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tax scout

Tax Scout | July – September, 2022

Main Stories

Dear Readers,

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

In our main story, we have dealt with the challenges arising from the CBDT guidelines issued on the scope of section 194R of the IT Act. In addition to the above story, we have also dealt with other important developments and judicial precedents in the field of taxation for this quarter.

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

Regards,
CYRIL SHROFF

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Index

Index

Challenges Arising from CBDT Guidelines on Section 194R

1. Introduction

A new section 194R, introduced through FA 2022, requires any person responsible for providing any benefit or perquisite to a resident, whether convertible into money or not, arising from their business or the exercise of their profession, to deduct TDS before providing such benefit or perquisite. Sub-sections (2) and (3) of section 194R allow the CBDT to issue guidelines, with prior approval, to remove any difficulties arising while giving effect to the provisions of section 194R. After such guidelines are issued, they need to be laid before each House of the Parliament.

Due to the ambiguous language of the said provision and the practical difficulties with respect to its implementation, several representations were made before the CBDT, soon after the introduction of the Finance Bill, 2022. In response to such representations, the CBDT issued a set of guidelines on June 16, 2022, *vide* Circular No. 12 of 2022[1] ("**Initial Guidelines**") to clarify the scope of the newly inserted section 194R. The Initial Guidelines only resulted in increased confusion regarding the applicability of section 194R. Hence, further representations were made before the CBDT. In response, the CBDT issued additional guidelines under the said provision, *vide* Circular No. 18 of 2022[2] ("**Additional Guidelines**", together with the Initial Guidelines, the "**194R Guidelines**").

However, the 194R Guidelines have created further confusion in the minds of taxpayers by purportedly traversing beyond the scope of the plain language of the provision itself. In this article, we discuss the scope of section 194R, the 194R Guidelines, and the practical challenges arising in the implementation of the said provision.

2. Overview of Section 194R

Section 194R of the IT Act was inserted *vide* FA, 2022, with the intention to broaden the tax base in a way that benefits or perquisites arising to a taxpayer from the exercise of business or profession, that are taxable under section 28(iv), are properly reported. The intent behind the insertion of the provision was elaborated under the memorandum explaining the provisions of Finance Bill, 2022, which provided:

> *"As per clause (iv) of section 28 of the Act, the value of any benefit or perquisite, whether convertible into money or not, arising from business or exercise of profession is to be charged as business income in the hands of the recipient of such benefit or perquisite.* ***<u>However, in many cases, such recipient does not report the receipt of benefits in their return of income, leading to furnishing of incorrect particulars of income</u>.***
>
> *Accordingly, in order to widen and deepen the tax base, it is proposed to insert a new section 194R to the Act."*

Similarly, during her Budget speech, the Hon'ble Finance Minister highlighted:

> *"It has been noticed that as a business promotion strategy, there is a tendency on businesses to pass on benefits to their agents.* ***<u>Such benefits are taxable in the hands of the agents. In order to track such transactions, I propose to provide for tax deduction by the person giving benefits</u>****, if the aggregate value of such benefits exceeds INR 20,000 during the financial year."*

1 https://www.incometaxindia.gov.in/communications/circular/circular-no-12-2022.pdf.
2 https://www.incometaxindia.gov.in/communications/circular/circular-no-18-2022.pdf.

Thus, section 194R was introduced to track benefits or perquisites chargeable to tax under section 28(iv) of the IT Act, which may or may not have been offered to tax by the taxpayers in their return of income or disclosed in their books of accounts. However, the provider of such benefits/ perquisites generally claims such payments as business expenditure in their return of income. Thus, an obligation has been created on the provider of such benefits/ perquisites to ensure that tax is withheld while providing such benefits/ perquisites. This would ensure that such transactions are properly reported by the providers and thus, tax due on such benefits/ perquisites can also be collected from the recipients.

2.1. What is covered under section 194R?

Section 194R provides as follows:

*(1) Any <u>person responsible for providing</u> to a resident, **any benefit or perquisite, whether convertible into money or not, arising from business or the exercise of a profession**, by such resident, shall, before providing such benefit or perquisite, as the case may be, to such resident, <u>ensure that tax has been deducted</u> in respect of such benefit or perquisite at the rate of ten per cent of the value or aggregate of value of such benefit or perquisite.*

[...]

The following illustration gives an overview of the provisions of section 194R –

- **<u>Applicability</u>**: July 1, 2022
- **<u>Nature of payments</u>**: Any benefit or perquisite, whether convertible into money or not, arising from business or the exercise of a profession of the recipient
- **Time of deducting TDS**: Before providing the aforementioned benefit/ perquisite
- **<u>Rate of TDS</u>**: 10% of the value/ aggregate value of the benefit/ perquisite.
- **<u>Threshold limit</u>**: Value of benefit/ perquisite provided should exceed INR 20,000 during the relevant FY
- **<u>Status of deductee</u>**: Resident
- **<u>Status of deductor</u>**: Any person (resident or non-resident) providing any benefit/ perquisite to a resident
- **<u>Exempt deductors</u>**: Individuals or HUF whose total sales, gross receipts or turnover does not exceed INR 10 million in case of business or INR 5 million in case of profession.

Broadly, section 194R may be attracted if the following conditions are satisfied:

- Benefit/perqusuite recipient is a tax resident of India • AND
- Such recipient is not an employee of the provider • AND
- Such recipient is engaged in any business or profession • AND
- The benefit/ perquisite arises form the recipient's business or profession.

If any of the aforementioned conditions are not satisfied, then section 194R will not be attracted.

2.2. How to determine the threshold limit?

The second proviso to section 194R provides that the provisions of this section shall not apply where the value or aggregate of value of the benefit or perquisite provided or likely to be provided to the deductee during the FY does not exceed INR 20,000. Further, the Initial Guidelines clarified that since the threshold limit is to be calculated under a particular FY, therefore, for FY 2022-23, the threshold will be calculated from April 1, 2022. However, since the provision comes into effect on July 1, 2022, the TDS obligation under the said provision will only be attracted after the effective date of the provision. This can be better understood through the following illustrations:

Illustration 1 X provides benefits/ perquisites worth INR 50,000 to Y on June 24, 2022.

- <u>Applicability of 194R</u>: No TDS deductible under section 194R since benefit/ perquisite is provided before July 1, 2022.

Illustration 2 X provides benefits/ perquisites worth INR 15,000 to Y on July 15, 2022.

- <u>Applicability of 194R</u>: No TDS deductible under section 194R since value of benefit/ perquisite is less than threshold limit.

Illustration 3 X provides benefits/ perquisites worth INR 25,000 to Y on August 3, 2022.

- <u>Applicability of 194R</u>: TDS of INR 2,500 will be deductible under section 194R.

Illustration 4 X provides benefits/ perquisites worth INR 50,000 to Y on May 7, 2022 and worth INR 5,000 on August 20, 2022.

- Applicability of 194R: No TDS deductible under section 194R since benefit/ perquisite is provided before July 1, 2022.

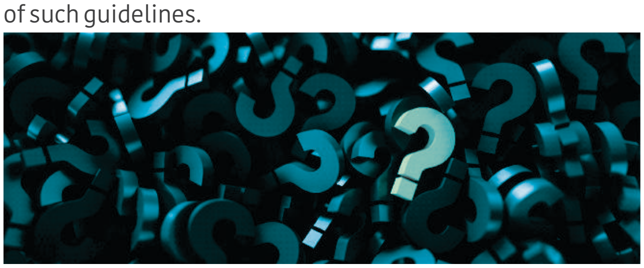
Illustration 5 X receives benefits/ perquisites worth INR 10,000 from A; worth INR 20,000 from B and worth INR 35,000 from C on August 7, 2022.

- Applicability of 194R: TDS of INR 3,500 will be deductible under section 194R for the benefit/ perquisite provided by C.

In the aforementioned illustrations, it is assumed that the cash component of the benefit/perquisite being provided is sufficient to meet the TDS obligation under section 194R.

3. Issues in Application of the Provision

As can be seen, the plain language of section 194R is broad, and does not provide much clarity on the ambit of its application. Recognising several hurdles in the practical implementation of the provision, taxpayers have made several representations to CBDT, after the introduction of the said provision vide the Finance Bill, 2022. In response, 194R Guidelines were issued to help ease the ambiguity in implementing section 194R, which were raised under such representations. However, instead of resolving the issues, these Guidelines have created more questions and challenges, including the legitimacy and the binding nature of such guidelines.



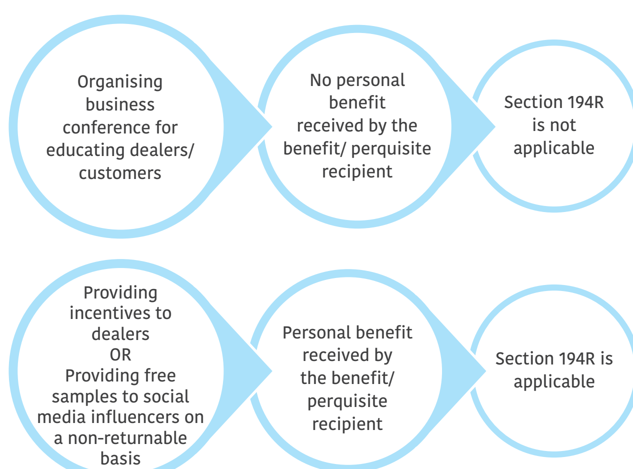
3.1. What is benefit or perquisite?

The words 'benefit' or 'perquisite' have not been defined under section 194R. It was hoped that reference may be drawn from jurisprudence under section 28(iv) of the IT Act, which similar to section 194R provides that the 'value of any benefit or perquisite, whether convertible into money or not, arising from business or the exercise of a profession', will be chargeable to tax under the head "profits and gains of business or profession". Further, as discussed above, the memorandum explaining the provisions of Finance Bill, 2022, as well as the Budget speech of the Hon'ble Finance Minister made a (direct or indirect) reference to taxability of benefit/ perquisite under section 28(iv).

However, 194R Guidelines have clarified that there is no need to determine taxability in the hands of the recipient for its application. Further, it has been specifically mentioned that the plain language of the provision does not make any reference to section 28(iv) and thus, benefit/ perquisite could be taxable under any other chargeable provision. Thus, 194R Guidelines have enlarged the scope of the said provision beyond the intent highlighted during the introduction of the said provision.

It is a generally accepted principle of interpretation of statutes that where words of everyday use occur in a taxing statute, they must be construed not in their scientific or technical sense but as understood in common parlance, i.e., in their popular sense. The common parlance of a word can be understood by looking at its dictionary meaning. The Oxford Dictionary of English and the Black's Law Dictionary define 'benefit' as, *inter alia*, an advantage, privilege, profit or gain. The word 'perquisite' has been defined as 'a privilege or benefit given in addition to one's salary or regular wages'. Since, this definition is sufficiently broad, it may be difficult for deductors to deny the application of section 194R simply because an asset/ payment may not fall under the definition of 'benefit' or 'perquisite'. Further, the 194R Guidelines have clarified that it is not necessary for taxpayers to undertake any analysis with respect to taxability of the benefit/ perquisite being provided before discharging TDS obligations under 194R.

The 194R Guidelines, however, have made a distinction between where *bonafide* business expense is incurred and where any (direct or indirect) personal benefit is provided to the benefit/ perquisite recipient. While the latter attracts section 194R, the former may not create any obligation under the said provision. This can be understood from the following illustrations given by the 194R Guidelines:



3.2. *What is meant by 'arising from business/ profession'?*

As per the plain language of section 194R, it is attracted only when a benefit/ perquisite is provided due to (i) exercise of a profession; or (ii) is arising from business, of the recipient. Thus, if the benefit/ perquisite has no connection or only a remote connection with the business or profession of the recipient, then it should not attract section 194R. Further, there should also be a business relationship between the benefit/ perquisite provider and the recipient. In the absence of such relationship, the benefit/ perquisite cannot be said to be 'arising' from the exercise of profession or business of the recipient.

Under section 28(iv), it has been clarified that where the receipt of any gift was connected to the business/ profession of a taxpayer, the same was taxable as benefit/ perquisite in the hands of such taxpayer. For instance, where the taxpayer performed brand endorsement activities for the benefit of the perquisite provider, any benefit or perquisite provided to the taxpayer was liable to be taxed as a gift.[3] However, where a taxpayer merely attended an event organised by the client and no services were rendered, the same was held to be not taxable.[4] A few more illustrations have been given below:

Benefit/ Perquisite Provided*	Whether Arising from Business or Profession?	Applicability of 194R
Greeting cards/ gifts to customers on Diwali, Christmas, etc.	It can be difficult to establish nexus with the customers' business or profession. Also, the customer may not be a business entity and hence, this may not be relevant.	Should not be applicable
Greeting cards/ gifts to independent consultants on Diwali, Christmas, etc.	Directly related to the business/ profession of the recipient	Should ordinarily get covered under section 194J of the IT Act. If no TDS is deducted under 194J, then 194R may become applicable.
Greeting cards/ gifts to employees on Diwali, Christmas, etc.	May be separately taxable under the head 'salaries'	Should not be applicable. TDS may be deductible under section 192 of the IT Act
Free samples given to customers by a retailer	It can be difficult to establish nexus with the customers' business or profession. Also, the customer may not be a business entity and hence, this may not be relevant.	Should not be applicable.
Free samples given to retailers by a distributor	Directly related to the business/ profession of the retailers.	May be applicable (provided TDS is not deductible under any other provision of the IT Act).
Writing off bad debts of a customer	It can be contended that the customer has not been able to recover money and hence, is being forced to write off the debt in its books and the objective is not to grant any benefit or amenity.	Should not be applicable.
Writing off bad debts of a distributor by a manufacturer	Same as above	Should not be applicable.
Transport services provided to industry expert for organising an unpaid conference for the company's employees	Directly related to the business/ profession of the recipient	Should not be applicable since no benefit has accrued to the industry expert.

3 *See* Priyanka Chopra v. DCIT, [2018] 89 taxmann.com 286/287 (Mumbai Trib.).
4 *See* ACIT, Mumbai v. Shahrukh Khan, [2017] 84 taxmann.com 209 (Mumbai Trib.).

3.3. How to determine the value of the benefit or perquisite?

Section 194R is silent on valuation norms for determining TDS liability under the said provision. The Initial Guidelines clarified that the value on which TDS is to be deducted will be the FMV of the product, unless:

i) The benefit/ perquisite provider has purchased the benefit/ perquisite prior to providing the same. In such case, the value will be the purchase price.

ii) The benefit/ perquisite provider manufactures such items itself. In such case, it will be the price that it charges its customers for such benefit/ perquisite.

Further, GST will not be included for the purposes of valuation.

3.4. Inclusion of Reimbursement of Out of Pocket Expenses ("OPEs")

194R Guidelines have clarified that reimbursement of OPEs are covered under the ambit of section 194R by clarifying that 'any expenditure which is the liability of a person carrying out business or profession, if met by the other person is in effect benefit/ perquisite provided by the second person to the first person in the course of business/ profession'. The Initial Guidelines stated that if the invoice for the OPEs is obtained under the name of the benefit/ perquisite provider, then it will not attract section 194R. However, if the invoice is obtained in the name of the recipient, it will attract section 194R.

The Additional Guidelines have further clarified that if ITC is available to the benefit/ perquisite provider, even if the invoice is in the name of the recipient, then it will not attract section 194R. In such cases, the benefit/ perquisite recipient should qualify as a "pure agent" under the GST Valuation Rules, 2017, and the requisite benefit/ perquisite shall be deemed not to have been provided. However, it may be noted that in order to claim ITC, GST provisions require the name of the provider to be mentioned on the invoice.

Further, the Additional Guidelines have also clarified that if TDS on OPEs has already been deducted under any other provision of the IT Act (such as sections 194C or 194J in light of Circular No. 715 dated August 8, 1995),[5] then section 194R will not be attracted. Thus, where the OPEs are already included as part of the professional fee of the recipient, on which TDS is deductible under the IT Act, section 194R is not attracted.

3.5. Inclusion of Waiver of loans

The Initial Guidelines provided that waiver of principal amount/ interest on loans advanced would be subject to TDS under section 194R. This had raised concerns among banks and financial institutions since it posed a significant practical challenge for them. The Additional Guidelines have now exempted banks and financial institutions from discharging TDS liability under the said provision. However, loans given by other corporate bodies and other institutions in the course of business, such as inter-corporate loans, loans given to professionals/ consultants, etc., will get covered under the said provision. Similarly, waiver of any credits given to dealers are also likely to be included. This interpretation adopted by 194R Guidelines may pose a cash-flow problem for both the provider as well as the recipient and may result in hardships even in cases where commercial exigencies require reprieve to be provided for outstanding loans.

In this respect, it is a settled position of law that 'any benefit or perquisite, whether convertible into money or not, arising from business or the exercise of a profession' under section 28(iv) does not include payments received wholly in cash and thus, does not include waivers of loans.[6] However, 194R Guidelines have interpreted section 194R to include payments made wholly in cash and its scope to traverse beyond just targeting income taxable under section 28(iv). Thus, any guidance sought from jurisprudence under section 28(iv) may not have significant bearing. In a few cases, it has been held that where the busines of the taxpayer was not to take loans, it could not be said to arise from business or profession.[7] However, this is not an absolute position but subject to a detailed factual analysis.[8] Further, loans taken for business purposes have a nexus with the business of taxpayers and any subsequent waivers may also have a similar nexus. Thus, this may prove to be a litigious issue in the future.

3.6. Whether the benefit/ perquisite provider can be deemed to be an assessee in default?

Section 201(1) of the IT Act, *inter alia*, provides that any person who is required to deduct any sum under the IT Act, fails to deduct such sum, then such person is deemed to be an Assessee in default in respect of such tax. Section 194(1) obligates a person to ensure that tax has been deducted but does not necessarily create an obligation to deduct tax. Thus, a question may arise on whether section 201 has any application on failure to deduct tax under section 194R. A parallel may be drawn from the proviso to section 194B(1), which uses similar language:

> *Provided that in a case where the winnings are wholly in kind or partly in cash and partly in kind but the part in cash is not sufficient to meet the liability of deduction*

[5] FAQ 30 of Circular No. 715 dated August 8, 1995 clarified that reimbursements need to be included in the invoice value while deducting TDS under sections 194C and 194J.

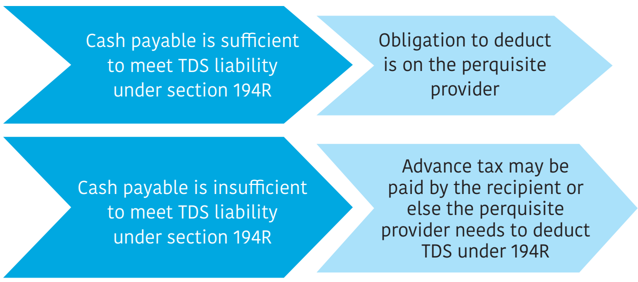
[6] *See* e.g., CIT v. Mahindra & Mahindra Ltd. [2018] 93 taxmann.com 32 (SC).

