show Cause Notice was issued alleging that the Appellant has failed to discharge service tax for supply of manpower services. The same was approved by the adjudicating authority and later affirmed by CESTAT during the appeal proceedings.

Aggrieved by the same, the Appellant filed an appeal before the SC.

Issue

Whether the services provided by the Appellant were in nature of job worker and exempted under service tax.

Arguments

The Appellant argued that the definition of 'contractor' under Contract Labour (Regulation and Abolition) Act 1970 ("**CLRA Act**") was applicable to both the provider of contract labour as well as a job worker. The indemnity to Sigma for default of Appellant was provided in the contract as Sigma was construed as a principal employer for purposes of CLRA Act and may be made liable for default in payment of wages by the Appellant. It also submitted that the agreement was for job work, as a contractor, it was required to determine the number of persons to be engaged for performing the contract. It was responsible for supervising the work and had control over the service conditions. There was no supply of manpower to Sigma as the control was not shifted to Sigma. It also urged that the invoice was based on work done on rate per piece. Therefore, as the service charge was basis the quantity of work done and not on the number of employees, it was job work. It also relied on the CESTAT decisions in the cases of *Om Enterprises v. Commissioner of Central Excise, Pune-I, Bhagyashree Enterprises v. Commissioner, Dhanashree Enterprises v. Commissioner & S. Balasubramani v. Commissioner*[112], wherein it was held that when a contractor carried out work and charged the principal employer on rate per piece, the nature of work was job work and not manpower supply.

The Respondent, on the other hand, objected on the ground that the exemption on job-work service was available if it was such an arrangement and the duty was paid on the final product by the principal manufacturer (which includes cost of job work). It contended that the agreement with Sigma was for manpower supply. The agreement fails to provide details or specifications pertaining to the work which was to be performed or the product to be manufactured, and the delivery schedules. Thus, the main elements of job work were missing.

Judgment

The SC observed the terms of the agreement which provided that the contractor (i.e. Appellant) was responsible for selecting the personnel for undertaking work, who would be under supervision and administration of a contractor, who in turn would be responsible for wages of its employee. The equipment, if required, would be provided by the contractor. The contract provided that contractor had to provide felting, material handling, pouring and supply of material to furnace at the factory of Sigma per kg of metal.

However, it was of the view that agreement failed to provide:

a) Details or nature of the process of work to be undertaken;

b) provisions for maintaining the quality of work; facilities and infrastructure to be utilised;

c) delivery timeline;

d) consequences for breach of the contractual obligation.

Thus, it was of the view that the contract was pure and simple having the provision of contract labour. The CESTAT decisions relied by the Appellant were fact specific and dependent on contracts under question in those decisions. Thus, it held that the exemption was not applicable as it was not job-work services.

111 Adiraj Manpower Services Pvt. Ltd. v. Commissioner of Central Excise Pune – II, 2022 (2) TMI 858 SC.

112 Om Enterprises v. Commissioner of Central Excise, Pune-I, 2018 (17) G.S.T.L. 260; Bhagyashree Enterprises v. Commissioner 2017 (3) G.S.T.L.515, Dhanashree Enterprises v. Commissioner 2017 (7) TMI 762., & S. Balasubramani v. Commissioner 2019 SCC OnLine CESTAT 480.

Significant Takeaway

The aforementioned decision provides guidelines for must-have contractual arrangement clauses in order for a supply to qualify as job work as ratified by the Apex court.

While the exemption is unavailable under GST legislation, the judgment would continue to be relevant as the concept of job work is still present. Another aspect that can be seen from the decision is that while the services to be performed by the contractor were mentioned, the SC was of the view that details were missing as the contractor was dealing in metallurgy where the raw materials were different forms of the same metal. Even as the process was continuously being carried at premisses of principal manufacturer, the requirement of delivery timeline may not be relevant.

Thus, before adopting a new business venture, it is necessary that a proper analysis is undertaken to meet the tests laid down by the SC as to whether the proposed arrangement shall be regarded as job work or not and only then, exemption from GST should be availed.

