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tax scout

Tax Scout | October – December, 2022

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Dear Readers,

We are delighted to present the latest issue of Tax Scout, our quarterly update
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 December 31, 2022.

In our main story, we have dealt with the minimum standard provisions related to treaty abuse under the Multilateral Instrument ("**MLI**") and its impact on India's DTAAs. In addition to the above story, we have also dealt with other important developments and judicial precedents in the field of taxation for this quarter.

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

Regards,

CYRIL SHROFF

Managing Partner
Cyril Amarchand Mangaldas

India's leading law firm

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Multilateral Instrument with a focus on minimum standard provisions related to treaty abuse (Articles 6 and 7) and its impact on India's DTAAs

I. Background

The Multilateral Instrument ("**MLI**") to implement changes / revisions to the double taxation avoidance agreements automatically to prevent Base Erosion and Profit Shifting ("**BEPS**") is one of the key Action Plans of the OECD's BEPS Project. It must be noted that the BEPS Project was announced in 2012 with the objective to combat BEPS strategies adopted by Multinational Enterprises ("**MNEs**"). BEPS has been defined as *"tax avoidance strategies that exploit gaps and mismatches in tax rules to artificially shift profits to low or no-tax locations"*.[1] It includes a broad range of tax avoidance strategies geared towards reducing the total tax liability by exploiting the gaps and the mismatches in treaty provisions and tax regimes of different jurisdictions.

Developments in the international community, *inter alia*, increase in the global reach of MNEs, technological developments making it easier for MNEs to carry out their economic activity in a particular jurisdiction without having any legal presence, which results in loss of tax revenue to the jurisdiction where economic activities were carried out. Further, MNEs were alleged to be involved in treaty shopping, wherein toothless holding entities were set up in tax-friendly jurisdictions to claim the benefits of tax treaties. In February 2013, the OECD published an extensive report titled *Addressing Base Erosion and Profit Shifting* highlighting the need to revise international tax framework and align it with developments in the global economy and also to ensure that profits are taxed where economic activities are carried out and value is created.[2] Pursuant to this, G20 countries and the OECD have worked extensively to address the issue of BEPS and released a report identifying key treaty-related measures titled *Action Plan on Base Erosion and Profit Shifting*. The report contained fifteen (15) action plans that must be adopted in the international tax framework to address BEPS by eliminating treaty abuse and ensure that income is taxed in the state of value creation. These included measures ranging from taxation of the digital economy, ensuring coherence in global corporate taxation, and regulating the dispute resolution process.

The OECD recognised that amendments to over three thousand DTAAs on an individual basis would involve significant time and resources. Further, such negotiations at the individual level might create further mismatches and inconsistencies in the international tax framework. Hence, an amenable and efficient mechanism was required to give effect to the recommendations of the BEPS Project. To combat this situation, the Action 15 of the BEPS Action Plan endorsed the development and adoption of a multilateral agreement for coordinated, consistent and swift implementation of the OECD recommendations. Accordingly, the text of MLI was released in 2016 after years of extensive negotiations involving participation from over hundred jurisdictions.[3] The text was developed to ensure that a quick solution to BEPS is offered while enabling the contracting jurisdictions to retain their autonomy at the time of

1 "Action Plan on Base Erosion and Profit Shifting." OECD Publishing (2013), https://doi.org/10.1787/9789264202719-en.
2 "Addressing Base Erosion and Profit Shifting." OECD Publishing (2013), https://doi.org/10.1787/9789264192744-en.
3 "Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting." OECD. Available at: https://www.oecd.org/tax/treaties/multilateral-convention-to-implement-tax-treaty-related-measures-to-prevent-BEPS.pdf.

participating in the process. Such autonomy was ensured by providing flexibility in implementing BEPS recommendations as per the requirement and objective of each contracting jurisdiction. As of December 2022, the MLI has one hundred (100) signatory jurisdictions including countries from different levels of development. Three more jurisdictions have expressed their intent to sign the MLI in the near future.[4] This is a testament to the success of MLI, which carries the potential to make a significant impact in the international taxation regime.

This article intends to provide a brief understanding of the functioning of the MLI with a focus on the minimum standard provisions relating to Action Plan 6 along with its impact on the DTAAs entered by India.

II. Understanding the application of MLI

The application of MLI requires the intending country to sign and ratify the MLI, in accordance with the municipal law of their respective countries. This instrument of ratification is then submitted to the OECD depositary. The MLI will *'enter into force'* on the first day of the calendar month after three-months from the date of deposit of the ratification instrument. However, the effective date of the MLI application would depend on the type of taxation to which its provision would be applicable. For taxes which are withheld at source on amounts paid to non-residents, the MLI will *'enter into effect'* on or after the first day of the next calendar year, from the dates on which the MLI comes into force for both treaty partners. A treaty partner has the flexibility to opt for a 'taxable period' instead of a 'calendar year' for this provision. For all other taxes, the MLI will 'enter into effect' for taxable periods beginning on or after the expiry of six calendar months from the dates on which the MLI comes into force for both treaty partners.