[7] *See* e.g., CIT v. Chetan Chemicals [2004] 139 taxman 301 (Gujarat); Jai Pal Gaba v. ITO [2019] 108 taxmann.com 494 (Chd).

[8] *See* e.g., Solid Containers v. Dy. CIT [2009] 178 Taxman 192 (Bom.).

*of tax in respect of whole of the winnings, the person responsible for paying shall, before releasing the winnings, **__ensure that tax has been paid__** in respect of the winnings.*

The Karnataka HC in ***CIT v. Hindustan Lever Ltd.,***[9] interpreted this proviso to not cast any duty/ responsibility to deduct TDS on the person responsible for paying lottery winning wholly in kind. Thus, on failure to ensure that tax had been paid before releasing the winnings, no proceedings could be initiated under section 201. However, penalty proceedings could be initiated under section 271C/ 276B.[10] Thus, it may be argued that section 201 should similarly not apply to defaults under section 194R. While this argument may have some merit, the language of section 194R states that the provider needs to ensure that tax has been __deducted__ and not 'paid' in contradistinction to the proviso to section 194B. Further, 194R Guidelines have clarified that responsibility to deduct under the provision arises as follows:



Further, Form 26Q has been amended[11] to provide for reporting of bank challan details when any advance tax is paid instead of deduction of TDS. Thus, the scheme of the amended Form 26Q and clarifications given under 194R Guidelines suggest that the provision creates an obligation to deduct TDS on the provider. Thus, it is likely that proceedings may be initiated under section 201 on failure to deduct TDS under the provision. Further, the Additional Guidelines have also stated that non-compliance with 194R may result in the benefit/ perquisite provider being treated as an Assessee in default under section 201 of the IT Act with all other consequences.

4. Legal Challenges Associated with the 194R Guidelines

The 194R Guidelines, being a subordinate legislation, cannot be inconsistent with or expand the scope of the primary legislation, i.e., the IT Act. Section 194R(2) empowers the CBDT to issue guidelines for removal of any difficulties in giving effect to the provisions of section 194R. The power to issue such guidelines under a 'removal of difficulty' clause is limited and cannot be exercised in contravention to the provisions of the IT Act. The guidelines need to be consistent with the scheme of the IT Act and the plain language of section 194R. Further, there should be removal of an actual difficulty and not a purported exercise of power.[12]

Based on the above discussions, 194R Guidelines could be potentially challenged on various grounds before the courts/ tribunals such as:

i) 194R Guidelines seek to interpret the law and expand the scope of what constitutes 'benefit' or 'perquisite', at times in direct conflict with prevailing jurisprudence.

ii) 194R Guidelines ignores the plain language of section 194R by interpreting payments made wholly in cash to be included within the ambit of section 194R.

iii) 194R Guidelines are inconsistent with the scheme of the IT Act under which taxability is typically *sine qua* non for attraction of machinery provisions such as TDS provisions.

It will be interesting to see how things unfold in the coming days.

5. Conclusion

Section 194R was introduced with the intent to track transactions taxable under section 28(iv) of the IT Act. However, the ambiguous language used in the drafting of the provision, coupled with the over-reaching 194R Guidelines have raised several difficulties for taxpayers. The compliance requirements under the provision are onerous and can greatly impact ease of doing business of Indian businesses/ professionals. While it is necessary to ensure that income chargeable to tax under the IT Act does not go unreported, it is also necessary to protect the interests of taxpayers at the same time. It should be clarified that only transactions taxable under section 28(iv) would be covered under section 194R as it was the primary intent while introducing the provision. Before any clarification is issued, taxpayers must be careful of meeting their own obligations under the said provision. It would be in their interest to adopt a conservative approach and deduct TDS at the time of providing any benefits or perquisites to any third party.

[9] [2013] 39 taxmann.com 152.

[10] It is further relevant to note that these provisions specifically include failure(s) under the proviso to section 194B within their ambit. However, no amendment has been made with respect to the inclusion of section 194R.

[11] https://incometaxindia.gov.in/communications/notification/notification-67-2022.pdf.

[12] *See* e.g., Straw Products v. ITO, [1968] 68 ITR 227 (SC); Madeva Upendra Sinai v. UOI, [1975] 98 ITR 209 (SC).

CASE LAW UPDATES- DIRECT TAX

INTERNATIONAL TAX

Section 206AA cannot override the beneficial provisions of the DTAA

In the case of ***Air India Ltd.***[13]***,*** the Delhi HC has held that the provisions of section 206AA cannot override the provisions of a DTAA. Accordingly, Air India could deduct tax according to the beneficial provisions of the DTAA entered between India and the Netherlands, as opposed to the higher rate provided in section 206AA.

Facts

Air India Ltd. ("**Assessee**") took certain aircraft engines on lease from Engine Lease Finance Corporation ("**ELFC**"). ELBC is a foreign company and was a tax resident of the Netherlands, with no PE in India. ELFC did not have a PAN allotted to it in India. The Assessee took a position that the gross lease rental payable to ELFC would be taxable in India at the rate of 10% as per the IT Act, read with the India-Netherlands DTAA. Accordingly, the withholding tax was grossed up and EBFC was paid the agreed lease rental and the balance withholding tax was deposited with the Indian Government. The Assessee reported the transaction without PAN in its quarterly TDS returns.

However, the IRA claimed that since the transaction was reported without a PAN, the Assessee was required to withhold tax at the rate of 20.12% as per the provisions of section 206AA.

On appeal, the CIT(A) upheld by contending that the provisions of 206AA override the provisions of the DTAA and taxes ought to have been deducted at the higher rate of 20%. On further appeal, the ITAT reversed this decision and observed that the beneficial provisions in the DTAA would override section 206AA of the IT Act, implying that tax ought to have been withheld at 10%. Aggrieved by this decision, the IRA filed an appeal before the Delhi HC.

Issue

Whether TDS rate ought to have been withheld at the higher rate as provided under section 206AA of the IT Act, disregarding the beneficial provisions of the DTAA?

Arguments

The IRA submitted that the provisions in section 206AA are non obstante in nature and accordingly override other provisions, including section 90(2), which allows the assessee to claim the application of beneficial provisions in the DTAA.

The IRA also argued that section 206AA provides that tax must be deducted at the highest of three rates covered in its sub-section (1), i.e. (i) the highest among the rate in relevant provision of this Act; (ii) rate or rates in force; or (iii) the rate of twenty per cent will be applicable in situations covered under section 206AA. Therefore, if the rate prescribed in the DTAA is not the highest, the beneficial tax rate would not be applicable to the transaction. Accordingly, taxes shall have to be withheld at the higher rate of 20%.

On the other hand, the Assessee maintained that section 206AA has no overriding effect on beneficial provisions of the DTAA. The Assessee argued that the DTAA gets negotiated between two sovereign countries and hence, its provisions shall have a greater acceptability in comparison to a domestic tax provision.

[13] Commissioner of Income Tax, International Taxation-1 v. Air India Ltd. (ITA No. 233/2022) (Delhi).

Decision

The Delhi HC relied on the decision of *Serum Institute of India*[14], which has been referred in multiple cases, including the earlier decision of the jurisdictional HC in the case of *Danisco India*[15] wherein it was held that section 206AA does not override section 90(2) of the Act.

In *Serum Institute of India*, the ITAT had observed that section 206AA is not a charging provision but a procedural one. The SC in the *Azadi Bachao Andolan*[16] judgement had held that charging provisions, including sections 4 and 5, lie subordinate to the principle enshrined in section 90(2). In light of this, it would be incorrect to contend that while charging provisions involving ascertainment of total income lie subordinate to section 90(2) of the Act, the provisions governing tax deduction override the same. In other words, the HC observed that section 206AA of the Act cannot have an overriding effect on section 90(2) of the IT Act. Accordingly, if tax has been deducted as per beneficial provisions of the DTAA, the provisions of section 206AA cannot be invoked to insist on deduction at a higher rate.

Following the above interpretation, the Delhi HC has held that the provisions of the DTAA acquire primacy and the rate of taxation must be dictated by the provisions therein. Accordingly, the Delhi HC followed its own earlier decision and decided the issue in favour of the Assessee.

Significant Takeaways

The issue concerning the nature of section 206AA has been a subject matter of debate before different forums, and the Delhi HC judgement offers much-needed clarity on the issue. To illustrate, in the case of *Bosch Ltd*,[17] the Bangalore tribunal held that non-residents with income exceeding the taxable limit were bound to obtain and furnish PAN. On failure to do so, the payer must withhold tax at the higher of the three rates prescribed in section 206AA. On the other hand, the cases cited in the current judgement and other decisions, including rulings in the case of *Quick Flight Ltd*[18] by Ahmedabad Tribunal, and *Pricol Ltd*[19] by Chennai Tribunal, had held that section 206AA will not override the provisions of section 90(2) of the IT Act.

Interestingly, the Delhi HC in *Danisco India* also referred to the SC decisions in the case of *Eli Lily & Co.*[20] and *GE India Technology*[21], where the apex court observed that the provisions of tax withholding under section 195 are applicable only to sums chargeable to tax under the Act. Hence, procedural provision relating to deduction cannot have an overriding effect on machinery provisions of the IT Act.

“ The provisions of section 206AA do not override the provisions of section 90(2) ”

[14] DDIT v. Serum Institute of India Limited (2015) 68 SOT 254 (Pune).
[15] Danisco India (P.) Ltd. v. Union of India (2018) 90 taxmann.com 295 (Delhi).
[16] Union of India and Anr., v. Azadi Bachao Andolan and Anr (2004) 10 SCC 1 (SC).
[17] BOSCH Limited v. ITO (2013) 115 TTJ 354 (Bang).
[18] Quick Flight Ltd. v. ITO (ITA No. 1204/Ahd/2014).
[19] DCIT v. Pricol Ltd. (2014) 223 Taxman 187 (Mad).
[20] CIT v. Eli Lilly and Co. (India) P. Ltd. (2009) 312 ITR 225 (SC).
[21] GE India Technology Centre (P) Ltd. v. CIT (2010) 327 ITR 456 (SC).

Brought forward capital losses can be carried forward without set-off against capital gains exempted under the DTAA

In ***M/s J.P. Morgan India Investment Company Mauritius Ltd.,***[22] the ITAT held that the Assessee was eligible to carry forward any capital loss brought forward from previous years without setting it off against capital gains, which are exempted as per Article 13(4) of the India-Mauritius DTAA.

Facts

J.P. Morgan India Investment Company Mauritius Ltd. ("**Assessee**") was a tax resident of Mauritius and registered with SEBI as a sub-account of J.P. Morgan Indian Investment Trust Plc. For AY 2016-17, the Assessee had disclosed short term capital gain and long-term capital gain income, which were claimed as exempt from tax in India as per Article 13(4) of the India-Mauritius DTAA. In its ROI, the Assessee had also brought forward its short-term capital loss and long-term capital loss from previous AYs. These brought forward capital losses were carried forward by the Assessee in its ROI to the next year, without setting it off against the capital gains arising in the AY 2016-17, claimed as exempt under the relevant DTAA. Accordingly, the income for the AY 2016-17 was computed as nil by the Assessee.

The AO held that the Assessee should have adjusted its brought forward capital loss against its capital gain income in the present year. Further, the AO held that any loss arising from an exempt source of income cannot be allowed to be set off against income from taxable sources. Accordingly, the AO adjusted the brought forward capital losses from the previous AYs against the capital gains of current year claimed as exempt under the relevant DTAA. Therefore, the AO issued a draft assessment order under section 144C of the IT Act computing nil income, and subsequently passed the final assessment order basis such draft assessment order. Against such final assessment order passed by the AO, the Assessee filed an appeal before the CIT(A).

The CIT(A) quashed the final assessment order as being time barred on the ground that a draft assessment order was not required to be passed in the instant case since there was no variation made to the "total income" that was prejudicial to the interest of the Assessee as per section 144C of IT Act, and therefore did not adjudicate on the other grounds. The income of the Assessee remained "nil" with or without the set off of losses and, therefore, according to the CIT(A), the AO should have passed a final assessment order within the timeline prescribed under section 153 of the IT Act.

Aggrieved by the order of the CIT(A), the IRA filed an appeal before the ITAT on the validity of the draft assessment order. Cross objections were filed by the Assessee on the merits of the case, on whether such brought forward losses can be set off against income exempt under the DTAA.

Issue

Whether the Assessee was eligible to carry forward capital losses of previous AYs without setting it off against capital gains exempted under the DTAA in the present year?

Arguments

The Assessee argued that its case was covered by the decision of the ITAT in *Goldman Sachs (Mauritius)*,[23] *BlueBay Mauritius Investment Ltd.*,[24] and *Flagship India Investment Co.*[25], where brought forward capital losses were allowed to be carried forward without any adjustment or set off against capital gains that were exempt under the India-Mauritius DTAA. In the aforesaid cases, the ITAT had held that in the absence of taxable income, the capital losses brought forward from previous year(s) were allowed to be carried forward without any set off against non-taxable gains. The Assessee also argued that once the capital losses were eligible to be carried forward in the respective AYs, they cannot be challenged in this year by claiming that they pertain to an exempt source of income and hence should not have been carried forward. Further, the Assessee argued that it was up to it to decide whether it would apply the provisions of the IT Act or the DTAA in a particular year and its decision in one year to not opt for the DTAA would not preclude it from availing such benefit in the subsequent years.

Whereas the IRA relied on the decision of the Hon'ble SC in *CIT v. Manmohan Das*,[26] wherein it was held that the AO shall determine whether the losses of the previous year may be set off against the profits of that year. Additionally, the IRA also placed reliance on the Calcutta HC decision in case of *R.M. Muthiah*[27] to hold that the tax liability of an Assessee has to be calculated as per the provisions of the IT Act, and if there arises a tax liability then DTAA must be resorted for negating or reducing the tax liability. However, if there is no tax liability as per the provisions of the IT Act, the benefit of the DTAA would not be required.

22 ACIT-3(1)(1) v. M/s J.P. Morgan India Investment Company Mauritius Ltd. (I.T.A. No. 2382/Mum/2021).
23 Goldman Sachs Investments (Mauritius) Limited v. DCIT(IT) (ITA No. 2201/Mum/2017).
24 ITA no. 1369/Mumbai 2021.
25 Flagship Indian Investment Company (Mauritius) Ltd v. ADIT (IT)-3(2), Mumbai (2010) 133 TTJ 792 (Mum).
26 CIT v. Manmohan Das (1966) 59 ITR 699 (SC).
27 CIT v. R M Muthiah [1993] 67 Taxman 222/202 ITR 508.

Decision

The ITAT in its order discussed the manner of allocation of taxing rights between treaty partners under a DTAA. It observed that under DTAA, an income may not be subject to tax in India because India would have given up its taxing rights on such income and a taxpayer can claim treaty benefits and choose to be assessed under the provisions of the DTAA instead of the IT Act. The ITAT observed that under the India-Mauritius DTAA, the taxing rights of capital gains would lie with the country of residence of a taxpayer as per Article 13(4) of the DTAA and hence, the source country has given up its taxing rights. Further, section 4 and section 5 of the IT Act were subject to the provisions of section 90 of the IT Act i.e. the DTAA. Therefore, when a taxpayer claims treaty benefits, its income would be assessed as per the provisions of the DTAA alone and not as per the IT Act. Alternatively, a taxpayer may choose to be governed by the provisions under the IT Act instead of the DTAA in which case the provision for carry forward of losses would apply. Therefore, it was up to the taxpayer to examine whether the provisions of the IT Act or the DTAA would be beneficial to him.

The ITAT held that the Assessee in the present case chose to be governed by the provisions of the DTAA for AY 2016-17 and consequently, the capital gains were not offered to be taxed in India. On the other hand, the capital losses earned during the previous years were offered to tax under the IT Act instead of the DTAA and were allowed to be carried forward as per the provisions of the IT Act. The ITAT also held that the eligibility of brought forward capital losses cannot be challenged in a subsequent year, as they were already held as eligible in the year they were incurred.

The ITAT observed that section 144C of the IT Act, in the context of passing of a draft assessment order, stated that such a requirement was applicable where there was variation *"in the income or loss returned"* and not 'total income'. Therefore, in the instant case, since a variation was made to the losses which were prejudicial to the interest of the Assessee, even though the income of the Assessee remained unchanged as "nil", the AO was justified in passing a draft assessment order under section 144C of the IT Act. Therefore, the appeal filed by the IRA was allowed in this regard.

Further, the ITAT held that the income from capital gains not being taxable in India due to benefit under the India-Mauritius DTAA shall not be included in total income for determining tax liability and therefore, the question of set off of capital losses from the previous years from such income shall not arise. Hence, the ITAT held that losses brought forward from previous years would be carried forward to the subsequent years without setting off against the capital gains in question. Therefore, the cross objections filed by the Assessee were also allowed.

Significant Takeaways

The ITAT ruling in the present case reiterates the legal position laid out in its earlier rulings of *Goldman Sachs (Mauritius)(supra), BlueBay Mauritius Investment Ltd.(supra)*, and *Flagship India Investment Co (supra)*, where the respective Assessees were held eligible to carry forward capital losses without setting it off against capital gains exempt under the India-Mauritius DTAA. Similar ruling was also laid out in the context of India-Singapore DTAA in the case of *Goldman Sachs India Investments (Singapore)*,[28] where the ITAT had allowed the carrying forward of capital losses from PYs, without set off against income exempt under the DTAA. In doing so, the ITAT observed that the application of DTAA cannot be thrust upon an Assessee and a decision to not avail benefit under a DTAA in a year does not preclude an Assessee from availing the benefit in the subsequent years. The said principle was also upheld in the case of *Patni Computer Systems Ltd*,[29] where the ITAT held that every year must be understood as an independent unit under the IT Act, and it was for the Assessee to examine whether in light of its factual position, the provisions of the IT Act were more beneficial to him or that of the applicable DTAA.

Notably, section 144C of the IT act was amended by the FA, 2020, where the words "in the income or loss returned" were omitted from the provision such that now where there is any variation which is prejudicial to an eligible Assessee as per section 144C of IT Act, a draft assessment order shall need to be passed. The intent behind the amendment was to eliminate any dispute that may arise due to the interpretation of the words 'income or loss returned' by the IRA and create a more simplified and taxpayer friendly regime for assessments..

"Capital gains exempt under DTAA do not form part of total income and therefore, question of set off of brought forward losses does not arise."