> **“Provisions for maintaining the quality of work; facilities and infrastructure to be utilised are necessary for differentiating job work with manpower supply.”**

REGULATORY DIRECT TAX UPDATES

Amendments to the Finance Bill, 2022

The Finance Bill, 2022 was presented in the Lok Sabha on February 1, 2022. Through the Notice of Amendments dated March 23, 2022 ("**Notice**"), the Finance Minister proposed 39 amendments to the Finance Bill, 2022. The amended Bill was passed on March 25, 2022. Subsequently, on March 30, 2022, through Presidential assent, the Finance Bill, 2022 was enacted into the Finance Act, 2022 ("**FA 2022**"). Some of the key amendments proposed through the Notice are provided here:

- The Notice proposed an amendment to the definition of 'books of account' in section 2(12A) of the IT Act. Through the amendment, digital books records have been recognized as valid books of accounts. Earlier, the provision recognised only written forms or print-outs stored in electronic forms as 'books of accounts'.

- The Notice proposed an amendment to section 10(4D) of the IT Act to extend the exemption from capital gains tax accruing to non-resident relating to specified investments who become residents in the future. The provision exempted the capital gains income of registered Cat-III AIFs made on the recognised stock exchange in IFSC, provided all the units in the Cat-III AIFs are held by non-residents. After the proposed amendment, the exemption would continue even if the said non-resident unitholders become resident in the future, so long as the shareholding does not exceed 5%.

- Section 10(46) of the IT Act provides certain exemptions to certain trusts/institution set up by Central/State Governments for the purposes of general public welfare, provided appropriate notification has been made by Central Government. As per the Notice, the approval granted to any charitable Trusts/institutions granted approval under section 10(23C) shall stand inoperative if the Central Government notifies the Trust/ institution under section 10(46).

- The Notice proposed an amendment to section 56(2)(x) of the IT Act such that the exception granted to funds received by charitable trusts from being taxed as 'income from other sources' shall not be extended to funds received by restricted persons referred to in section 13(3) i.e., the author of trusts is held to have utilised the funds received for personal benefit, then section 56(2)(x) would also be applicable.

- The Finance Bill 2022 proposed the insertion of section 115 BBH to the IT Act. This provision shall tax income on the transfer of crypto currencies at the rate of 30%. However, the Finance Bill 2022 did not define the term 'transfer' for the purposes of this provision. The Notice inserted a sub-section to section 115 BBH clarifying that the definition of 'transfer' as provided within section 2(47) shall be applicable to section 115 BBH as well, irrespective of the virtual digital asset being classified as capital asset or not.

- The Finance Bill, 2022 proposed the insertion of clause (8A) to section 139 to enable taxpayers to file a belated return of income in certain cases. This Notice proposed that even if the return of income had been filed on time, the taxpayer can file the updated return of income and that if such updated return of income results in addition of carry forward losses or MAT credits, then the taxpayer shall have to file updated return for all the subsequent years.

- The Notice proposed the insertion of sub-section (18) to section 155 of the IT Act requiring the assessee to *voluntarily* file an application to the AO for re-computation of income such that surcharges and cesses are disallowed. Under section 40 of the IT Act, surcharges and cesses do not qualify as allowable deductions. The amendment proposed by the Bill places the onus on the assessee to file for re-computation of income such that surcharge/cess is disallowed. If such application is not filed by the assessee, then such unallowable surcharge/cess would be considered 'under-reported' income and penalty would be levied under section 270A of the IT Act.

- Section 194S proposed to be inserted by the Finance Bill 2022 imposed TDS on the transfer of digital currency to the extent of 1% of the transaction amount. The Notice proposes the insertion of clause (4) to section 194S of the IT Act such that if a particular transactions results in TDS being charged under section 194-O (TDS on e-commerce) as well as TDS under 194-S, then TDS shall be deducted under 194-S instead of 194-O.

Extension of timelines for compliances of AY 2021 – 22

Due to the protracted effects of COVID-19, the CBDT, by Circular 1/2022 issued on January 11, 2022 ("**Circular**"), extended the timelines for various filings under the Income Tax Act, 1961 ("**IT Act**") for the Assessment Year 2021-22. Post the issuance of this Circular, the revised due dates are as follows:

i) The due date for filing audit reports under section 139(1) of the IT Act was extended to February 15, 2022. This deadline was last extended till January 15, 2022 by Circular No. 9/2021[113];

ii) The due date for filing audit reports under section 139(1) of the IT Act pertaining to international transactions or specified domestic transactions subject to transfer pricing regulations was extended to February 15, 2022;

iii) The due date for filing audit reports under section 92E of the IT Act pertaining to international transactions or specified domestic transactions subject to transfer pricing regulations was extended to February 15, 2022. This deadline was last extended till January 31, 2022 by Circular No.9 / 2021 (supra);

iv) The due date for filing Return on Income for taxpayers (including those who had to furnish an audit report under section 92E of the IT Act) under section 139 of the IT Act was extended to March 15, 2022. The deadline was earlier extended to February 15, 2022 and February 28, 2022 (for taxpayers filing audit reports under section 92E) by Circular No. 9/2021 (supra).