Additionally, the MLI does not automatically modify all existing DTAAs of the concerned jurisdiction. it applies only to those DTAAs for which the contracting jurisdiction has conveyed an express intention to be covered under the MLI. Such intention is conveyed usually by way of a notification. The DTAAs which are brought under the ambit of the MLIs are referred as covered tax agreements ("**CTAs**").[5] Accordingly, a contracting jurisdiction may exclude any specific set of treaties from the scope of MLI. Further, the MLI does not function as an amending protocol or replace the text of the CTAs entered by the contracting jurisdictions in its entirety. Instead, the provisions of the MLI are applied parallelly to the original provisions of the CTAs to supplement, complement, and enable the modification of its text to bring them in line with the OECD recommendations.[6]

Further, while drafting the provisions of the MLI, OECD and G20 members were conscious that the 'one-size fits all' approach will not work owing to the complexity of existing DTAAs. Accordingly, the provisions were designed to ensure mandatory compliance with the key measures, while allowing flexibility in the application of other measures. To illustrate, the provisions of the MLI can be characterised as either minimum standard provisions or optional provisions. Minimum standard provisions require mandatory adherence by the contracting jurisdictions, and they may opt-out only in limited cases. These cases may involve a situation where the CTA already meets the minimum standards with its existing language, or if the parties to the CTA jointly decide that they will reach a satisfactory solution while keeping in mind the minimum standard prescribed by the MLI. For optional provisions, i.e., provisions that do not set a minimum standard, the contracting jurisdictions are provided with greater flexibility by reserving in them the right for such provisions to not apply to their CTAs. Such reservation against the application of a provision can be made by a contracting jurisdiction for all its CTAs, or a specific CTA.

Further flexibility has been offered to contracting jurisdictions by providing multiple alternatives to address a particular BEPS issue. Such flexibility is extended in cases of both minimum standard and optional provisions, where the contracting jurisdictions may adopt the most favourable alternative. To illustrate, for provisions geared towards combating treaty abuse, contracting jurisdictions are offered three alternatives. The first is an extensive Principal Purpose Test ("**PPT**"). The second is a combination of the PPT and a Simplified Limitation of Benefit ("**SLOB**") provision. The third is a detailed limitation of benefit ("**LOB**") provision. Similar flexibility is granted by way of certain optional language or clauses which contracting jurisdictions can voluntarily opt to include in their CTAs. These provisions deal with, *inter alia*, rules relating to PE, transparent entities, and prevention of treaty abuse. Contracting jurisdictions are required to notify the OECD depositary of their choice of alternatives, and any optional language that they would like to include in their CTAs.

4 "Signatories and Parties to the MLI: Status as of 16 December 2022" OECD. Available online at: https://www.oecd.org/tax/treaties/beps-mli-signatories-and-parties.pdf.

5 Reuven S. Avi-Yonah & Haiyan Xu, "A Global Treaty Override? The New OECD Multilateral Tax Instrument and Its Limits." 39 MICH. J. INT'L L. 155 (2018). Available at: https://repository.law.umich.edu/mjil/vol39/iss2/2.

6 "Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting: Functioning under Public International Law" OECD (2015). Available online at: https://www.oecd.org/tax/treaties/legal-note-on-the-functioning-of-the-MLI-under-public-international-law.pdf.

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III. India's position on the MLI and action plan 6

India was one of the key participants in the drafting and of the first few adopters of the MLI. India deposited its instrument of ratification with the OECD depository on June 25, 2019.[7] Accordingly, the MLI 'enters into force' for India on October 1, 2019. Additionally, for the provisions regulating the 'coming into effect'" of the MLI, India has opted to use the term 'taxable period' instead of 'calendar year' for determining the effective date for provisions regulating withholding taxes.

The example of the India-Singapore CTA can be used to understand the timelines for the MLI coming into effect for India. As discussed, the MLI comes into force for India on October 1, 2019. Similarly, the MLI comes into force for Singapore on September 1, 2020. For provisions relating to the withholding of taxes, the MLI will *'enter into effect'* on or after the first day of the next taxable period that begins on the later of the dates on which the MLI comes into force for both treaty partners. The later date on which the MLI comes into force for both treaty partners is September 1, 2020, and accordingly, the relevant date of coming into effect for taxes to be withheld in India becomes April 1, 2021. For all other taxes, the MLI will come into effect for taxable periods beginning on or after expiry of six calendar months from the date on which the MLI comes into force for both treaty partners. Accordingly, the relevant date of coming into effect for such taxes levied in India also becomes April 1, 2021.