[28] Goldman Sachs India Investments (Singapore) PTE Limited Vs DCIT (Mum) ITA No. 6619/Mum/2016.

[29] DCIT v. Patni Computer Systems Ltd (2008) 114 ITD 159 (Pune).

Interest on income tax refund received by a Dutch entity not taxable under India-Netherlands DTAA by incorporating the benefit of MFN clause

In the case of ***Koninklijke Philips NV,***[30] the Kolkata ITAT ruled that interest on income tax refund is not taxable in India under the provisions of India-Netherlands DTAA, after incorporating the beneficial provisions of the India-Italy DTAA through the MFN clause.

Facts

Koninklijke Philips ("**Assessee**"), the parent company of Philips Group, is a non-resident company incorporated under the laws of Netherlands and during the relevant period, did not have a PE in India. For the AYs 2008-09 to 2012-13, the Assessee was entitled to refund of income tax, including interest under section 244A(1A) of the IT Act, due to refund of excess taxes paid on additions made by the AO, confirmed by the CIT(A), and ultimately, deleted by the ITAT. While paying interest on income-tax refund, the AO deducted TDS under section 195 of the IT Act.

Aggrieved, the Assessee challenged the said order before the CIT(A). The Assessee argued that tax should not have been deducted by virtue of the MFN clause in the India-Netherlands DTAA, which restricts the scope of taxation on interest as per the provisions of Article 12 of the India-Italy DTAA. The CIT(A) observed that the application of the provisions of the India-Italy DTAA would involve treating interest on income tax refund as a debt obligation owed by the Government towards the Assessee and the importation of provisions of India-Italy DTAA to India-Netherlands DTAA would amount as a deeming provision created in the context of reading of provisions. Citing the same, the CIT(A) did not allow the benefit of MFN clause to the Assessee. Aggrieved by the order of the CIT(A), the Assessee filed an appeal before the ITAT.

Issue

Whether interest payable on income tax refund to the Assessee is taxable in India, in light of the provisions of the India-Italy DTAA, read with India-Netherlands DTAA?

Arguments

The Assessee submitted that no tax should have been deducted on interest payments by the AO since the restrictive scope of taxation on interest under Article 12 of the India-Italy DTAA should have been applied because of MFN clause under the India-Netherlands DTAA. The Assessee submitted that as per Article 11 of the India-Netherlands DTAA, refund of tax by the IRA qualifies as a "debt claim" and any interest paid for delay on such refund under section 244A being "income from debt claim" would qualify as "interest" as per Article 11(6) of the India-Netherlands DTAA.

Further, Article 11 of the India-Netherlands DTAA provides that interest income should to be taxed in India at the rate of 10 percent. However, the MFN clause included in the Protocol to the India-Netherlands DTAA provides that if subsequent to the signing of the India-Netherlands DTAA, India enters into a DTAA with another OECD member country, which contains more beneficial provisions either in terms of its scope or tax rate with respect to interest income, then the provisions of that particular DTAA will apply to the India-Netherlands DTAA. Accordingly, the Assessee submitted that India had entered into a DTAA with Italy (a member of OECD) in 1995, after signing the India-Netherlands DTAA in 1989. Accordingly, provisions under the India-Italy DTAA could be imported into the India-Netherlands DTAA to the extent that they are more beneficial to the Assessee by virtue of the MFN clause in the Protocol to the India-Netherlands DTAA.

The Assessee referred to Article 12(4) of the India-Italy DTAA, which defines interest to include "debt claim of every kind". This is similar to the definition of interest in the India-Netherlands DTAA. Hence, the interest on income tax refund is covered within the definition of interest in the India-Italy DTAA. The Assessee also relied on the decision in *Ansaldo Energio SPA v. CIT*,[31] wherein the Madras HC had held that interest on income tax refund qualifies as a "debt claim".

Further, under the India-Italy DTAA, interest received from the government of the contracting state is excluded from taxation. The Assessee submitted that in the instant case, interest had been received by the IRA on behalf of the government and hence, must be excluded due to the MFN clause contained in the India-Netherlands DTAA, which provides for the applicability of restrictive scope of taxation of interest, according to the India-Italy DTAA.

On the other hand, the IRA submitted that DTAA is specific to each country and provisions of DTAA with one county cannot be imported to another for the benefit of the Assessee. The IRA relied on the CIT(A)'s order to submit that if the Assessee's case was allowed, it would be equivalent to applying a deeming provision. The provisions of each DTAA are specific for those two contracting states and hence, the benefit of one DTAA cannot be imported into another through the MFN clause automatically.

[30] Knoninklike Philips NV v. DICT TS 699 ITAT 2022 (Kolkata).
[31] Ansaldo Energio SPA v. CIT (IT) (2016) 384 ITR 312 (Madras).

Decision

The ITAT noted that if the MFN clause is in operation, then the provisions of a DTAA entered into by India with another OECD member country after signing of the India-Netherlands DTAA will be imported into the India-Netherlands DTAA if they are more beneficial to the Assessee. Accordingly, the beneficial provisions of the India-Italy DTAA can be imported into the reading of the India-Netherlands DTAA by virtue of the MFN clause. Hence, the restrictive scope of taxation on interest in the India-Italy DTAA exempting taxation of interest income would be applicable in the instant case.

Further, the ITAT relied on the decision of the Delhi HC in *Steria (India) Ltd.*[32] to observe that section 90 of the IT Act provides that the provisions of the DTAA are applicable to the Assessee to the extent that they are more beneficial. Similarly, in the context of the MFN clause, the provisions of the India-Italy DTAA become available to the Assessee as they are more beneficial. Hence, there is nothing that has been deemed in importing the provisions of the India-Italy DTAA into the India-Netherlands DTAA, especially as the scheme is based on the negotiated terms between the countries.

The ITAT relied on the decision of the Madras HC in *Ansaldo Energio SPA*[33] to hold that interest on income tax refund qualifies as a debt claim payable by the revenue. Accordingly, such interest is not taxable under Article 12(3)(a) of the India-Italy DTAA. This provision would be applicable in the instant case by virtue of the MFN clause in the India-Netherlands DTAA and, therefore, interest received by the Assessee under section 244A(1A) is not taxable. Hence, the ITAT held that no tax was required to be deducted on the interest payments to the Assessee. Accordingly, the appeal by the Assessee was allowed.

Significant Takeaways

The applicability of the MFN clause of a DTAA has been vociferously litigated recently at different levels and remains a contentious issue. Notably, the CBDT issued a Circular[34] stating conditions which must be satisfied to claim benefits under the MFN clause. One of the conditions requires CBDT to issue a separate notification under section 90 of the IT Act for importing favourable benefits under one DTAA to the other. The CBDT circular has been challenged before the Delhi Hc[35] on the grounds that it overlooks the plain language of the provisions of the IT Act and the MFN clauses in the DTAA.

In the instant ruling, the ITAT relied upon the Delhi HC decision in *Steria (India) Ltd.*, which stated that no separate CBDT notification was required for the applicability of the MFN clause and the resultant importation of the beneficial provisions of one DTAA into the other.

Therefore, the decision of the SC in the context of applicability and interpretation of MFN clauses is keenly awaited to settle the long pending controversy.

> **“Interest on income tax refund received by a Dutch resident is not chargeable to tax in India as per India-Netherlands DTAA by virtue of MFN clause.”**

[32] Steria (India) Ltd. v CIT (2016) 241 Taxman 268 (Delhi).
[33] Ansaldo Energio SPA v. CIT (IT) (2016) 384 ITR 312 (Madras).
[34] CBDT Circular No. 3/2022 dated 3 February 2022.
[35] *“Delhi HC entertains challenge against CBDT's MFN Clause Circular over dividend payment; Grants interim relief ”* Taxsutra. June 7, 2022. Available online: https://www.taxsutra.com/news/delhi-hc-entertains-challenge-against-cbdts-mfn-clause-circular-over-dividend-payment-grants.

CASE LAW UPDATES- DIRECT TAX

TRANSACTIONAL ADVISORY

Valuation under section 56(2)(viia) can only be questioned basis the prescribed methods

In the case of ***Convergys India Services Pvt. Ltd.***[36] ("**Convergys**"), the ITAT held that the AO could not question the valuation of unquoted shares made under section 56(2)(viia) of the IT Act, if the valuation method is in accordance with those prescribed under Rule 11UA of the IT Rules.

Facts

Convergys is an Indian company engaged in the service of providing IT enabled customer care back-office support. During the relevant AY, the Assessee had acquired the shares of an Indian private limited company ("**Acquiree**") at a FMV of INR 242.03 per share, which was determined by an independent chartered accountant. After the acquisition, the Acquiree, through an Extraordinary General Meeting ("**EGM**"), revised the face value of each equity share to INR 250 per share.

Against this background, the AO questioned the valuation of the shares and held that the correct FMV of the Acquiree was INR 250 per share. Accordingly, the AO made additions under section 56(2)(viia) by taxing the notional income accruing to the Assessee from acquiring the shares of the Acquiree at a price lower than the FMV.

The DRP concurred with the position adopted by the AO. Aggrieved, the Assessee appealed before the ITAT.

Issue

Whether the revised face value of shares of the Acquiree, fixed at its EGM, was the correct FMV of the shares of the Acquiree for the purpose of section 56(2)(viia) of the IT Act?

Arguments

It was argued by the Assessee that the FMV at which the shares of the Acquiree were purchased was determined by an independent chartered accountant. It was asserted that the independent chartered accountant had computed the FMV using the Net Asset Value ("**NAV**") method, as prescribed under the IT Rules, after taking into account the relevant information and documents, such as the trial balance up to July 31, 2015, the audited financial statements of the Acquiree as on March 31, 2014, and the unaudited financial statements as on March 31, 2015. It was contended by the Assessee that there was no valid ground to doubt the credibility of the accountant or the valuation report prepared by him. On the other hand, the IRA doubted the veracity of the valuation exercise undertaken by the Assessee, on the grounds that the FMV of the shares of the Acquiree was determined basis the trial balance on the date of valuation rather than based on audited balance sheet. Accordingly, the IRA asserted that the increased face value of the unquoted shares, as presented by the Acquiree itself, should be considered for the purpose of valuation.

Decision

The ITAT observed that section 56(2)(viia) of the IT Act would be applicable only if the consideration paid for acquiring the shares of the Acquiree was less than the aggregate FMV of such shares, determined as per the methodology prescribed under Rule 11UA of the IT Rules.

The ITAT further noted that it is a well settled principle that if a rule has been prescribed by an Act, it has to be mandatorily followed and moreover, if the statute specifically conferred a power in the taxpayer to do an act and has stipulated the

[36] Convergys India Services Pvt. Ltd v. DCIT ITA No. 782/2021 (Delhi).

manner in which such power has to be exercised, the statue actually prohibits the exercise of such power in any other manner.

Thus, the ITAT held that if Rule 11UA has specifically prescribed the methodology of computing FMV of shares proposed to be transferred, the IRA cannot subsequently question the FMV adopted by the Assessee using any other method. Accordingly, the ITAT noted that the adoption of the revised face value of shares as FMV for the purposes of section 56(2)(viia) by the IRA was not in consonance with Rule 11UA and accordingly, granted relief to the Assessee.

Significant Takeaways

The consequence of not following the prescribed method while assessing the applicability of anti-avoidance provisions (such as section 56(2)(viia) or section 56(2)(x)) would lead to vesting of wide, arbitrary and discretionary powers in the hands of the IRA, leading to confusion, uncertainty and chaos. Thus, the ITAT decision is in line with the intent and aim of the legislation and also helps to provide a stable and certain tax regime to the taxpayer.

It is relevant to note that while this decision has been rendered in the context of section 56(2)(viia) of the IT Act, it is equally relevant in the context of sections 56(2)(x) and 50CA of the IT Act since their intent and objectives are similar.

It may also be relevant to note that Rule 11UA requires that the FMV of shares to be computed as per a prescribed formula basis the audited balance sheet on the date of valuation.

However, it may not always be practically possible to obtain a valuation as per the audited balance sheet on the date of the transfer. Thus, various taxpayers, as a practical way out, rely on the valuation provided by unaudited financial statements on a day closest to the transaction date. While ideally such valuation should generally not be questioned, provided there are no significant deviations in the audited financial statements, it would be advisable for taxpayers to seek adequate guidance and embed appropriate caveats in the definitive transaction documents to ensure that it does not become entangled in post-transaction disputes.

> **“ IRA can only question the FMV based on the methods prescribed in the relevant rules. ”**

CASE LAW UPDATES- DIRECT TAX

ROUTINE

Clarificatory amendment to section 14A of the IT Act does not have retroactive application

In the case of ***ERA Infrastructure (India) Ltd.***[37]***,*** the Delhi HC held that the clarificatory amendment introduced in section 14A of the IT Act, vide FA, 2022, cannot be said to be retrospective in nature since it alters the law as it stood earlier.

Facts

Era Infrastructure ("**Assessee**") is an Indian company engaged in the business of developing infrastructure facilities. While computing the income of the Assessee for AYs 2013-14 and 2014-15, the AO disallowed the deduction of certain expenses under section 14A of the IT Act. The Assessee got the requisite relief from CIT(A), wherein CIT(A) held that in the absence of any exempt income arising to the Assessee in the relevant AY, the provisions of section 14A would not apply.

Subsequently, IRA appealed to ITAT Delhi. ITAT in its order confirmed CIT(A)'s findings and deleted the disallowance made by the AO. The ITAT placed reliance on the decision of the Delhi HC in *PCIT v. IL&FS Energy Development Company Ltd*[38] ("**IL&FS**"), wherein it was held that no disallowance could be made under section 14A of the IT Act, if the taxpayer had not earned any exempt income during the relevant AY. Aggrieved, the IRA filed an appealed before the Delhi HC.

Issues

Whether disallowance could be made under section 14A of the IT Act, in the absence of any exempt income arising to the Assessee in the relevant AY?

Arguments

The Assessee placed reliance on the Delhi HC decision in *IL&FS* and submitted that no disallowance could be made under section 14A of the IT Act, since the Assessee had not earned any exempt income during the relevant AY.

On the other hand, the IRA submitted that FA 2022 has amended the provisions of section 14A of the IT Act to clarify that disallowance can be made under section 14A of the IT Act, even in cases where expenditure has been incurred to earn exempt income, but no income has accrued to the taxpayer during the relevant AY.

The IRA also argued that ITAT's reliance on *IL&FS* was misplaced as an SLP was preferred against it and was pending before the SC. It was further argued that due to amendments introduced through FA 2022, the decision rendered in IL&FS and related judgments were no longer relevant.

Decision

The Delhi HC placed reliance on the Memorandum of the Finance Bill 2022 ("**Memorandum**") and observed that the Memorandum unequivocally stated that the amendment made to section 14A would come into effect from AY 2022-23.

The HC further placed reliance on the two landmark rulings of the SC in *Sedco*[39] and *M.M. Aqua*[40], wherein it had held that a retrospective application of an explanatory amendment cannot be allowed if such amendment has the impact of altering the law as it stood prior to the said amendment. Accordingly, the Delhi HC held that while a clarificatory amendment was introduced to section 14A, the same cannot be presumed to have

[37] Pr. CIT v. ERA Infrastructure (India) Ltd., [2022] 141 taxmann.com 289 (Delhi).
[38] PCIT v. IL&FS Energy Development Company Ltd [2017] 297 CTR 0452 (Delhi).
[39] Sedco Forex International Drill. Inc. v. CIT, (2005) 12 SC 717.
[40] M.M. Aqua Technologies Ltd. v. Commissioner of Income Tax, Delhi-III, AIR 2021 SC 3997.

retrospective application since it alters the law as it stood earlier.

Accordingly, the Delhi HC held that this amendment shall be applicable prospectively. In the instant case, it was held that following the ruling of the Delhi HC in the case of *IL&FS*, no disallowance could be made under section 14A as the Assessee had not earned any exempt income in the relevant AY.

Significant Takeways

There has been considerable litigation with respect to section 14A. Various courts across the country have held that no disallowance should be made if the taxpayer had not earned any exempt income in the relevant year. The amendment introduced to section 14A intends to overturn these decisions. While the legislature, in line with the government's commitment to provide a stable and certain taxation regime, had introduced this amendment prospectively, the use of "for removal of doubts" has created the controversy because the judiciary had earlier held that clarificatory amendments may have retrospective application and accordingly, it was contended by the IRA that the said amendment is retrospective in nature.

The Delhi HC, in line with the SC's decision in *CIT v. Vatika Township*,[41] held that clarificatory amendments should not be *ipso facto* given a retrospective effect. It further clarified that

due regard should be given to the substance of the amendment and the legislative intent behind introducing such amendments, not only its form.

It is pertinent to note that the IRA may further appeal to the SC to finally settle the issue. As has also been noted in this case, this position is also subject to SC's adjudication in the appeal to the judgment of the Delhi HC in *IL&FS*, which, hopefully, shall settle the issue of disallowances to be made under section 14A in the absence of exempt income.

" Amendment to section 14A relating to disallowance of expenditure in the absence of exempt income, does not apply retrospectively. "

[41] CIT v. Vatika Township (2014) 1 SCC 1.

Provision for non-disclosure of "reason to believe" for search not violative of Article 14, 19 and 21 of the Constitution

In the case of ***SRS Mining***[42] ("**Assessee**"), the Hon'ble Madras HC in respect of search proceedings initiated in the case of the Assessee held that the statement of any witness not cross examined by the Assessee cannot be used by the IRA even for corroboration purposes. It also held that the Explanation added to sections 132(1), 132(1A) and 132A(1) of the IT Act vide Finance Act, 2017, with retrospective effect for non-disclosure of "reason to believe" for carrying out search to the Assessee, were not violative of Articles 14, 19 and 21 of the Constitution.

Facts

Assessee was a firm primarily involved in the business of providing excavators, equipment, etc. on hire for sand mining activities and other related works. A search and seizure operation under section 132 of the IT Act was conducted on the Assessee and its partners around December 2016 and certain loose sheets, documents, cash, jewellery, etc., were seized during the same. The IRA had appointed a special auditor during the assessment for special audit and eventually, the assessments for AYs 2014-15 to 2016-17 were concluded under section 153A and for AY 2017-18 under section 143(3) of IT Act. The IRA did not provide an opportunity to the Assessee to cross examine the witnesses examined by it. The Assessee challenged these assessment orders passed by the AO ("**Impugned Orders**") by way of filing writ petitions before the Hon'ble Madras HC on several grounds.

The Assessee had filed an earlier writ petition[43] ("**First Writ**") in the Hon'ble Madras HC, prior to the abovesaid writ petitions when it was not allowed to cross-examine certain witnesses by the AO. However, the IRA had submitted to the HC that statements of such witnesses could not be relied upon and an order to this effect was passed by the HC on September 28, 2021.