The Circular clarified that the extended deadlines would not apply to the penal rates of interest charged on late filing of returns under section 234A of the IT Act. Therefore, regardless of the extended deadlines, taxpayers making delayed filing of returns would be required to pay interest at the penal rate of 1% per month on the total income of the taxpayer reduced by advance taxes, Tax deducted at Source, allowable deductions and other reliefs available to the taxpayer.

The Circular also clarified that for individual Indian residents who are exempt from payment of advance tax under section 207(2) (senior citizen above the age of 60 years who do not earn income in the nature of profits and gains from business and profession) who have filed their self-assessment under section 140A of the IT Act within the original due date (without extension), the tax paid under self-assessment shall be regarded as advance tax for the purposes of the IT Act.

CBDT extends timeline for linking Aadhaar with PAN by March 31, 2023, but with fee

Section 139AA of the IT Act mandates every person who is eligible to obtain Aadhaar number and who has been allotted a PAN to intimate his Aadhaar number to the ITA, so that Aadhaar and PAN can be linked. This has been mandated since instances had been noted by IRA wherein multiple PANs had been allotted to one person or one PAN had been allotted to more than one person. The original time allowed to link Aadhaar with PAN was March 31, 2022. In case of failure to link PAN with Aadhaar, under section 139AA(2) of the IT Act, the PAN shall become inoperative after the date so notified, pursuant to which, the consequences of non-furnishing, non-intimation and non-quoting of PAN shall follow. The PAN can be made operative again upon intimation of Aadhaar after payment of a fee prescribed under section 234H of the IT Act.

Recently, by way of CBDT Notification[114], the timeline for linking PAN with Aadhaar has been extended from March 31, 2022 to March 31, 2023, without facing the consequences of non-operative PAN. Thus, till March 31, 2023, even in case of non-linking of Aadhaar, the PAN will continue to be functional for the procedures under the IT Act, like furnishing of return of income, processing of refunds, etc.

However, if PAN-Aadhar linking is done beyond the deadline of March 31, 2022, then as per Rule 114(5A) of the IT Rules, a late fee of INR 500 until June 30, 2022 and INR 1000 thereafter would be levied.

[113] CBDT Circular No. 9/2021 dated May 20, 2021.
[114] CBDT Notification No. 17/2022/F. No. 370142/14/2022-TPL, dated 29 March 2022.

After March 31, 2023, in case of failure to intimate Aadhaar, the PAN shall become inoperative and all the consequences under the IT Act for not furnishing, intimating or quoting the PAN shall apply to such taxpayers.

The CBDT has also recently issued a Circular[115] as well as a Press Release[116] to explain the issue and the repercussions in detail.

CBDT clarifies norms for computation of capital gains on amounts received under ULIPs

The Finance Act, 2021 had, *inter alia*, removed the tax-exempt status of unit-linked insurance policies ("**ULIPs**" or "**policies**") by amending section 10(10D) of the Income Tax Act, 1961 ("**IT Act**"). The amendment made sums received under a ULIP taxable if (i) the ULIP was issued on or after February 1, 2021; and (ii) the premium payable for any FY during the term of the policy, exceeded INR 2,50,000. Further, where multiple ULIPs are held by a taxpayer, the aggregate premium for all the policies needs to be below INR 2,50,000, in any FY, to enjoy the tax-exempt status. Similarly, clause (1B) was inserted under section 45 to make any profit or gains received under such non-exempt ULIPs, chargeable under the head 'capital gains'. In exercise of its power, the CBDT has recently issued certain guidelines to clarify norms for computation of capital gains on amounts received under ULIPs and to clarify the availability of exemption under section 10(10D) of the IT Act.

The CBDT *vide* circular dated January 19, 2022,[117] issued guidelines under the following situations –

i) where no sum is received by the taxpayer from ULIPs in any previous year, preceding the current previous year or where sum is received but the same has not been claimed as tax-exempt; and

ii) where sum is received in any previous year, preceding the current previous year, and the same has been claimed as tax-exempt ("**Old ULIPs**").

The guidelines regarding availability of exemption under section 10(10D) under both situations, can be summarised as below:

Situation (i):

Number of policies for which consideration was received in the relevant FY	Premium payable individually for all such policy/ policies during the relevant FY exceeds INR 2,50,000	Aggregate premium payable for all policies, in the relevant FY exceeds INR 2,50,000	Exemption available under section 10(10D)
One	No	NA	Yes
One	Yes	NA	No
Multiple	No	No	Yes
Multiple	No	Yes	Yes, but only for those ULIPs, for which the aggregate premium payable does not exceed INR 2,50,000
Multiple	Yes	Yes	No

Situation (ii):

Number of policies for which consideration was received in the relevant FY	Aggregate premium payable with respect to such policy/policies and Old ULIPs, in the relevant FY exceeds INR 2,50,000	Exemption available under section 10(10D)
One	No	Yes
One	Yes	No
Multiple	No	Yes
Multiple	Yes	Yes, but only for those ULIPs (including Old ULIPs), for which the aggregate premium payable does not exceed INR 2,50,000

115 CBDT Circular No. 7 of 2022 dated March 30, 2022.

116 CBDT Press Release dated March 30, 2022 available at https://www.incometaxindia.gov.in/Lists/Press%20Releases/Attachments/1065/Press-Release-Amendment-to-the-provisions-of-IT-Rules-1962-for-prescribing-fees-un-234H-of-IT-Act-1961-dated-30-03-2022.pdf.

117 CBDT Circular No. 2/2022, dated January 19, 2022.

The CBDT has further notified the Income tax (2nd Amendment) Rules, 2022 to amend the IT Rules.[118] Rule 8AD has been inserted to the IT Rules which prescribes the manner for computation of capital gains under section 45(1B) of the IT Act. According to Rule 8AD:

i) Where sum has been received under a taxable ULIP for the **first time**, the total premium paid till the date of receipt of the amount received for the first time should be deducted from the amount received for the first time (including amount allocated by way of bonus) to arrive at the capital gain amount;

ii) For **any subsequent sum** received under a taxable ULIP, the total premium paid after the receipt of amount under (i) above should be deducted from the amount received after the receipt of amount under (i) above (including amount allocated by way of bonus) to arrive at the capital gain amount.

Thus, once the return on capital gain is filed, then only fresh income received and fresh premium paid subsequently, after the computation will be considered for the next capital gain calculation. Rule 8AD further clarifies that capital gains computed under Rule 8AD would be deemed to be capital gains arising from the transfer of a unit of an equity-oriented fund set up under a scheme of an insurance company comprising ULIPs.

CBDT notifies Faceless Inquiry or Valuation Scheme, 2022

The CBDT, *vide* its Notification dated March 30, 2022[119], has notified the 'Faceless Inquiry or Valuation Scheme, 2022.'

In keeping with its resolve to make the various assessment or other proceedings under the IT Act faceless, the CBDT increased the scope of faceless proceedings by bringing in certain amendments *vide* the Taxation and Other Laws (Relaxation and Amendment of Certain Provisions) Act, 2020 ("**Amendment Act 2020**"), which received the assent of the President and got enacted as a law on September 29, 2020. Vide the Amendment Act, 2020, a new section 142B was inserted in the IT Act w.e.f. November 1, 2020 to enable the Central Government to notify a scheme so that the IRA may carry on the following proceedings under the IT Act in a faceless manner:

- **Issuance of notice under section 142(1) of IT Act or making inquiry before assessment under section 142(2) of IT Act**: Said provision empowers the IRA to issue a notice to an assessee where a return of income has not been filed within the specified time period or where additional details or information is required by the AO.
- **Directing assessee to get his accounts audited under section 142(2A) of IT Act**: Said provision empowers the AO to refer the accounts of an assessee for special audit for a detailed scrutiny.
- **Estimation of the value of any asset, property or investment by a Valuation Officer under section 142A of the Act**: To enable the AO to make a reference to a Valuation Officer for estimation of the value of any asset, property or investment of the assessee and use such valuation report during the course of assessment proceedings in case of an assessee.