Issue

i) Whether section 292CC is unconstitutional and violative of Articles 14, 19 and 21 of the Constitution?

ii) Whether insertion of Explanations to sections 132(1), 132(1A) and 132A(1) retrospectively from date of enactment of said provision for non-disclosure of "reason to believe" or "reason to suspect" to any person or any authority or Appellate Tribunal was unconstitutional and violative of Articles of 14, 19 and 21 of the Constitution?

iii) Whether the statements recorded under oath from certain people who were not allowed to be cross examined by the Assessee invalidates their statements and whether such statements can be used against the Assessee, even if only for corroboration purposes?

Arguments

On the issue of maintainability of the said writ petitions since an alternate remedy of filing appeal was available, the Assessee argued that the Impugned Orders were passed in violation of the principles of natural justice and also in violation of the Hon'ble HC's earlier order dated September 28, 2021, against the First Writ filed by the Assessee. Further, the writ petitions challenged the constitutional validity of certain provisions of the IT Act and hence, were maintainable. The constitutional validity of the relevant provisions were challenged on the following grounds:

1. Section 292CC of the IT Act could not have been introduced retrospectively and Explanations to sections 132(1), 132(1A) and 132A(1) could not have been inserted retrospectively, taking away existing rights;

2. Non-disclosure of "reason to believe" or "reason to suspect" to any person or any authority or

   the ITAT was in violation of principles of natural justice. The "reason to believe" or "reason to suspect" form the basis of issuing notice under section 142(1) and go to the root of the matter and if they would not be disclosed even to the ITAT, the foundation for initiating proceedings would never be known.

The Assessee argued that either the taxpayer or the appellate authorities like the CIT(A) or the ITAT should have access to the "reasons to believe" and "reasons to suspect" recorded by the IRA at the time of initiating the search proceedings, failing which the Assessee's fundamental rights under Article 14, 19 and 21 would be contravened.

Whereas the IRA argued that constitutional validity of the provisions had been challenged only to avoid the remedy of a statutory appeal. The Hon'ble SC had, on earlier occasions, allowed retrospective amendment in provisions and a retrospective amendment by itself is not illegal. The IRA also pointed out that retrospectivity of section 292CC had been challenged despite the fact that the AYs under consideration in the present case were AY 2014-15 to 2017-18 and such amendments were merely clarificatory in nature.

With respect to Explanations added to sections 132(1), 132(1A) and 132A(1) of the IT Act with retrospective effect, the IRA argued that recording of such reasons was an administrative action and the amendments were brought to bring in secrecy and confidentiality to serve the object and did not offend Articles 14, 19 or 21 of the Constitution. The "reason to believe" and "reason to suspect" can anyways be examined by the HC or the SC when the relevant matter reaches them. Even otherwise, it is a settled

[42] SRS Mining v. Union of India W.P.Nos. 3625, 3635, 3661 and 3673 OF 2022, (2022) 141 taxmann.com 272 (Madras).
[43] W.P. No. 16176/2021.

position vide several judicial precedents that adequacy of "reasons" was not relevant as long as they led to the formation of a belief and relied on the ruling in the case of *Dr. Pratap Singh v. Director of Enforcement*[44]. The IRA also relied on *Vijay Mandanlal Choudhary and others v. Union of India*, wherein Hon'ble SC had upheld the constitutional validity of another provision (i.e. section 44) with retrospective effect.

The Assessee argued that even though a special auditor was appointed by the IRA, the special audit report was discarded by the AO himself and assessment was made in an arbitrary manner. It was contended that the entire exercise of special audit was only a ruse, without which the assessment would have been barred by the period of limitation. On the other hand, IRA argued that a special audit report was not binding on the AO.

The Assessee also argued that the AO had relied on witness statements, without giving the Assessee any opportunity to cross-examine them, in utter disregard of the earlier HC order. The IRA contended that the statements were used merely for corroborative purposes and that non-grant of cross-examination was a curable defect that could be cured at the appellate stage before the CIT(A). The IRA relied on the ruling in *ICDS Limited v. Commissioner of Income Tax and another*[45] to contend that directions can be given to the CIT(A) to provide cross-examination opportunity instead of setting aside the assessment order. The IRA further argued that in the case of hostile witnesses, cross-examination is not required and their statements can be relied upon only if they can be corroborated by the evidence available on record.

The Assessee further contended that section 132 for search and seizure was invoked against three individuals (i.e. Mr. Prem Kumar, Mr. K. Sreenivasalu and Mr. J. Sekar Reddy) and not against the Assessee firm, whereas the material seized during the search was sought to be used against the Assessee. Therefore, the Assessee stated that section 153C of the IT Act for assessment of income of "any person other than person referred in section 153A" ought to have been invoked against the Assessee instead of section 153A of IT Act, which can only be invoked when the search was made on the Assessee itself, which was not the case here. Whereas the IRA argued that section 153C of the IT Act is used only when a search is conducted on some other person whereas in the instant case the search was conducted on the Assessee itself.

The Assessee also pointed out that the same material obtained by the AO during the search had been used for making assessment in the hands of four yard owners and simultaneously against the Assessee as well. The same set of documents cannot possibly be relied upon by the AO for making addition on different persons simultaneously. Whereas the IRA argued that the respective assessment proceedings were independent of each other.

Further, with respect to authorisation of warrant under section 132(1) of IT Act, the Assessee argued that under the provisions of section 132(1) of IT Act, the Additional Director of Income Tax ("**ADIT**") does not have the powers to issue a warrant of search unless he is specifically empowered in this behalf by the competent authorities. Whereas the IRA argued that the said issue cannot be raised by the Assessee at this stage.

Decision

The Hon'ble Madras HC held that the IRA could not refute the allegations that the Assessee was not provided an opportunity to cross-examine certain witnesses and their statements were relied upon despite its own earlier order. Therefore, the HC held that due to the violation of principles of natural justice, since cross examination of witnesses was not allowed by the IRA, the writ petition is maintainable despite an alternate remedy of statutory appeal being available. The HC referred to the ruling of the Hon'ble SC in the case of *Assistant Commissioner of State Tax v. Commercial Steel Limited*[46] and stated that scope of interference in an assessment order under the writ jurisdiction of the Courts was restricted to exceptional cases such as where there is: (i) a breach of fundamental rights; (ii) a violation of the principles of natural justice; (iii) an excess of jurisdiction; or (iv) a challenge to the vires of the statute or delegated legislation.

The HC deprecated the action of the AO in acting against the earlier order of the HC and held it to be contemptuous in nature and decided that none of the statements of witnesses can be used even for corroboration without an opportunity of cross-examination. As for the argument of the IRA that an opportunity of cross examination can be provided by the CIT(A) subsequently, the HC held that when the IRA had already conceded in the First Writ that it would not rely on such statements, it was not allowed to take a contrary stance in violation of the earlier order of the HC. The HC relied on the rulings of *Andaman Timber Industries v. CCE*[47], *CIT v. Sunita Dhadda*[48] *and Kishinchand Chellaram v. CIT*[49] and stated that statements of witnesses not cross examined cannot be relied upon. The HC further held that loose sheets could not have been relied upon in the absence of supportive evidence to prove them. Therefore, a fresh assessment would be required.

Further, the HC held that an act of retraction is not provided either in the IT Act or the Indian Evidence Act, 1872, and even to declare a witness as hostile, he has to be produced before the relevant authority whereas no such procedure has been followed. Statements have been retracted by the witnesses prior

44 Dr. Pratap Singh v. Director of Enforcement SLP (Criminal) No.4364 of 2014.
45 ICDS Limited v. Commissioner of Income Tax and another (2020) 10 SCC 529.
46 Assistant Commissioner of State Tax v. Commercial Steel Limited 2021 SCC Online SC 884.
47 Andaman Timber Industries v. CCE (2015) 324 ELT 641 , (2016) 15 SCC 785.
48 CIT v. Sunita Dhadda (2018) 100 Taxman.com 526 (SC).
49 Kishinchand Chellaram v. CIT (1980) 125 ITR 713 (SC).

to conclusion of the First Writ, which should have been disclosed to the HC immediately.

With respect to the constitutional validity of section 292CC of the IT Act, the HC held that retrospectivity of the provision had no effect on the present case as the search was conducted much after the amendment. As for challenge to the Explanations added to sections 132(1), 132(1A) and 132A(1) with retrospective effect, the HC summarily rejected the contentions of the Assessee and held that the Explanations were added to serve the objects of those provisions as contended by the IRA and anyway, such amendments were not offending any of the constitutional provisions, including Articles 14, 19, and 21 of the Constitution. Further, it held that retrospectivity of a provision by itself is not impermissible unless an amendment is regarded as unconstitutional.

With respect to the special audit report, the HC held that such report was not binding on the AO. However, the reasons furnished by the AO for not relying on such report were not very sound and accordingly, remanded the matter back to the AO to consider the report and provide proper reasons.

With respect to authorisation of search warrant under section 132(1) of IT Act, the HC emphasised that the ADIT was required to be authorised by the Principal Director General or Director General or Principal Director or Director or the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner. The HC remanded this issue back to the AO for fresh consideration and allowed the Assessee to peruse the authorisation of search warrant and raise such arguments before the AO.

With respect to invocation of section 153C of IT Act or section 153A of IT Act, the HC held that in some cases *panchanamas* were issued in the name of the Assessee and the material was collected during the course of a joint search conducted against the individuals as well as the Assessee and hence, section 153A of IT Act would be applicable. Nevertheless, the HC remanded the issue to the AO to consider whether section 153C was required to be invoked or not.

With respect to placing reliance on the same material for making addition on different persons simultaneously, the HC held that using the same material to assess income first in the hands of the yard owners i.e. the three individuals, and then against the Assessee was illegal. It observed that when search was carried out on three individuals, the AO should have recorded a satisfaction that the material seized during search disclosed "undisclosed income" in the hands of the Assessee. Therefore, the HC held that since the AO was satisfied that the material collected during the search belonged to the yard owners, the search against the Assessee was illegal and remanded the matter back and directed the AO to eliminate the material already used against the yard owners while making assessment in the case of the Assessee.

Significant Takeaways

The search and seizure operation were conducted in case of the Assessee on December 12, 2016, when the government had announced demonetisation of specified currency notes in India i.e. on November 8, 2016. A number of search and seizure operations were carried out on several assessees. In many instances, search and seizure operations could have been carried out to conduct a fishing and roving enquiry instead of proper rationale and reason to believe. Recording of "reasons to believe" prior to taking action under the IT Act is an administrative action and the aspect of adequacy of such reason to believe cannot be gone into by an assessee as already held in several rulings, including the recent Hon'ble SC's ruling in the case of *Principal Director Of Income Tax (Investigation) vs Laljibhai Kanjibhai Mandalia*[50]. However, clear non-disclosure of such reasons to the concerned assessee by way of insertion of an explanation in the relevant provision might only lead to lack of transparency and may cause severe hardship to honest taxpayers in the coming days and the possibility of witch hunting cannot be ruled out.

The Hon'ble Madras HC vide the present ruling summarily held the provisions of section 292CC and the Explanations added to sections 132(1), 132(1A) and 132A of the Act of 1961 to be constitutionally valid. However, it remains to be seen to what extent non-disclosure of such basic information, forming the initiation of an onerous process of investigation by the IRA, would impact the transparency or fairness of the overall assessment process. While such reasons can be made available to the Hon'ble HC or SC to examine the reasons for formation of belief, it might only be fair that such reasons be made available for perusal to the lower authorities too.

"Provisions for non-disclosure of "reason to believe" behind a search to an Assessee held constitutionally valid."

[50] Principal Director Of Income Tax (Investigation) vs Laljibhai Kanjibhai Mandalia Civil Appeal No. 4081 of 2022 (Arising out of SLP (Civil) No. 25046 of 2019).

Intimation issued under section 143(1) does not tantamount to an "assessment"; fresh material not required for re-opening of assessment

In the case of ***Ernst and Young U.S. LLP***[51], the Delhi HC reiterated the settled legal principle that there is a distinction between an intimation issued under section 143(1) and an assessment under section 143(3) of the IT Act. In case assessment was completed under section 143(1), there was no need for fresh tangible material for re-opening of assessment under section 148 of the IT Act and the question of change of opinion did not arise. It also held that to avail benefit of the applicable DTAA, the benefit of which was already allowed in another AY, the Assessee will have to show that similar/ identical services were rendered in the present year as well.

Facts

M/s Ernst and Young U.S. LLP ("**Assessee**") was issued a show cause notice by the AO for re-opening of assessment for AY 2018-19 on the ground that professional service charges to the tune of INR 1,92,35,080 received from S.R. Batliboi & Co. LLP ("**SRBC**") had not been offered as income in its ROI for AY 2018-19.

The Petitioner filed a detailed reply to such notice vide a letter informing the AO that it had claimed benefit of Article 15 of the relevant DTAA in respect of such receipts and that such claim had already been accepted in the case of the Assessee for AY 2019-20. An order was passed by the AO under section 148A(d) of the IT Act with an erroneous footing that a reply had never been filed by the Assessee. Against the order, a writ petition[52] was filed by the Assessee before the Delhi HC and the Hon'ble HC set aside such order and the notice issued under section 148 and directed the AO to pass a fresh order duly considering the reply filed by the Assessee within eight weeks.

Subsequently, the AO passed an order stating that the Assessee had failed to provide relevant documents such as the contracts under which services were rendered by Assessee, copy of invoices, documentary evidences supporting the nature of the services rendered, mode of rendering services, i.e. whether employees of Assessee visited India and for what duration or whether the services were rendered remotely from outside India, confirmation letters from other parties i.e. SRBC. Therefore, the AO alleged such amount to be taxable under the IT Act unless the Assessee substantiated that Article 15 of the relevant DTAA was applicable.

Issue

Whether fresh material was required for re-opening of assessment when only an intimation was issued to the Assessee under section 143(1) of IT Act?

Arguments

The Assessee argued that the AO had already accepted the Assessee's claim w.r.t. such professional receipts from SRBC in the present AY by making an assessment under section 143(1) and accepting the ROI filed by the Assessee. Further, the AO had already accepted the Assessee's claim under Article 15 of the relevant DTAA in the subsequent AY (i.e. AY 2019-20) during the course of assessment proceedings, therefore, it was not permissible for the AO to depart from its earlier order and take a contrary stand in AY 2018-19 unless it had concrete material, which indicated there was a change in the factual position.

Whereas the IRA argued that even if the benefit of Article 15 of the relevant DTAA is granted in one year, it would not ipso facto imply that benefit would be available in all other years. The Assessee would need to establish that the nature of services rendered in the present year were similar or identical to the other year.

Decision

The Hon'ble Delhi HC said that various HCs and the SC have from time to time held that the doctrine of change of opinion would not be applicable where only an intimation was issued under section 143(1) and, therefore, fresh tangible material was not required for re-opening of assessment in such a year. In this regard, the HC placed reliance on the ruling of the Hon'ble SC in *Rajesh Jhaveri Stock Brokers Private Limited*[53], wherein it held that an intimation issued under section 143(1) cannot be said to be an assessment carried out by the AO and, therefore, the question of change of opinion would not arise. Further, the Hon'ble Delhi HC relied upon its own ruling in *Indu Lata Rangwala*[54], wherein it was held that an intimation under section 143(1) of IT Act was not an assessment in the strictest sense of the term. Therefore, AO can re-open assessment on the basis of the ROI or accompanying documents and fresh material was not required. Therefore, in the instant case, the AO was not required to form a belief that income had escaped assessment basis fresh material to initiate reassessment proceedings under section 148.

51 Ernst and Young U.S. LLP v. Assistant Commissioner of Income Tax, Circle International Taxation 1(2)(2) ,Delhi and ANR WP(C) No. 11862/ 2022.
52 W.P.(C) No. 7791/ 2022.
53 Assistant Commissioner of Income Tax v. Rajesh Jhaveri Stock Brokers Private Limited, (2008) 14 SCC 208.
54 Indu Lata Rangwala v. Deputy Commissioner of Income Tax, (2016) SCC Online Del 3006.

Further, the Hon'ble Delhi HC held that the Assessee had failed to submit relevant documents such as underlying contract, invoices, etc., to substantiate that the nature of services rendered were similar to AY 2019-20. Therefore, the Hon'ble HC held that the Assessee shall have to furnish the requisite documents to satisfy the AO and accordingly, dismissed the writ petition filed by the Assessee.

Significant Takeaways

As an intimation issued under section 143(1) of the IT Act cannot be treated as an order, if the ROI is processed under section 143(1), it is not necessary in such a case for the AO to come across some fresh tangible material to form 'reasons to believe' that income has escaped assessment to initiate reassessment proceedings.

Further, as far as the question of nature of services is concerned, it is pertinent to note that the underlying agreement and other supporting documents would be necessary to ascertain the exact nature of the services rendered and whether or not they would fall within the ambit of the services covered by Article 15 of the relevant DTAA. In the instant case, the matter has been remanded back to the AO for resumption of further proceedings and inspection of such documents. The Hon'ble HC, drawing reference from settled judicial precedents, held that there was no change of opinion in the absence of any fresh material relied upon by the AO and dismissed the writ petition filed by the Assessee.

Hence, it is advisable that taxpayers take notices issued by the IRA seriously and respond to them in a comprehensive manner so that they can be relied upon and defended later. It is also pertinent to note that the provisions under which a notice is issued should be examined carefully and responses should be prepared in a comprehensive manner.

“ Intimation u/s 143(1) does not tantamount to an assessment. ”

SC disallows deduction for bad debts on advance given for purchase of commercial property

In ***Khyati Realtors (P.) Ltd.,***[55] the SC disallowed the deduction claimed under section 36(1)(vii) and section 37(1) of the IT Act for bad debts arising from advance paid for purchase of commercial property. The SC held that given the facts and circumstances of the case, the conditions for claiming deduction under the said section were not satisfied.

Facts

Khyati Realtors ("**Assessee**") was engaged in the business of real estate development, trading in transferable development rights and related financing activities. The Assessee had paid certain amounts to a real estate developer as advance for booking a commercial property. Subsequently, the deal failed and the Assessee was unable to recover the advance paid to the real estate developer.

The Assessee, in the relevant FY, wrote off the advance as bad debt and claimed it as an expense under section 36(1)(vii) of the IT Act and alternatively, under section 37(1) of the IT Act.

Section 36(1)(vii) of the IT Act, *inter alia*, provides that a taxpayer may claim deduction for bad debt provided that when the debt is created, a corresponding income is booked in the relevant FY or it represented moneys lent in the ordinary course of business of banking or money lending. Similarly, section 37(1) of the IT Act provides that a taxpayer may claim deduction for expenditure incurred wholly or exclusively for the purposes of business, provided the expenditure is not a capital expenditure and has not been specifically covered under certain specified provisions (including section 36(1)(vii) of the IT Act).

The AO disallowed the claim of the Assessee on the grounds that conditions for availing deduction under section 36(1)(vii) were not met. Further, the AO also denied the deduction to the Assessee under section 37 on the grounds that such deduction was specifically dealt with under section 36(1), therefore the provisions of section 37 would not be applicable. The CIT(A) also upheld the order of the AO on similar grounds.

Aggrieved, the Assessee appealed before the ITAT, which upheld the claim of the Assessee under section 37(1) of the IT Act, even though it affirmed the order of the AO with respect to the Assessee's claim under section 36(1)(vii) of the IT Act. The order of the ITAT was also upheld by the Bombay HC. Aggrieved by these orders, the IRA approached the SC.

Issue

Whether the Assessee should be allowed to claim deduction for bad debts arising on account of advance payments made for booking a commercial property, becoming irrecoverable?

Arguments

The IRA placed reliance on the SC's decision in *Catholic Syrian Bank Ltd v. Commissioner of Income Tax, Thrissur*[56] and contended that in order to claim deduction under section 36(1)(vii) of the IT Act, it was pertinent for the Assessee to establish that the conditions stipulated therein had been duly satisfied. Thus, it was argued that the Assessee had not brought any new material on record to establish that the conditions under section 36(1) were satisfied. Therefore, it could not claim deduction under section 36(1)(vii) of the IT Act.

The IRA further argued that the Assessee's claim that the amount given as advance is in the nature of a loan was not backed by any material detailing the terms of the loan, or the conditions of repayment, including interest. The IRA also submitted that the Assessee's claim that the advance amount could alternatively be deducted as an expenditure laid out for commercial purposes under section 37 of the IT Act was belated and raised for the first time before the ITAT.

On the other hand, the Assessee asserted that as per its Memorandum of Association, it was permitted to undertake a wide range of activities such as business of real estate and financing. Accordingly, it was argued that the advance paid to the real estate developer was advances given in its ordinary course of business and accordingly, the bad debt arising from writing off of such advance should be allowed as deduction under section 36(1). The Assessee also placed reliance on the decision of SC in *T.R.F. Limited v. Commissioner of Income Tax, Ranchi*[57] and argued that once the debt was written off as irrecoverable, it was not permissible for the IRA to scrutinise the decision of the write off.

Additionally, the Assessee argued that even if the bad debt could not be claimed as deduction under section 36(1)(vii) of the IT Act, the Assessee could still claim deduction for such bad debts under section 37(1) of the IT Act, as expenditure incurred exclusively for business purposes. Reliance in this regard was placed on *CIT v. The Mysore Sugar Co. Ltd.*[58]

55 PCIT v. Khyati Realtors (P.) Ltd [2022] 141 taxmann.com 461 (SC).
56 Catholic Syrian Bank Ltd v. Commissioner of Income Tax, Thrissur (2012) 3 SCC 784.
57 T.R.F. Limited v. Commissioner of Income Tax, Ranchi (2010) 13 SCC 532 (Jhar. HC).

Decision

At the outset, the SC acknowledged that a taxpayer was entitled to claim deduction for a bad debt arising in relation to its business under section 36(1)(vii) of the IT Act, subject to the fulfilment of the conditions set forth in section 36(2). Further, the SC relied on its earlier rulings in *Southern Technologies*[59] and *Catholic Syrian Bank (supra)* and held that in order to claim deduction under section 36(1)(vii) of the IT Act, it was essential that the taxpayer establishes that bad debt has actually been written off in its accounts and all the relevant conditions under section 36 of the IT Act have been duly complied with.

Having said the above, the SC went on to observe that in the present case nothing was brought on record to suggest that advance made by the Assessee to the real estate developer was in its ordinary course of business. The SC observed that as rightly noted by the CIT(A), there was no material to support the claim of the Assessee that the advance was paid for acquiring a property, like documents/ agreements stipulating the terms of the proposed purchase of the commercial property. Similarly, the SC noted that the Assessee had also failed to produce any documents or material to support its alternative claim that the impugned amount was given as a loan. The SC also noted that the Assessee had failed to establish that the amount paid as advance was actually written off in its books of accounts.

With the above observations, the SC held that the Assessee had failed to satisfy the conditions stipulated under section 36(1)(vii) of the IT Act and accordingly, it was not entitled to claim deduction thereunder. Separately, the SC also held that since the advance was given for the purposes of acquiring an immoveable property, it was in the nature of a capital expenditure. Accordingly, such an expenditure could not be allowed as a business expenditure.

The SC distinguished its decision in *TRF Ltd.*, which was relied upon by the Assessee to assert that the IRA could not question the decision of the taxpayer to write off a debt and it was sufficient to show that the debt had been written off. In this regard, the SC clarified that in *TRF Ltd.*, the court had not considered or discussed other conditions for claiming deduction for bad debts. The SC was of the opinion that the decision rendered in *Southern Technologies (supra)* and *Catholic Syrian Bank (supra)*, which laid down the conditions for writing off bad debts, were more applicable to the present issue.

The SC also examined the alternative claim of the Assessee with respect to admissibility of deduction under section 37 of the IT Act and noted that deduction under the said section can only be allowed if expenditure has been incurred exclusively for the purposes of business, and such expenditure is not capital in nature. In this regard, the SC confirmed its decision in *The Mysore Sugar Co. Ltd. (supra)*[60], wherein it was held that even if a claim for deduction is not allowed under section 36(1)(vii), it may be allowed under section 37(1).

[58] CIT v. The Mysore Sugar Co. Ltd. 1963 (2) SCR 976.
[59] Southern Technologies Ltd. v. Joint Commissioner of Income Tax, Coimbatore, (2010) 2 SCC 548.
[60] 1963 (2) SCR 976.

However, the SC opined that in the present dispute, the *Southern Technologies (supra)* ruling was applicable. In the said case, the SC had held that a "provision" for doubtful debt, which is outside the scope of section 36(1)(vii) cannot be alternatively allowed under section 37(1) since section 37(1) applies only to items not covered under earlier provisions. Additionally, it had noted that if a provision for doubtful debt is expressly excluded from section 36(1)(vii), then such provision cannot be claimed as deduction under section 37(1) of the IT Act, even on the basis of "real income" theory.[61]

Therefore, in light of the aforementioned discussion, the SC disallowed the Assessee's claim for deduction and set aside the order of the Bombay HC and ITAT.

Significant Takeaways

This case further complicates the jurisprudence with respect to claiming deduction against bad debts, which are written off as irrecoverable. The SC considered its previous decisions on the issue and summarised the principles with respect to claiming deduction under section 36(1)(vii) of the IT Act, as follows: First, that the amount of bad debt has to be written off as irrecoverable in the accounts of the taxpayer for the relevant FY. Second, such bad debt written off as irrecoverable cannot include provision for bad debts. Third, the deduction can be disallowed if the said bad debt has not been accounted for in computing the income of the FY of the taxpayer in which the debt was created. Lastly, the taxpayer ought to comply with the ingredients of section 36(1)(vii) and section 36(2) of the IT Act to be eligible to claim deduction.

It may also be pertinent to note the peculiarity of this decision given the manner in which each authority had perceived the facts at hand. In the instant case, the ITAT had accepted that the advance for purchase of property was in the ordinary course of real estate business. But the SC has rejected this premise on the grounds that there was nothing in the Assessee's account to show that the advance was made in the ordinary course of business. Similarly, the SC has held that advance was made for the purchase of immoveable property, as against the finding of the Tribunal, which had held that the advance was paid for acquiring immoveable property to be held as stock in-trade. There was a clear divergence in the consideration of facts by the SC and the ITAT. As a rule, the higher appellate authorities do not interfere with factual findings of the ITAT (which is the final fact-finding authority), unless they are challenged as being perverse or not borne from record. However, in the instant case, the SC seemed to have gone beyond its jurisdiction and tried to interpret the facts in a different manner and hence, took a divergent approach.

It would be interesting to see how the taxpayers accept this decision, also whether there would be further review of the above decision. This is because, prima facie, the SC seems to have erred in re-examining the facts. It appears to have arrived at a wrong conclusion that the Assessee had paid the money as a capital advance to acquire an immoveable property.

> **"Taxpayer would need to establish that the bad debt has been actually written off in its books, in order to claim deduction under section 36(1)(vii)."**

[61] Briefly, real income theory states that income tax is a tax on the real income, i.e., the income arrived at after accounting for the permissible expenses and deductions.

SC strikes down the old benami law as unconstitutional

In ***Ganpati Dealcom Pvt. Ltd.***[62]**,** the SC had quashed all prosecution and forfeiture proceedings pertaining to transactions entered into before October 25, 2016. The old benami law i.e. Benami Transactions Act of 1988 ("**Benami Act**") was amended on the said date by the Benami Transactions (Prohibition) Amendment Act, 2016 ("**2016 Amendments**"), and the Supreme Court declared the retrospective application of the amended sections 3 and 5, introduced through this amendment, as unconstitutional.

Facts

Ganpati Dealcom Pvt. Ltd ("**Assessee**") had purchased a property for INR 9.44 crore on May 02, 2011, and subsequently, the shares of the Assessee were sold for a consideration of INR 0.19 crore to related parties on March 31, 2012. Proceedings were initiated under section 24(1) of the 2016 Amendments. It must be noted that section 24(1) was originally not there in the Benami Act. The Assessee challenged the proceedings before the Calcutta HC, which quashed the proceedings on the ground that there was no provision in the 2016 Amendments to provide that the amended provisions shall be applied retrospectively and in the absence of such specific reference, the provisions forming a part of the 2016 Amendments cannot be considered as retrospective in nature. The HC noted that the Benami Act was never operationalised until the amendment was made since it lacked machinery provisions to give effect to its charging provisions. Therefore, it held that the Benami Act cannot be operationalised retrospectively indirectly by reading the provisions of the 2016 Amendments. Challenging the decision of the Calcutta HC, IRA filed a SLP before the SC.

Issue

Whether the amendments brought by the 2016 Amendments were machinery and procedural in nature? Also, should it be applicable retrospectively?

Decision

The SC suo motu expanded the scope of the questions involved. It stated that before deciding whether the 2016 Amendments have retrospective application or not, it needs to decide whether the retrospective changes brought to the Benami Act are constitutional in the first place. The SC observed that the erstwhile Benami Act was merely a shell and lacked the substance that criminal legislation required to be sustained. It held that a conjoint reading of section 2(a) and section 3 shows that the original enactment did not contemplate any *mens rea*, as it criminalised the mere act of paying consideration for the acquisition of property by another person. By excluding *mens rea* in the Benami Act, an unduly harsh law in the form of strict liability was envisaged, which went against the settled principles as well as the recommendations made in the 57th and the 130th Law Commission Reports, on the basis of which the Benami Act was enacted. The SC noted that the element of *mens rea* was introduced only through the 2016 Amendments through section 53, hence departing from the situation of strict liability that existed in the Benami Act. The vagueness made the charging section for initiating criminal proceedings under the Benami Act (i.e. section 3) susceptible to serious arbitrariness, which could have also led to judicial transgression. The SC had held that these were incurable defects that could not have been rectified even through the judicial process.

The SC also struck down the forfeiture provision forming a part of the Benami Act (i.e. section 5) by observing that it is a 'half-baked provision', which does not even provide any mechanism to ascertain when such forfeiture is warranted. The Court noted that section 5 delegated its power to an authority to come up with a mechanism to implement acquisition related proceedings and held that such delegation of power to authority is squarely excessive and arbitrary. It held that the absence of substantive provisions, coupled with the omissions made the Benami Act to be fanciful and oppressive.

Hence, on the above grounds, the retrospective changes brought to section 3 (criminal provision) and section 5 (forfeiture proceedings) of the Benami Act were held to be unconstitutional for manifest arbitrariness and hence were stillborn. The Court also struck down section 3(2) of the 2016 Amendments, which imposes punishment for transactions that took place before the 2016 Amendments came into effect, i.e. from the date of the 1988 Act to October 25, 2016. It also held that section 3(2) of the 2016 Amendments is violative of Article 20(1) of the Constitution of India, which *inter alia* provides that criminal punishment/ liability cannot be imposed retrospectively. On similar lines, the Court also observed that the forfeiture procedure under Section 5 of the 2016 Amendments is an in-rem forfeiture and poses a penal character. Accordingly, it was held that Section 5 can only be applied prospectively and not retrospectively.

[62] Union of India v. M/s. Ganpati Dealcom Pvt. Ltd. Civil Appeal No. 5783 of 2022 dated August 23, 2022

The Court also held that section 4 of the Benami Act cannot be said to be unconstitutional as it is civil in nature, and not criminal like sections 3 and 5 of the benami Act. It may be noted that section 4 of the Benami Act *inter alia* stated that the real owner of the property cannot claim any ownership over the benami property. The Court having held section 4 to be constitutional, noted the flip side of giving effect to section 4 of the Benami Act, without any effective enforcement proceedings, since would mean that benamidar would be considered as the owner of the property without any consequence. Therefore, it concluded that section 4 too cannot be permitted to operate retrospectively.

Significant Takeaway

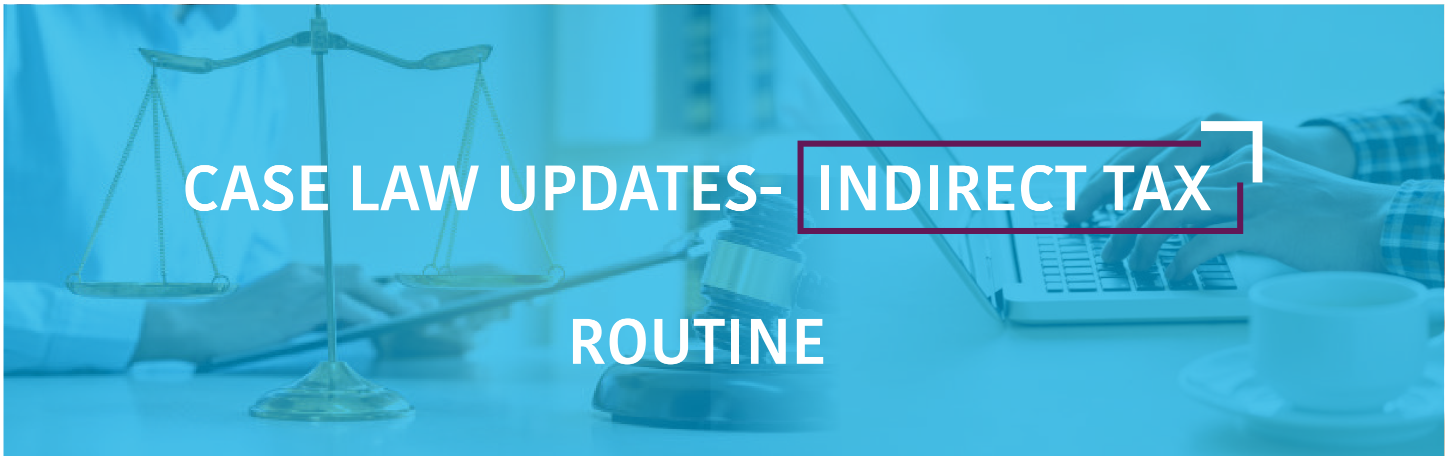
The SC's judgement on this matter was keenly awaited by several stakeholders, especially the parties against whom prosecution proceedings have been initiated for benami transactions. This ruling provides them with much-needed relief by treating any criminal prosecution or forfeiture proceedings initiated under the legislation before October 25, 2016, as null and void.

As indicated above, thousands of cases have been initiated by the Government post the enactment of the 2016 Amendments. Now, cases pertaining to transactions that took place prior to October 25, 2016, would have to be quashed.

It may be noted that the Government may expedite the ongoing proceedings under the IT Act in such cases. It is worthwhile to highlight that Section 68 of the IT Act also empowers the IRA to impose taxes on unexplained cash credits and, therefore, transactions under the purview of the Benami Act may also have to be reviewed carefully under the IT Act. Further, the provisions of the IT Act also provide for severe penal and prosecution proceedings in cases of tax evasion.

Separately, this decision of SC may trigger controversy from the perspective of the Black Money (Undisclosed Foreign Income and Assets) and Imposition Act, 2015 ("**Black Money Act**"). Primarily, the Black Money Act was introduced to penalise and prosecute taxpayers who have stashed undisclosed amounts of money abroad. It may be noted that the Black Money Act was also introduced along with the 2016 Amendments, with the intention to clamp down on unaccounted money. The Black Money Act also penalises transactions in a retrospective manner. Section 72(c) provides that the year in which the IRA initiates proceedings against undisclosed foreign income shall be deemed to be the year in which the transaction took place for the purposes of the Black Money Act. Going by the rationale of this judgment, particularly in relation to the observation that imposition of criminal punishment in a retrospective manner is a violation of Article 20(1) of the Constitution of India, the retrospectivity of Section 72(c) of the Black Money Act may also be challenged by aggrieved persons!

> **" The 2016 Amendment Act was not merely procedural, rather, prescribed substantive provisions. "**



CASE LAW UPDATES- INDIRECT TAX

ROUTINE

CERSAI registered dues of secured creditors get priority over statutory VAT dues

In ***Jalgaon Janta Sahakari Bank Limited***[63], the Bombay HC held that the dues of a secured creditor would get priority over the dues of the relevant department of the State Government in a matter that is under the IBC.

Facts

Jalgaon Janta Sahakari Bank Ltd. and multiple other creditors had approached the Bombay HC by filing a writ petition to address the priority of claims of a secured creditor and other statutory dues under the Recovery of Debts and Bankruptcy Act, 1993 ("**RDDB Act**"), and Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 ("**SARFAESI Act**").

Issue

i) Whether a secured creditor has a prior right over dues payable under the Maharashtra Value Added Tax, 2002 ("**MVAT Act**") as per SARFAESI Act and the RDDB Act?

ii) Whether the 'first charge' created over any property by the operation of a State law provides any precedence over the dues of a secured creditor.

Arguments

The Petitioner contended that the priority created by section 31B of the RDDB Act and section 26E of the SARFESI Act provides for priority of secured creditors above all other dues, including statutory dues. Further, the Petitioners contended that there did not exist any dispute between the State indirect tax legislations like MVAT Act and Central legislations such as the SARFESI Act and the RDDB Act as they operate in different fields. Section 37 of the MVAT Act and section 38C of the erstwhile Bombay Sales Tax, 1959 ("**BST Act**"), clearly stated that creation of any 'first charge' by any Central legislation would prevail over 'first charge' created under the MVAT Act and BST Act, respectively.

The Petitioners argued that in cases where priority under section 26E of the SARFAESI Act was not applicable due to non-registration of the claim in CERSAI, the secured creditors were entitled to priority in terms of section 31B of the RDDB Act. Further, it was also contended by the Petitioners that section 31B of the RDDB Act will apply where proceedings by the secured creditor are preferred under the SARFAESI Act and not under the RDDB Act.