By virtue of powers conferred on the CBDT *vide* aforesaid section 142B of IT Act, the CBDT *vide* the aforesaid Notification dated March 30, 2022 has finally notified the 'Faceless Inquiry or Valuation Scheme, 2022' to provide that the aforesaid proceedings under section 142(1), 142(2), 142(2A) or 142A of IT Act shall be conducted in a faceless manner through automated allocation. Automated allocation of cases implies that there would be elimination of human interface between the assessee and the concerned AO from the IRA and instead the relevant proceedings for any assessee as referred to above would be assigned to one of the tax officers throughout the country randomly using automated algorithms with the help of technological tools in a computerised manner, thereby ensuring anonymity.

[118] Notification No. 8/2022, dated January 18, 2022.
[119] Notification No. 19/2022/F. No. 370142/15/2022-TPL dated March 30, 2022.

REGULATORY INDIRECT TAX UPDATES

E-invoicing under the GST Legislation

Notification No. 13/2020-Central Tax dated March 21, 2020, read with Notification No. 01/2022- Central Tax dated February 24, 2022, provides that a registered person having aggregate turnover exceeding INR 20 crore in any preceding financial year from 2017-2018 onwards shall issue an e-invoice w.e.f. April 01, 2022 for 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 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.

Amendment to FTP and HBP

Notification No. 64/2015-2020, dated March 31, 2022, Notification No. 66/2015-2020, dated April 01, 2022, and Public Notice 53/2015-2020, dated March 31, 2022, notified the following major amendments to the FTP and HBP:

a) To ensure policy continuity, the current FTP and HBP, has been extended till March 31, 2022;

b) Exemption from payment of IGST and Compensation Cess on imports made under Advance Authorisations / EPCG Scheme and by EOUs, etc., has been extended up to June 30, 2022;

c) Status Certificates issued under this FTP shall be valid for a period of five years from the date on which application for recognition was filed or June 30, 2022, whichever is later;

d) Norm ratified for purpose of advance authorisation shall be valid till September 30, 2022.

Extension in last date for applying for scrips

Vide Notification No. 58/2015-2020, dated March 07, 2022, the last date for submitting applications has been extended as follows:

MEIS (for exports made in the period - 01.04.2020 to 31.12.2020). Further the maximum limit of INR 500 crore on disbursement has been removed.	April 30, 2022
2% additional ad hoc incentive (only for exports made in the period 01.01.2020 to 31.03.2020)	April 30, 2022
ROSCTL (for exports made in the period 07.03.2019 to 31.12.2020)	March 15, 2022
ROSL (for exports made upto 06.03.2019 for which claims have not yet been disbursed under scrip mechanism)	March 15, 2022

Electronic Cash Ledger under Customs

Vide Notification dated March 30, 2022, the Government has enforced chapter pertaining to electronic cash ledger w.e.f. June 01, 2022.

In this regard, *vide* Notification No. 20/2022-Customs (N.T.) dated March 30, 2022, the CBIC has notified Customs (Electronic Cash Ledger) Regulations, 2022, detailing the procedure of maintaining the cash ledger, manner of making payments, and claiming of refund.

The CBIC has further *vide* Notification No. 20/2022-Customs (N.T.) dated March 30, 2022, exempted the deposit of cash in electronic cash ledger in respect of following:

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

b) accompanied baggage.

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
DDT	Dividend Distribution Tax
DIT	Learned Director of Income Tax

GLOSSARY

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

GLOSSARY

ABBREVIATION	MEANING
MoU	Memorandum of Understanding
MRP	Maximum Retail Price
NAA	National Anti-profiteering Authority
NCLT	National Company Law Tribunal
OECD	Organisation for Economic Co-operation and Development
PAN	Permanent Account Number
PCIT	Learned Principal Commissioner of Income Tax
PE	Permanent Establishment
Pvt.	Private
PY	Previous Year
R&D	Research and Development
RBI	Reserve Bank of India
SC	Hon'ble Supreme Court
SEBI	Security Exchange Board of India
SEZ	Special Economic Zone
SGST	State Goods and Services Tax
SGST Act	State Goods and Services Tax Act, 2017
SLP	Special Leave Petition
ST Rules	Service Tax Rules, 1994
TCS	Tax Collected at Source
TDS	Tax Deducted at Source
TPO	Transfer Pricing Officer
TRC	Tax Residency Certificate
UK	United Kingdom
USA	United States of America
UTGST	Union Territory Goods and Services Tax
UTGST Act	Union Territory Goods and Services Tax Act, 2017
VAT	Value Added Tax
VAT Tribunal	Hon'ble VAT Tribunal

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ahead of the curve

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