The Respondent contended that the language of the section 26E of the SARFAESI Act does not explicitly create 'first charge' in favour of secured creditors. It only provides for priority in payment to secured creditors over other creditors. The Respondents argued that legislations such as BST Act, MVAT Act, Workmen's Compensation Act, 1923, etc., use the phrase 'first charge', which was absent in the SARFAESI Act and RDDB Act. The Respondents also claimed that 'first charge' and 'priority' were not synonymous in nature as 'first charge' shows superiority of the charge of the concerned party, whereas 'priority' indicated hierarchy of payment without disturbing the superiority of charge attached to any specific property. Thus, section 26E of the SARFAESI Act only provides for the manner of distribution and not the right of first charge. The Respondents submitted that if the Parliament had intended to treat mortgage dues of bankers

[63] Jalgaon Janta Sahakari Bank Ltd. and another v. Joint Commissioner of Sales Tax and another, 2022 SCC OnLine Bom 1767.

and tax dues equally, they would have used specific language in the SARFAESI Act and RDDB Act and would not have used the words 'in priority'.

The Respondent also argued that a non-obstante clause overrides a contrary provision in any other law if it is in the same field of law. Since the field of operations of section 26E of the SARFAESI Act and section 37 of the MVAT Act was different, there was no conflict and no law could prevail over the other.

Decision

The Bombay HC observed that a secured creditor who has registered the security interest or other creditor who has registered the attachment order in its favour, would have priority over subsequent security interest created over the property or any transfer by way of sale, lease, assignment or licence, etc. It also observed that even a 'first charge' could be made subordinate or subservient by an express provision. The State indirect tax legislation such as the BST Act and the MVAT Act clearly provided that the first charge under them would be subordinate to any Central legislation creating first charge. The Bombay HC was of the view that as multiple legislations used 'first charge', the Parliament specifically used the term 'priority over all other dues' in the SARFAESI Act to prevent any misunderstanding. The HC also stated that it is a settled principle of law that in terms of hierarchy, secured debts are above crown debts[64]. It also stated that the provisions were amended in 2016 to clearly depict that secured creditors would take precedence over revenues or any due or taxes payable to the State Government. Hence, it denied the Respondent's claim that first charge is above the priority list created by SARFAESI Act and RDDB Act.

Significant Takeaways

The aforementioned decision provides priority of claims of secured creditors over various statutory dues even in the presence of the phrase 'first charge' under the SARFAESI Act. However, it must be noted that this decision appears to have been overruled by the Hon'ble SC in the case of Rainbow Papers[65] while dealing with the IBC legislation, while interpreting a similar claim pertaining to section 48 of the Gujarat Value Added Tax Act, 2003 ("**GVAT**").

It would be interesting now to see how this decision is taken by the IRA. We believe that the possibility of the IRA immediately approaching the SC and requesting it to reconsider the HC decision in lieu of its own decision in the case of Rainbow Papers cannot be ruled out.

> **"Secured creditors would get priority before the statutory dues under SARFAESI Act."**

[64] Dena Bank v. Bhikhabhai Prabhudas Parekh & Co.(2000) 5 SCC 694

[65] State Tax officer v. Rainbow Papers Ltd., 2022 (9) TMI 317 -SUPREME COURT.

Refund of countervailing duty and special additional duty paid towards regularisation of export obligation is available as refund

In New ***Age Laminators Pvt. Limited.***[66], the Hon'ble CESTAT held that post the implementation of GST, as no input credit can be availed for CVD and SAD, the taxpayer is eligible for refund in cash.

Facts

New Age Laminators Pvt. Ltd. ("**Appellant**") manufactures automotive metalised polyster laminated craft paper. It obtained an advance licence to procure raw material without paying applicable customs duty. However, the Appellant was unable to fulfil the conditions of advance licence, i.e. export certain quantities of the final product within a particular time limit. As per the applicable FTP, the importer was required to pay the applicable customs duty, proportionate to the unfulfilled export obligation ("**EO**") to regularise the license.

The Appellant paid the customs duty, which included BCD, CVD and SAD, post the implementation of GST. The GST legislation did not prescribe any mechanism to avail tax credit of CVD and SAD unlike the prior CENVAT credit regime. Accordingly, the Appellant filed refund application under section142(3) and (6) of the CGST Act, which provides that every claim for refund for CENVAT credit under the existing law, shall be disposed as per the existing law. The refund would be granted in cash. However, the adjudicating authority denied the refund. Aggrieved, the Appellant filed an appeal before the Commissioner Appeals, which also denied the same and thus the Appellant approached the CESTAT.

Issue

Can the refund of CVD and SAD paid for regularisation of license be available post GST implementation?

Arguments

The Appellant asserted that CVD and SAD paid along with customs duty are entitled to be treated as CENVAT credit under Rule 3 of CENVAT Credit Rules. The said rule provides that a manufacturer can avail credit of additional duty leviable under the CT Act. As post the implementation of GST, there is no mechanism to avail CENVAT credit or transition the credit to GST electronic credit ledger, the Appellant was eligible for refund under sections 142(3) and 142(6) of the CGST Act.

On the other hand, the Respondent argued that CVD and SAD were paid for failure to fulfil EO, post the same was pointed out by the IRA. Hence, credit for the same cannot be availed as CENVAT credit. Post the implementation of GST, no CENVAT credit was eligible to be availed. Therefore, the question of claiming refund would not arise after the introduction of GST.

Decision

The CESTAT directed the Respondent to refund the amount of CVD and SAD paid by the Appellant since the Appellant had paid CVD and SAD during the GST regime for imports that were made in pre-GST era to regularise the license issued under the advance authorisation scheme. As per the CESTAT, there was no restriction in availing CENVAT credit on CVD and SAD. However, when GST was implemented, the same could not be availed. In the instant case, there was no documentation concern. As CENVAT credit could not be availed, the Appellant was eligible for refund under the provisions of sections 142(3) and 142(6) of the CGST Act.

Significant Takeaways

This is a welcome decision clarifying the position of law during the transition phase. The aforementioned decision allows refund of taxes paid during the earlier period for regularisation of licences when there was no restriction in availing CENVAT Credit. The decision could substantially reduce the burden on taxpayers who had been unable to comply with EO and had to discharge customs duty for regularisation of licence after several years of actual import.

> **"Refund is available for erstwhile taxes paid if CENVAT credit was available."**

[66] New Age Laminators Pvt. Ltd. v. C.CE. GST., 2022 (142) Taxmann.com 189 (CESTAT- New Delhi).

Supplier would not be treated as intermediary in the absence of liaising activity

In the case of ***BlackRock Services India Pvt Ltd.***[67]**,** the Hon'ble CESTAT held that refund cannot be denied on export of service by claiming that the supplier was liaising or acting as an intermediary between the recipient and its customers.

Facts

BlackRock Services India Pvt Ltd. ("**Appellant**") is involved in the development of an interface of an operating system for an investment manager called Aladdin. The Appellant provides support on the Aladdin platform, while also helping with the maintenance and troubleshooting. The Appellant had units in an SEZ and an STPI that were 100% export units. The Appellant also assisted HLX, US, for the creation of a client account on the platform, which is a back-end process. However, there was no client interaction involved. The Appellant received the pre-agreed consideration from HLX in convertible foreign exchange. The Appellant filed a refund claim for the period from April, 2016, to March, 2017, for refund of unutilised CENVAT credit availed on input services used in providing taxable services. The IRA rejected the refund claim on the ground that services provided by the Appellant were in the nature of intermediary services and place of supply of such services was in India. Therefore, one of the conditions to qualify for CENVAT credit was not satisfied, which is for the services to be regarded as export of service, the place of supply needs to be outside India.

Aggrieved, the Appellant filed an appeal against the order before the CESTAT.

Issue

Whether the services provided by the Appellant to HLX fell within "business support services" or "intermediary service"?

Arguments

The Appellant contended that in terms of the agreement entered into by them with HLX, it is an independent contractor. The Appellant was required to provide business support, services, IT enabled services. There was no involvement of any third party or consumer and at no stage was the Appellant required to touch base with any customer of HLX. As per the agreement, there was no requirement to engage with any other party for the execution or facilitation of such services. Hence, support services were rendered on a principal to principal basis. The consideration for services to be rendered by the Appellant was not in the form of commission based on the success of service performed, but cost-plus basis. HLX does not have any clients in India. The Appellant also argued that the lower authorities have incorrectly treated the Appellant as an agent to classify it as an intermediary.

On the other hand, the Respondent argued that the Appellant had assisted HLX in setting up client accounts on the Aladdin platform database. It also assisted in resolving client queries. There was an involvement of three parties, Appellant, HLX and its client. Accordingly, it was an intermediary and not entitled for refund of unutilised credit.

Decision

The CESTAT reviewed the definition of intermediary as defined in Place of Provision of Service Rules, 2012. It concluded that in a case of an intermediary, the arrangement requires a minimum of three parties, two of them transacting in the supply of goods or services and one arranging or facilitating the main supply. Hence, an activity between only two parties cannot be considered as an intermediary service. The intermediary does not include the person who supplies goods or services on his own account. The CESTAT also observed that sub-contracting for a service was not an intermediary service. Where a sub-contractor provides the main supply, completely or partially, it cannot be equated with arranging or facilitating the main supply between the principal supplier and its customers. It stated that the aforesaid principle was in line with Guidance Note dated June 20, 2012, issued under the erstwhile service tax regime and clarification dated September 20, 2021, under the GST regime issued by the CBIC.

In the instant case, the support services rendered by the Appellant in relation to creation of clients account was limited to the performing of backend services on HLX systems. The activities of Appellants such as maintenance, support or troubleshooting function, were performed on requisition from HLX for seamless access of services. There was no requirement of any interaction with the clients of HLX. The Appellant received a pre-agreed consideration from HLX in convertible foreign exchange. There was nothing on record to show that the Appellant was liasioning or acting as intermediary between HLX and its clients. Non-submission of agreement between HLX and its client, as appellant was not privy to the agreement between HLX and its client was not a sustainable ground for rejecting the refund claim. It relied on the settled principles of law that the burden to prove that the classification claimed by the taxpayer

[67] BlackRock Services India Pvt Ltd. v. Commissioner of CGST, 2022 (142) taxmann.com 208 (CESTAT- Chandigarh).

was incorrect, lies on the IRA. The IRA cannot allege intermediary as classification basis assumptions and presumptions.

Hence, it held that the Appellant was not an intermediary.

Significant Takeaways

This decision is in line with the spirit of not exporting tax out of India. The decision highlights the most significant point that merely because a company in India undertakes certain activity of a customer's customer, the same cannot be presumed to be reason for classifying the company as an intermediary. Hence, where a service provider renders pure back office support to an overseas office like research or sales promotion, the services should not be classified as an Intermediary. Since, the definition is the same in GST legislation, the decision would benefit the taxpayer under the GST regime as well to taxpayers who are struggling with negative advance rulings[68] rendered under the GST legislation. Further, the constitutionality of section 13(8)(b) of the IGST Act, dealing with place of supply of an intermediary has been questioned before various forums[69]. Till the SC does not provide an affirmative definition, the risk of tax authorities alleging such service providers to be intermediaries cannot be ruled out.

> **"Rendering of back-end services would not make a supplier an intermediary."**

68 In re: Toshniwal Brothers TS-31-AAAR-2019-NT (AAAR); In re: Vservglobal Private Limited TS-676-AAR-2018-NT; In re: Global Reach Education Services Pvt. Ltd. TS-123-AAR-2018-NT.

69 ATE Enterprises Pvt Ltd. v. UOI and Orthers TS-257-HC(BOM)-2021-GST; Dharmendra M. Jani vs. UOI TS-272-HC (BOM)-2021-GST; The Material Recycling Association of India v. State of Gujarat TS-586-HC-2020(GUJ)-NT.

Delayed payment of GST through electronic cash ledger attracts interest

In ***India Yamaha Motor Private Limited***[70]**,** the Madras HC has held that the presence of adequate funds in the electronic cash ledger ("**ECL**") would not relax the levy of interest under section 50(1) of the CGST Act, if the same is not debited on time for any short or non-payment of GST at the time of filing of return for a month in which the supply was made.

Facts

India Yamaha Motor Private Limited ("**Petitioner**") is engaged in supplying two-wheeler vehicles. The Petitioner had filed the monthly return in Form GSTR 3B for July, 2017, by its due date for its Chennai plant. However, after filing of the said return, the Petitioner noticed that there was an inadvertent error whereby the data pertaining to its Faridabad plant was furnished instead of the Chennai plant in the monthly return. Subsequently, the Petitioner filed a grievance petition before the GST authority. During its pendency, the Petitioner did not file monthly returns for the period August, 2017, to October, 2017, as proper tax liability could not be ascertained without furnishing correct past return. It resulted in short disclosure of GST liability for the period of July-October, 2017. While the Petitioner filed delayed monthly returns and paid pending tax dues, no interest was paid on delay on the pretext that no interest was payable as there was sufficient balance in the electronic cash ledger ("**ECL**") and electronic credit ledger ("**ECrL**") on due dates of monthly return. The adjudicating authority disagreed and passed an order dated April 10, 2019, wherein the Petitioner was directed to remit interest of INR 5 crore for delayed payment of GST for the period from July, 2017 to October, 2017, without issuing a SCN.

The Petitioner filed a writ petition before the Madras HC challenging the order of the Respondents.

Issue

Whether interest under section 50 of the GST Act is to be levied on delayed payment of GST when there is sufficient balance in ECL and ECrL on due dates of monthly return?

Arguments

The Petitioner contended that due to an inadvertent mistake in furnishing details for the month of July, 2017, it had not filed monthly returns for the subsequent months from August to October 2017. It was done to ensure that no incorrect data is submitted subsequently, which would disable ascertainment of proper tax liability. The Petitioner also submitted that it had sufficient balance in both the ECL and ECrL and no loss was suffered by the IRA since balance was visible on the GSTN portal. Hence, no interest should be levied since the act of levying interest was compensatory in nature[71].

The Petitioner asserted that the proviso to Section 50 of the CGST Act provides that interest would not be leviable on delayed payment made through ITC as ITC was present on EcrL. Using the similar logic, no interest should be levied on debit through cash as well. The Petitioner also relied upon ***Refex Industries Limited***[72], where HC took note of the amendment to section 50 of the CGST Act and held that the proviso should operate retrospectively and thus, in cases where an assessee had sufficient ITC, there was no question of the IRA requiring to be compensated, since funds were available with it, to the credit of that assessee. The Petitioner also relied on ***Bharti Airtel Limited***[73], to argue that the law provides for self-assessment of turnover based on output tax liability and balance available in ECL and ECrL.

The Respondent agreed to provide reduction in the amount of interest on account of the amendments[74] to section 50 of the CGST Act, as it provided for levy of interest to the extent of cash payments was effected. However, the Respondents contended that the ITC balance in ECrL of the Petitioner cannot, prior to their utilisation, be equated with payment of GST liability of the Petitioner. It urged that cash balance in ECL cannot be equated with cash remittances made to the credit of the Government. The balance available in ECL was the property of the taxpayer and the taxpayer can claim refund of the balance as per his requirement. It would go to the Government Exchequer only when return is filed and the amount is debited from ECL.

70 India Yamaha Motor Private Limited v. The Assistant Commissioner and others, TS-448-HC(MAD)-2022-GST.
71 Pratibha Processors and others v. Union of India - 1996 (88) E.L.T. 12 (S.C.)
72 Refex Industry Limited v. the Assistant Commissioner of CGST and Central Excise, 2020 (2) TMI 794 – Madras HC.
73 Union of India v. Bharti Airtel Limited and Others., 2021 (11) TMI 109 SC
74 Inserted by Finance Act 2019.

Decision

The Madras HC observed that the Respondent has already agreed to provide benefit to the Petitioner in relation to imposing interest only when the tax amount was paid in cash. However, w.r.t. the Petitioner's claim that ECL and ECrL must be treated similarly as balance was available on the GSTN portal, the HC differentiated on it. The HC observed that payment occurs only when returns are filed, and the amount is debited from either of the ledgers. The balance available in ECL continues to be the property of the taxpayer and refund of the balance can be claimed as per the taxpayer's requirement. It would go to the Government Exchequer only when return is filed, and the amount is debited from ECL. Interpreting proviso to section 50 of CGST Act in any other manner would be incorrect. The language specifically provides regarding the requirement of remittance. Further, ITC availed may be erroneous or incorrect on account of several reasons such as availing restricted credit, failure to reverse ITC for exempt supplies, etc. Therefore, till ITC is utilised by debiting ECrL, no automatic exemption on computation of interest can be granted to the taxpayer.

Significant Takeaways

Availability of sufficient amount in ECL and ECrL of a taxpayer does not automatically discharge the GST liability of the concerned person unless tax returns are submitted after making requisite adjustments. There must be proper debit from the ECrL towards the tax liability. Recently, the High Court of Cuttack in ***Utkal Automobiles***[75] also observed that interest under section 50 of the GST Act is leviable only on the portion remitted by the ECL and not on the gross tax liability if remitted via credit in the ECrL.

This decision has differentiated between availability of balance in ECL and ECrL and has clarified that the only criteria is payment. There may be a situation where the taxpayer had less ITC on the due date of filing return, but is able to avail significant amounts of ITC in the interim to discharge his liability from ITC to avoid imposition of interest. While no similar interest provision has been introduced in customs, the decision may play a significant role as the concept of electronic ledger has also been introduced in Customs recently.

> **"Mere availability of balance in the ledger does not automatically absolve a taxpayer from interest."**

[75] Utkal Automobiles (P) v. Union of India, 2022 (142) taxmann.com 116 (Orissa HC)

IRA is a secured creditor under IBC for tax dues against which first charge was created

In ***Rainbow Papers***[76], the SC has held that NCLT must reject a resolution plan that ignores the statutory demands payable to any State Government or legal authority. The statutory creditors, having a first charge over the assets of a corporate debtor by virtue of the applicable statute, should be treated as a secured creditor under the provisions of IBC.

Facts

Rainbow Papers Limited ("**Respondent**") manufactures and sells oars and crafts. For non-payment of VAT and CST under the Gujarat Value Added Tax Act, 2003 ("**GVAT Act**"), amounting to INR 47.36 crore for 2011-12, the IRA initiated recovery proceedings on July 08, 2016, and attached one of the properties of the Respondent. Subsequently, an operational creditor filed for initiation of Corporate Insolvency Resolution Process ("**CIRP**") before the Ahmedabad Bench of the NCLT. Post the initiation of CIRP, various creditors filed their claims. The IRA also furnished their claims to the Resolution Professional ("**RP**"). However, the claim filed by the IRA was beyond the time limit declared in the public announcement by the RP. Later, when the IRA enquired, they were told that their outstanding tax dues claim was waived off as per the resolution plan approved by the NCLT.

Subsequently, the IRA ("**Appellant**") challenged the resolution plan before the Ahmedabad Bench of the NCLT, which was dismissed on the ground that section 53 of the IBC makes it amply clear that the Appellant is an operational creditor, who is placed at the end of the list of beneficiaries under the waterfall mechanism for distribution at the time of liquidation. On appeal, NCLAT also dismissed the appeal, holding that the State cannot claim first charge over the property of the Respondent, and also that section 48 of the GVAT Act, providing for first charge on the property of the taxpayer on account of outstanding tax, interest, penalty, etc., cannot prevail over the distribution mechanism envisaged under section 53 of the IBC. Aggrieved, the IRA filed an appeal before the SC.

Issue

i) Whether section 53 of the IBC, dealing with the sequence of beneficiaries, overrides first charge created under section 48 of the GVAT Act?

Arguments

The IRA contended that merely because it is qualified as an operational creditor, it does not automatically imply that it cannot be treated as a secured creditor. The IRA also argued that the RP does not have adjudicatory powers to accept or reject any claims, instead it only has the duty to receive, verify and collate claims filed against the corporate debtor[77]. Further, the IRA argued that as per section 30(2) of the IBC, it places a duty on the RP to ensure and undertake that the resolution plan conforms the requirements. The IRA submitted that when an appeal or grievance is raised before the NCLT or NCLAT with respect to the resolution plan, the NCLT or NCLAT is required to examine if the said resolution plan is meeting the requirements under section 30 (2) of the IBC. The IRA argued that the definition of secured creditor under section 3(30) of the IBC was comprehensive enough to cover all forms of security interests and arrangements securing payment. As IRA has already created a charge over property under section 48 of GVAT Act, the Appellant could be regarded as a secured creditor. It was also submitted that it is immaterial whether the provisions of IBC would prevail over the GVAT Act or not, instead it is important to consider that the Appellant falls under the purview of a secured creditor. Further, on the procedural aspect, the IRA contested that the RP had failed to examine the books of accounts, which would have reflected the statutory dues as the attachment proceedings were initiated earlier.

The Respondent argued that the Appellants filed a belated claim and, therefore, the resolution plan could not be questioned because it was prepared basis information furnished by the creditors to the RP. The Respondent also argued that IBC prevails over other legislations. Either section 48 of the GVAT or the GVAT Act itself cannot override a Central legislation like the IBC Act. It is also pertinent to note that section 53 of the IBC Act provides for sequence of beneficiaries who would get priority in claim at the time of distribution upon liquidation. The IRA was an operational creditor and hence, it was later in the sequence of beneficiaries. Thus, the claim of the IRA would have no priority over secured creditors or financial creditors' claims.

Decision

The SC did a detailed analysis of the various provisions of the IBC legislation and GVAT Act. The SC noted that the IRA had attached one of the properties of the Respondent before the process of

[76] State Tax Officer v. Rainbow Papers Limited, 2022 (9) TMI 317 – SC.
[77] Swiss Ribbons (P) Limited v. Union of India (2019) 4 SCC 17.

CIRP was initiated against the Respondent. It also observed that the definition of secured creditor was wide and could include statutory dues if charge had already been created under any other law. It held that section 53 of the IBC begins with a non-obstante clause, however, section 48 of the GVAT Act was not contrary to or inconsistent with it or any other provisions of the IBC. The SC further held that under section 53(1)(b)(ii), the debts owed to a secured creditor, which would include the Appellant under the GVAT Act, were to rank *pari passu* with other specified debts, including debts on account of workman's dues. Further, the SC held that the timeline for submission of claims under the IBC and the rules thereunder, is directory and not mandatory in nature[78].

Additionally, the SC held that a resolution plan cannot be deemed to be in compliance with the IBC rules if it does not include statutory dues to the Government or Government bodies. As a result, the resolution plan approved by the CoC, securing the interests of financial institutions and creditors at the cost of statutory dues would be incorrect. The SC held that section 31 of the IBC makes it clear that the NCLT can approve the resolution plan only upon satisfaction of the requirements laid down under section 30(2) of the IBC and when it does not, the same cannot be approved.

Significant Takeaways

In our view, the outcome of the decision was inclined towards the IRA since they had taken an affirmative action in attaching the property of the Respondent before initiation of the IBC proceedings, thereby creating a charge much over the underlying assets. No earlier decision has dealt with tax dues wherein the IRA has already exercised their right to recover the outstanding tax dues by attaching certain assets belonging to the taxpayer. It is possible that the IRA may try to rely on the aforesaid decision to contest the validity of resolution/ liquidation plans, irrespective of whether the taxpayers' assets are attached. It is pertinent to note that while most of the central indirect tax legislations such as the GST Act, Customs Act, the erstwhile Central Excise Act also provide for a first charge provision, most of these statutes also contain an exclusion, giving primacy to the IBC. Thus, while as per the relevant indirect tax legislations, the IRA gets a first charge against all assets of the Assessee for pending tax dues, they may not always be treated at par with secured creditors unless the underlying assets have been attached by them prior to the invocation of the IBC proceedings.

However, it remains to be seen how this decision is considered by the IRA as well as the Assessees. In case the IRA decides to take recourse of this decision and regard that it should be construed as a secured creditor in all cases, regardless of whether any asset is attached or not, it may open a plethora of litigations because the financial and secured creditors may not accept such a situation. It is, therefore, imperative that the SC make it position clear or the IRA clarifies its stance *vis-a-vis* the SC decision in the case of Rainbow (supra) so that unnecessary litigation can be avoided.

"The definition of secured creditor in the IBC does not exclude any Government or Governmental Authority."

78 Vishal Saxena and another v. Swami Deen Gupta Resolution Professional (2020) SCC Online NCLT 2734.

Telecom operator would be eligible for ITC refund for supply of services to Foreign Telecom Operator

In ***Vodafone India Limited***[79], the Bombay HC has held that telecommunication services provided by Vodafone to individual subscribers of Foreign Telecom Operators ("**FTOs**") does not make such subscribers its own customers. The telecom services provided to such individual subscribers would qualify as export services.

Facts

Vodafone India Limited ("**Assessee**") provides telecom services to its customers in India. It has also entered into a contract with FTOs to provide (a) International Inbound Roaming ("**IIR**") Services and (b) International Long Distance ("**ILD**") services. The FTOs have entered into such an arrangement with the Assessee because they do not hold a telecom license in India to provide their subscribers continuity and uninterrupted telecom services when they visit India. The Assessee, based on the usage by the overseas subscribers in India, raises its invoices on the FTOs for the telecom services rendered by it. The Assessee does not collect any remuneration directly from the customers of FTOs.

The FTOs pay the Assessee in convertible foreign exchange. According to the Assessee, the telecommunication services rendered by it to the FTOs qualified as export of service and thus, it made an application for refund of IGST paid by it at the time of export of such services. However, the IRA issued two SCNs to question the refund. IRA did not accept the reasoning provided by the Assessee and rejected its claim on two grounds. First, the place of supply of services was Maharashtra and not outside India and hence, it did not qualify as export of service. Second, a part of the claim was time barred because it was filed after two years from the date of receipt of foreign currency. Aggrieved, the Assessee filed an appeal before the Joint Commissioner of CGST (Appeals), wherein the appellate commissioner accepted the claim and directed the IRA to grant the refund of IGST. However, the IRA still did not sanction the amount of refund. Aggrieved by the inaction, the Assessee filed a writ petition before the Bombay HC.

The IRA also filed a writ petition challenging the order of the appellate commissioner.

Issue

Whether telecom services provided by the Assessee to the FTOs, which allows the FTOs' customers to utilise telecom services while they are in India, would qualify as export of service?

Arguments

The Assessee contended that with IIR and ILD services, a customer may continue using the same number and avail telecom services in different countries while travelling outside their home country. The Assessee was obligated to render such services to FTOs because it had already entered into a contractual arrangement with them to render such services for a consideration payable by them in convertible foreign exchange. In order to qualify as export of service, the relevant conditions are:

a) the supplier must be in India;

b) recipient should be outside India;

c) the place of supply should be outside India;

d) payment should be received in convertible foreign exchange; and

e) the supplier and the recipient of service are not merely a branch or an agency or a representational office in any territory, which will be treated as having an establishment in that territory.

It was submitted by the Assessee that the place of supply was outside India as services were consumed outside India in terms of section 13 (2) of IGST Act. It also contended that section 13(3)(b) of IGST Act, dealing with place of supply provided that the actual performance was relevant only when services were rendered to an individual or an individual on behalf of the recipient of services. However, in the instant case, services were rendered by the Assessee to the FTOs and not to any individual customer.

The Assessee also relied on earlier decisions of CESTAT rendered in relation to the erstwhile service tax law, where the CESTAT had interpreted that the service recipients were FTOs and not individual subscribers of the FTOs travelling to India. It had held that the customer's customer was not your customer. As services were rendered to FTOs located outside India, the place of supply was outside India.[80]

The Assessee also submitted that if the analogy of Revenue was to be accepted, it would lead to not only rejection of refund of IGST, but also consequential demand of GST for services consumed in India. It also stated an arguendo that if continuity services were to be considered as domestic supplies, there would be no requirement on part of the Assessee for payment of GST in cash under reverse charge on inward supply of continuity services received from FTOs when the Assessee's customers

[79] Vodafone Idea Limited v. The Union of India (2022) 140 taxmann.com (Bombay HC).
[80] Vodafone Essar Cellular Ltd. v. CCE, 2013 (33) taxmann.com 358 (CESTAT- Mumbai); CST v. Bayer Material Science, 2014 (51) taxmann.com 222.

utilise telecom services in foreign territories. In such a case, the Assessee should be eligible for refund of IGST paid on import of services from the FTOs.

The IRA, on the other hand, submitted that CESTAT decisions have all been challenged by the IRA in the SC, therefore, the question of law was sub-judice and thus, the petition was maintainable.

On merits, IRA argued that the customers of the FTOs travelling to India utilised the services rendered by the Assessee. The customers visiting India made/ received calls during the duration of their stay within the territory of Maharashtra. IRA also argued that the customers were acting on behalf of FTOs and hence, section 13(3)(b) of IGST Act was applicable and thus, the place of actual performance of service would be the place of supply. Accordingly, it was contended by the IRA that one of the prescribed conditions to qualify as export of services was not met.

Decision

The Bombay HC upheld the order of the appellate commissioner. It observed that the Assessee had contractually entered into the contracts with the FTOs and not with individual subscribers of FTOs travelling to India. The recipient of services were FTOs themselves and not the subscribers since the consideration was paid by the FTOs, for the purpose of GST legislation. The relationship between the subscribers of FTOs and the FTOs were on a principal-to-principal basis and not principal-agent basis. In case of deficiency in the provision of services, the subscribers could take the FTOs to task.

HC also noted that section 13(3)(b) of IGST Act was applicable to services provided to an individual. In the instant case, the Assessee was providing services to the FTOs under their contractual agreements, and FTOs were supplying services to their individual subscribers on the basis of their agreements. The Assessee was unaware of the details of the subscribers. Hence, it concluded that no services were rendered by the Assessee to such individual customers. The HC also emphasised on the concept that a customer's customer cannot be your own customer. Accordingly, it concluded that services were provided by the Assessee to FTOs and not to FTOs' subscribers.

Significant Takeaways

This is a good decision under the GST legislation, dealing with the conceptual aspect of place of supply under the GST legislation when multiple parties are involved. Various taxpayers are facing trouble in seeking refund from GST as the IRA has been trying to reject the refund claims of various customers by claiming that refund cannot be granted since they are in the nature of intermediary services, actual performance related services, immovable property related services, etc. As the GST Tribunal has not been set up yet, the expectation of a well-reasoned and taxpayer friendly approach from the lower authorities continues to be low and taxpayers are left with no viable alternate solution. The above decision would play a significant role in assisting taxpayers to argue that 'customer's customer is not your customer'. The judgement clearly establishes that mere presence of a customer's customer in India or any indirect connection with India at the time of rendering of service would not shift the place of supply to India if the same does not fall in specified services.

"Customer's customer may not be your customer."

REGULATORY DIRECT TAX UPDATES

CBDT prescribes forms and documents required to claim COVID-19 related tax exemptions

In Budget 2022, the Central Government had announced that any sum of money received by an individual on account of reimbursement for medical treatment of self or family members on account of COVID-19 will not be taxable. Additionally, any sum of money received by family members of a deceased individual from the employer of the deceased individual will not be taxable.

Consequently, the CBDT had come out with three notifications dated August 5, 2022, providing the conditions required to be fulfilled to claim such tax-free reimbursements from the employer, and for such reimbursements to qualify as exempt income under the provisions of the IT Act. The notifications are deemed to be effective from April 1, 2020, and are applicable to assessment year 2020-21 and subsequent assessment years. The key notifications are:

i) The Central government *vide* **Notification No. 90/2022** has notified the conditions under clause (ii)(c) to the first proviso to section 17(2) to claim tax exemption of any sum paid by an employer for any expenditure incurred by the employee on his or his family member's treatment. The conditions require the employee to submit the following documents to the employer: (i) COVID-19 positive report, or medical report if clinically determined to be COVID-19 positive through investigations, (ii) all necessary documents of medical diagnosis or treatment for COVID-19 or illness related to COVID-19, suffered within six months from the date of being determined as COVID-19 positive, and (iii) a certification in respect of all expenditure incurred on the treatment of COVID-19 or illness related to COVID-19 of the employee or of any member of his family.

ii) The Central Government *vide* the **Notification No. 91/2022** has notified the conditions under clause (XII) to the first proviso to section 56(2)(x) for an individual to claim tax exemption of money received for his or his family member's medical treatment under section 56(2)(x). The conditions require the individuals to keep record of the documents listed in clause (i) and (ii) of Notification No. 90/2022. Additionally, a Statement with the details of any amount received for any expenditure actually incurred by him for his or his family member's medical treatment for any illness related to COVID-19 must be furnished in Form No. 1 provided in the notification. Such details in Form No. 1 are required to be furnished within nine months from the end of financial year in which the amount is received or December 31, 2022, whichever is later.

iii) The Central government *vide* **Notification No. 92/2022** has notified conditions under clause (XIII) to the first proviso to section 56(2)(x) for a family member of the deceased person to claim exemption of any ex-gratia payment received from the employer: (a) the death should have taken place within six months from the date of testing positive or from the date of being clinically determined as a COVID-19 case, for which any sum of money has been received by the family member, (b) the family member is required to keep record of the documents mentioned in clause (i) of Notification No. 90/2022, and a medical report or death certificate issued by a medical practitioner or a Government civil registration office, stating that death is related to COVID-19. Additionally, a statement of the amount received by a family member from the deceased person's employer or any other person for COVID-19 death in any financial year, is required to be furnished by the family member in Form A provided in the notification. Such details in Form A are required to be furnished within nine months from the end of financial year in which the amount is received or December 31, 2022, whichever is later.

CBDT issued procedure for PAN application & allotment through Form FiLLiP for LLPs

The proviso to Rule 114(1) of IT Rules provides that an applicant may apply for allotment of a PAN through a common application form notified by the Central Government in the Official Gazette, and the Principal Director General of Income Tax (Systems) or Director General of Income-tax (Systems) shall specify the classes of persons, forms and format, along with the procedure for the safe and secure transmission of such forms and formats in relation to the furnishing of PAN.

In exercise of such power, the CBDT, vide its Notification No. 04/2022, dated July 26, 2022, has notified that the application for allotment of PAN will be filed in Form FiLLip by a newly incorporated LLP with the Ministry of Corporate Affairs ("**MCA**"). After the generation of the LLP Identification Number, the MCA will forward the data in Form 49A to the IRA under its digital signature. The classes, forms, format and procedure for PAN has been provided as under:

S. No.	Particulars	
1.	Classes of persons to which FiLLiP form will apply	Newly incorporated LLP
2.	Applicable form	Simplified Proforma for incorporating LLPs (Form FiLLiP) of MCA notified *vide* notification G.S.R. 173E, dated March 4, 2022.
3.	Procedure	- Application for allotment of PAN will be filed in FiLLip form, using digital signature of the applicant as specified by the MCA - After generation of LLP Identification Number (LLPIN), MCA will forward the data in form 49A to the Income-tax Authority under its digital signature, Class 2/ Class 3 of MCA
4.	Format	Xml

CBDT amends Rule 128 to extend time limit for filing Form 67 to claim Foreign Tax Credit

The CBDT, *vide* Notification No. 100/2022 dated August 18, 2022, notified the Income-tax (27th Amendment) Rules, 2022, amending Rule 128(9) of the Income-tax Rules, 1962. Rule 128 deals with availing foreign tax credit by a resident, whereas sub-rule (9) provides for the time period within which a resident assessee has to submit Form No. 67. Form No. 67 enables the resident assessee to provide information of income earned from a country or specified territory outside India and details of the foreign tax credit claimed.

Notification No. 100/2022 substitutes the erstwhile Rule 128(9) and mentions that the statement in Form No. 67 is to be furnished on or before the end of the assessment year, relevant to the previous year in which the income for which foreign tax credit is being claimed has been offered to tax or assessed to tax in India or within the time period specified under section 139(1) or 139(4). While sub-section (1) of section 139 requires a person to furnish the return of income on or before the due date, sub-section (4) grants an extension to the assessee to furnish the return three months prior to end of relevant assessment year or before the completion of the assessment, whichever is earlier.

Sub-section (8A) of section 139 allows an assessee to furnish an updated return of income within twenty-four months from the end of the relevant assessment year. The said Notification also provides for Form No. 67, only to the extent of the updated income, to be furnished on or before the date on which the updated return is filed.

This Notification contains an explanatory memorandum which states that the 27th Amendment shall not be applied retrospectively and will be applicable to claims of foreign tax credit furnished during the financial year 2022-23.

CBDT issues additional guidelines under section 194R of the IT Act

The FA 2022, *inter alia*, introduced section 194R in the IT Act, which provides for deduction of tax at source on providing any benefit or perquisite to a resident, arising from such resident's business or profession. The said provision mandates the person responsible for providing such benefit/ perquisite to deduct tax at the rate of 10% of the value or aggregate of the value of benefit/ perquisite. To remove difficulties in implementing the provisions of section 194R of the IT Act, the CBDT had previously issued guidelines[81] to clarify the scope of the said section. Recently, the CBDT issued additional guidelines under the said

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

provision.[82] The key takeaways from the additional guidelines are provided below:

i) One-time loan settlement with borrowers/ waiver of loan granted, with a specified list of borrowers (primarily banks and other financial institutions), would not be subject to TDS under section 194R.

ii) Any expenditure incurred by a 'pure agent' (as defined in GST Valuation Rules, 2017), for which ITC is available to the benefit/ perquisite provider and is not treated as the supply of the pure agent, will not attract TDS liability under section 194R even if the invoice is in the name of the pure agent.

iii) If out of pocket expenses form a part of the consideration, on which TDS is deducted under any other provision of the IT Act (such as 194J/ 194C in accordance with the CBDT Circular No. 715, dated August 8, 1995), there will be no further liability under section 194R.

iv) If benefit/ perquisite is provided in a group activity whereby it is difficult to match the benefit/ perquisite to each participant, the provider of such benefit/ perquisite may choose not to claim such expense as deductible expenditure in his computation of total income. Upon making such choice, such benefit/ perquisite provider would not be required to deduct tax under section 194R.

v) Where a dealer receives a car as a gift from the company, on which TDS is duly deducted under section 194R by the company and the dealer includes the benefit/ perquisite from such a gift in his return of income, it would be deemed that the actual cost of the car for the purposes of section 32 of the IT Act shall be the amount of benefit included by the dealer in his return of income and thus, would be eligible to claim depreciation on the same, subject to fulfilment of other conditions specified for claiming the depreciation.

vi) Section 194R is not applicable on benefit/ perquisite provided by the organisation in scope of the United Nations (Privileges and Immunity Act) 1947, an international organisation whose income is exempt under specific act of parliament, an embassy, a high commission, legation, commission, consulate and trade representation of a foreign state.

vii) TDS under section 194R is not required to be deducted on issuance of bonus/ right shares issued by a company in which the public are substantially interested, where bonus/ right shares are issued to all shareholders of such a company.

CBDT notifies rules for maintenance of books by charitable institutions

CBDT *vide* its Notification dated August 10, 2022[83], has notified the Income-tax (24th Amendment) Rules, 2022, and inserted new Rule 17AA in the IT Rules.

Vide the Finance Act, 2022, tenth proviso to section 10(23C) of the IT Act and sub-clause (b) in Section 12A(1) of the IT Act were substituted to provide that a charitable institution having total income exceeding the maximum amount not chargeable to income-tax and required to avail exemption under these provisions, would be required to maintain the books of accounts as would be prescribed under the income tax laws. In this regard, new Rule 17AA has been inserted in the IT Rules vide the aforesaid Notification dated August 10, 2022, which provides that such a charitable institution would need to maintain the following documents:

A) Books of accounts such as a cash book, ledger, journal, bills and receipts issued by or to an assessee and other such books to substantiate the transactions effected during the year.

B) Books of accounts as referred to in serial no. A above for a business undertaking as referred to in section 11(4) of the IT Act.

C) Books of accounts as referred to in serial no. A above for business other than a business undertaking as referred to in section 11(4) of the IT Act.

D) Other documents as follows:

   i) record of all projects and institutions run by such person, containing details of their name, address and objectives.

   ii) record of income arising during the previous year in respect of voluntary contributions (name, address, PAN and Aadhaar number of the donor), income from property held under trust as per section 11 of the IT Act, along with a list of such properties and any other income.

   iii) record of a) application of income during the previous year in India, including the amount, name and address of payees, purpose of application, etc., b) payment to any other charitable institution, c) application of income outside India, d) deemed application of income as referred in clause (2) of Explanation 1 of section 11(1)

[82] Circular No. 18 of 2022 dated September 13, 2022.
[83] Notification No. 94/2022/ F. No. 370142/34/2022-TPL dated August 10, 2022

of the IT Act, e) accumulation of income as per Explanation 3 to the third proviso to section 10(23C) or section 11(2) of the IT Act and f) investment made as per Section 11(5) or other modes.

iv) record of the preceding year prior to the current year in respect of a) application of income accumulated in prior years, including the amount, name and address of payees, purpose of application, etc., b) application out of deemed application of income for prior years, c) other application out of income accumulated during prior years, d) investment made as per section 11(5) or other modes.

v) record of voluntary contribution received toward a corpus of the assessee's institution in respect of: a) the contribution received (name, address, PAN and Aadhaar number of the donor b) application of such amount c) payment to any other charitable institution, d) investment made as per section 11(5) or other modes, e) application out of contribution received in prior years, f) payment towards corpus of any other charitable institution, g) investment made as per section 11(5) or other modes h) amount invested back in to such voluntary contribution.

vi) record of contribution received for renovation or repair of temple, mosque, gurdwara, church or any other place notified under section 80G(2)(b), treated as corpus in respect of: a) contribution received, b) contribution received during prior years, treated as corpus during the previous year, c) application out of such voluntary contribution, d) payment towards corpus of any other charitable institution, e) investment made as per section 11(5) or other modes, f) application out of corpus received during prior years, g) payment towards corpus of any other charitable institution out of such voluntary contribution received during prior years h) investment made as per section 11(5) or other modes in which such corpus received during any prior years is invested.

vii) record of loans and borrowings containing information about a) date of loan and date of repayment, name, address, PAN and Aadhaar number of lender, b) amount applied out of such loan, c) amount applied out of loan or borrowing received during prior years, d) repayment of such loan or borrowing not claimed as application during prior years.

viii) record of properties held by the assessee, containing information about a) nature, cost of acquisition, etc., of movable and immovable properties.

ix) record of specified persons as referred under section 13(3) of the IT Act (containing their name, address, PAN No., Aadhaar No.) and details of transactions undertaken with such specified persons.

x) any other documents containing any other relevant information.

Further, it has been provided that such books of accounts and documents may be maintained in written form/ electronic form/ digital form/ as print-outs or in any other electromagnetic data storage device. These records need to be maintained at the registered office of such charitable institution or such other place as duly intimated to the AO.

These records need to be maintained for a period of ten years from the end of the relevant AY. In case of re-opening of assessment for any AY under section 147 of the IT Act, such records maintained at the time of reopening shall continue to be retained till the finalisation of such assessment proceedings.

Successor entities to file return of income in Form ITR-A

The Finance Act, 2022 had inserted a new section 170A to enable entities going through business reorganisation to file modified returns for the period between the date of effectivity of the order and the date of issuance of the final order from the competent authority. The modified return shall be furnished in the prescribed form and manner within six months from the end of the month in which the said order was issued.

To implement the changes, the CBDT has now notified a new Rule 12AD, prescribing norms for filing of returns under section 170A. Rule 12AD provides that the modified return of income shall be furnished electronically, by a successor entity to a business reorganisation, in Form ITR-A.

If the assessment proceedings for the relevant years are pending or completed, the IRA shall pass an order modifying the total income or proceed to complete the assessment or reassessment proceedings in accordance with the order of the business reorganisation and the modified return so furnished.

REGULATORY INDIRECT TAX UPDATES

E-invoicing under the GST Legislation

Notification No. 13/2020-Central Tax, dated March 21, 2020, read with Notification No. 17/2022- Central Tax, dated August 01, 2022, provides that a registered person having aggregate turnover exceeding INR 10 crore in any preceding financial year from 2017-18 onwards shall issue an e-invoice w.e.f. October 01, 2022, for supply of goods and/or services or for exports. Invoice issued in any other manner will not be treated as a valid invoice. The e-invoice can be generated on the GST electronic portal by furnishing the relevant information. However, the following suppliers would not be required to comply with the aforesaid system:

a) SEZ unit,

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

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

d) supplier supplying passenger transportation service,

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

Extension/ reduction in list of RCM

CBIC, vide Notification No. 05/2022- Central Tax (Rate), dated July 13, 2022, provides that on service by way of renting of residential dwelling to a registered person, the recipient shall be liable to discharge GST.

However, a Goods Transport Agency can opt for payment of GST under forward charge mechanism.

No requirement to file annual return

CBIC vide Notification No. 10/2022- Central Tax, dated July 05, 2022, has exempted registered person whose aggregate turnover in FY 2021-22 is up to INR 2 crore, from filing annual return for the said FY.

Extension on account of COVID-Pandemic

CBIC, vide Notification No. 13/2022- Central Tax, dated July 05, 2022, has extended the following dates:

a) Time limit for issuance of order for recovery of tax not paid or short paid or of input tax credit wrongly availed or utilised, in respect of a tax period for FY 2017-18, from February 07, 2023, to September 30, 2023.

b) Excludes the period from March 01, 2020, to February 28, 2022, for computation of the period of limitation for issuance of order for recovery of erroneous refund.

c) Excludes the period from March 01, 2020, to February 28, 2022, for computation of period of limitation for filing refund application.

Amendments to CGST Act

CBIC has implemented the following provision from July 5, 2022, onwards, vide Notification No. 09/2022- Central Tax, dated July 05, 2022:

a) Transfer of amount available in the electronic cash ledger of one State registration to the electronic cash ledger of another State.

b) Where the ITC has been wrongly availed and utilised (instead of undue or excess claim of ITC), the registered person shall pay interest at 18%.

Clarifications under GST legislations

The following clarifications have been issued by CBIC:

a) It has been clarified that where inputs and output goods are the same, but output supplies are made under a concessional notification, resulting in inverted duty structure, refund would be available vide Circular No. 173/05/2022, dated July 06, 2022. It was earlier denied by paragraph 3.2 of Circular No.135/05/2020-GST, dated March 31, 2020.

b) Refund of unutilised ITC on account of export of electricity, vide Circular No.175/07/2022-GST dated July 06, 2022:

   i. no requirement for filing of Shipping Bill/ Bill of Export in respect of export of electricity

   ii. the relevant date for determining the limitation date shall be the last date of the month, in which electricity has been exported as per monthly Regional Energy Account (REA), issued by the Regional Power Committee Secretariat.

   iii. If there is a mismatch in the quantum of electricity exported, as mentioned in the invoice vis-à-vis the statement of scheduled energy uploaded with the REA on the Regional Power Committee website, the lower value would be considered for turnover of export of electricity.

   iv. Furnish/ upload the details contained in the new format, i.e. Statement 3B of FORM GST RFD-01, containing the number and date of export invoices, details of energy exported, tariff per unit for export of electricity as per the agreement.

   v. Upload the copy of statement of scheduled energy for electricity exported by Generation Plants, issued as part of REA by Regional Power Committee Secretariat.

c) Various issues were clarified vide Circular No.174/04/2022-GST, dated July 06, 2022:

   i. The refund in respect of deemed export supplies is the refund of tax paid on such supplies. To overcome certain issues on the GSTN portal, it was advised that the tax amount would be available as ITC on the portal. As they are not ITC as per the GST legislation, any restriction applicable to ITC formula, dealing with refund of unutilised ITC, would not be applicable to such GST.

   ii. Proviso pertaining to availability of ITC in respect of such goods or services used to provide any facility to the employee, where it is obligatory for an employer to provide the same to its employees, under any law, is not restricted to travel benefits and is available for insurance, food and beverage, etc.

   iii. Any perquisites provided by the employer to his/ her employee, as part of a contractual agreement, would not be subject to GST as they are in lieu of the services provided by the employee to the employer in relation to his employment.

   iv. Amount available in the electronic credit ledger of a registered person can be utilised for making any payment towards output tax, whether self-assessed in the return or payable as a consequence of any proceeding. However, the same cannot be used to pay GST payable under reverse charge mechanism or for making payment of any interest, penalty, fees, or payment of erroneous refund sanctioned to the taxpayer.

d) CBIC vide Circular No. 178/10/2022-GST, dated August 3, 2022, clarified the applicability of GST on certain payments such as liquidated damages, penalty fees, etc., which were alleged to be covered by entry 5(e) of Schedule II to the CGST Act. The said entry covers the act or obligation of (a) refraining to do an act, (b) to tolerate an act or (c) to do an act. Following has been clarified:

   i. Liquidated Damages are not taxable under the GST legislation as the amount does not constitute as consideration paid for a separate independent activity. Liquidated damage is an amount having a compensatory nature and there exists no express contract between the parties to refrain or tolerate or do any act.

   ii. Compensation for cancellation of coal blocks, basis the decision of SC, to old allotees of the mines by the Government for transferring it to new allottee was not taxable.

   iii. Penalty or fine for cheque dishonor was not for tolerating of an act or situation, but a fine. Therefore, it is not taxable.

iv. Penalty imposed for violation of laws as 'supply' rendered or received, as statutes are not framed to tolerate any act. Therefore, it is not taxable.

v. Forfeiture of salary in the event the employee leaves the employment before the minimum agreed period is deterrent in nature. It discourages non-serious candidates from joining the organisation. It is not taxable.

vi. Compensation for not collecting toll charges was payment for access of roads, paid by the NHAI rather than the actual users of the road. The nature of service rendered did not change. Therefore, it would remain exempt as per applicable entry.

vii. Late payment, surcharge or fees accepted as late payment fees from the consumer is considered to be bundled with the main supply being rendered by the supplier. Similarly, cancellation charges or forfeiture of amount in case of non-refundable tickets are facilitation charges for making arrangement and then cancelling such arrangement. Therefore, collection of late fees or cancellation fees by the supplier would be ancillary to the principal supply and would be taxed at the same rate as the principal supply.

Further, the CBIC has stated in the circular that the abovementioned scenarios are guidelines that can be followed by the field formations, however, taxability in each case will depend on the facts of that case.

Customs (Import of Goods at Concessional Rate of Duty or for Specified End Use) Rules, 2022

CBIC vide Notification No. 174/2022- Customs, dated September 09, 2022, has introduced new rules replacing the 2017 rules. The earlier rules were followed where a notification dealing with exemption or concessional rate provided for the fulfillment of these rules for manufacturing or providing specific services as a condition for availing the concessional rate. The rules have now been expanded to cover situations where the benefit is dependent upon the use of imported goods for being put to a specified end use. While the new rules are on the same lines as the earlier rules, since it also provides for manufacturing of products through 100% outsourcing of materials imported at a concessional rate of customs duty under the relevant notification, except gold. However, the new rules have included the following changes:

a) Time period specified in the notifications for utilisation would apply in all cases. However, where no period is prescribed, the time period of six months would apply. The jurisdictional Commissioner can further extend such period by another three months on furnishing sufficient reason that were beyond the importer's control.

b) Compliances in relation to end use such as procedure of intimation, generation of a unique IGCR Identification Number, submission of bond, maintenance of records, and filing of monthly statement. The importer must supply goods under an invoice or wherever applicable, through an e-way bill, where the intended purpose of the import is supply of goods to an end use recipient.

c) The value or requirement of Bond/ BG (Bank Guarantee) depending on the importer.

d) Introduction of a new Form IGCR-3A for confirmation of consumption for the intended purpose at the common portal at any point in time for immediate re-credit of the bond by the jurisdictional officer.

The aforesaid aspects have been further clarified vide Circular No.18 /2022-Customs, dated September 10, 2022.

Exemption on IGST and Cess for goods imported under EPCG/ Advance Authorisation, etc.

CBIC, vide Notification No. 37/2022-Customs, dated June 30, 2022, and DGFT, vide Notification no. 16/2015-20, dated July 01, 2022, has exempted payment of IGST and Compensation Cess on imports made under Advance Authorisations/ EPCG Scheme and by EOUs, etc., indefinitely.

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

DGFT, vide Policy Circular 43/2015-20 dated June 27, 2022, has relaxed the condition for submitting bill of export in case of exports made from SEZ units under EPCG for supplies made prior to April 01, 2015. In order to discharge export obligations, the taxpayer would be required to submit corroborative evidence, such as:

a) ARE-1 form attested by jurisdictional officer;

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

c) Evidence of payment made by the SEZ unit.

Work from Home ("WFH") in SEZ

Vide SEZ (Third Amendment) Rules, 2022, dated July 14, 2022, a new Rule 43A has been inserted to prescribe WFH procedures. As per the rule, employees and contractual employees of IT and ITES sector, employees who are temporarily incapacitated or are travelling or working offsite can WFH, subject to fulfillment of prescribed conditions. The conditions are as follows:

a) The SEZ unit has to submit a proposal to the development commissioner ("DC") of the concerned SEZ, atleast 15 days in advance (except employees who are temporarily incapacitated or are travelling), containing details of employees, date for commencement of WFH, and other terms of working. For an unit whose employees are already in WFH, the proposal has to be submitted within 90 days from July, 2022.

b) The proposal shall cover a maximum 50% of total employees.

c) The Unit shall maintain accurate attendance record for the entire period. An Unit shall ensure that the export revenue of the resultant products or services are accounted for by the Unit to which the employee is tagged. DC may approve a higher number of employees to WFH for any bona-fide reason to be recorded in writing;

d) WFH proposal shall be valid for one year. DC may subsequently extend it for 1 year at a time.

e) WFH work by employees has to be an authorised service of the Unit and is related to a project of the Unit.

f) Comply with the conditions for temporary removal of goods to DTA.

In this regard, the Department of Commerce has also published standing operating procedure, vide Instruction No. 110 dated August 12, 2022, which provides content of proposal, calculation of percentage of employees.

Payment of exports and imports can be made or received in INR

The DGFT, vide Notification No. 33/2015-2020, dated September 16, 2022, has permitted invoicing, payment and settlement of exports and imports in INR currency, in line with the RBI's A.P. (DIR Series) Circular No. 10, dated July 11, 2022. However, in case of import, the payment shall be made in special VOSTRO account of the correspondent bank in the designated country and in case of export, the payment shall be received from special VOSTRO account of correspondent bank in designated country.

GLOSSARY

ABBREVIATION	MEANING
AAR	Hon'ble Authority for Advance Rulings
AAAR	Hon'ble Appellate Authority for Advance Rulings
AO	Learned Assessing Officer
AY	Assessment Year
Customs Act	Customs Act, 1962
CBDT	Central Board of Direct Taxes
CENVAT	Central Value Added Tax
CESTAT	Hon'ble Customs, Excise and Service Tax Appellate Tribunal
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)
CVD	Countervailing Duty
DGFT	Directorate General of Foreign Trade
DRP	Dispute Resolution Panel
DTAA	Double Taxation Avoidance Agreement
EPCG	Export Promotion Capital Goods
FA	Finance Act
FMV	Fair Market Value
FTP	Foreign Trade Policy
FY	Financial Year
GST	Goods and Services Tax
HC	Hon'ble High Court
HUF	Hindu Undivided Family
IBC	Insolvency and Bankruptcy Code, 2016
IGST	Integrated Goods and Services Tax
IGST Act	Integrated Goods and Services Tax Act, 2017
INR	Indian Rupees

GLOSSARY

ABBREVIATION	MEANING
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
NCLT	National Company Law Tribunal
NCLAT	National Company Law Appellate 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
RBI	Reserve Bank of India
SAD	Special Additional Duty
SC	Hon'ble Supreme Court
SCN	Show-cause Notice
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
TDS	Tax Deducted at Source
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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