Notably, India has notified ninety-three (93) DTAAs as CTAs indicating a strong commitment towards implementing the recommendations of the OECD to tackle treaty abuse. However, the MLI will not impact India's DTAAs with a few key trading countries. This includes the USA and Brazil as they are not signatories to the MLI. Further, the MLI will have no bearing on India's DTAAs with Mauritius, China, and Germany as the DTAA has not been notified as a CTA by them.[8]

i. BEPS Action Plan 6:

BEPS Action Plan 6 provides protection against the abuse of tax treaties to avoid and evade taxes. The Action Plan provides for two minimum standard provisions under Article 6 and Article 7. The provisions include an express statement on non-taxation and methods to address the practice of treaty abuse for contracting jurisdictions to include in their CTAs, respectively.

a. Article 6 of the MLI:

Article 6 requires the contracting jurisdictions to express their clear intention to exclude opportunities for treaty abuse including practices like treaty shopping in their CTAs. Such intent is usually reflected in the preamble or object document and is instrumental in interpreting the provisions of the CTA.

Article 31(1) of the Vienna Convention on the Laws of Treaties (1969) provides that international treaties must be interpreted "*in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in light of its object and purpose.*" [9] Accordingly, the preamble of a treaty takes prime significance while interpreting a treaty as it reflects the underlying motivation behind entering into the treaty. The significance of the preamble language in interpreting a DTAA was further highlighted by the SC of India in the landmark *Azadi Bachao Andolan case*.[10] The SC referenced to *"encouragement of mutual trade and investment"* in the preamble of the Indo-Mauritius DTAA to legitimise the practice of tax planning as it seemed consistent with India's intentions reflected in the preamble. The SC held that treaty shopping and other forms of abuse may have been intended and in fact, permitted owing to scarce foreign capital or technology, keeping in mind *"the encouragement of mutual trade and investment"*. The judgment highlighted how important is the need for the preambles' languages to be clear and unequivocal in their intentions so that they can prevent opportunities for tax evasion practices.

To ensure the same, Article 6(1) of the MLI that deals with the *"Purpose of a Covered Tax Agreement"* requires contracting jurisdiction to incorporate the following preamble language in the CTAs, *"Intending to eliminate double taxation with respect to the taxes covered by this agreement without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance (including through treaty shopping arrangements aimed at obtaining reliefs under the agreement for the indirect benefit of residents in third jurisdictions)."* This is a minimum

[7] "Ratification by India of the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting" (Press Release). Government of India. Available online at: https://www.incometaxindia.gov.in/Lists/Press%20Releases/Attachments/770/PressRelease-Ratification_India_Multilateral_Convention_3_7_19.pdf
[8] "India's MLI Position". OECD. Available online at: https://www.oecd.org/tax/treaties/beps-mli-position-india.pdf.
[9] Vienna Convention on the Law of Treaties. Art 31, October 23, 1969. 1155 L.N.T.S. 331.
[10] Union of India v. Azadi Bachao Andolan 263 ITR 706. Supreme Court of India. (2003).

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standard provision mandated to clarify that the CTA must be interpreted in line with the OECD recommendations and is not intended to be utilised for tax avoidance and tax evasion. Article 6(3) of the MLI further provides an optional language that a contracting jurisdiction may include in the preamble of their CTA. The optional language states, *"Desiring to further develop their economic relationship and to enhance their co-operation in tax matters."* The optional language recognises the development of economic relations as another key objective of the CTA between the parties and can be instrumental in interpreting the application of the anti-abuse tests.

Notably, the language of Article 6(1) will replace any existing preamble of the CTA if both parties have notified such intention to the OECD Depository. In case one or both parties to the CTA remain silent, then the above language shall be included in addition to the existing preamble language. India has remained silent on its position on Article 6 of the MLI. It has not notified any treaty provision or existing preamble language to the OECD Depositary under Article 6 of the MLI. Accordingly, the preamble language of Article 6(1) has not replaced any existing preamble language in India's CTAs and is included as an addition to the existing preamble language. Further, as India has not opted for the optional language of Article 6(3), it is not included in any of India's CTAs.

To illustrate, India's CTA with key trading nations including the UK, France, Japan, and Singapore contained *"prevention of double taxation and avoidance of fiscal evasion"* as the purpose in the preamble. Similarly, the preamble language in India's CTAs with several key trading nations included *"promoting economic co-operation"* as the purpose. For all such CTAs, the preamble language of Article 6(1) is now included in addition to the existing preamble language. As the preamble language in the MLI is clear about the intention to prevent opportunities for tax evasion practices, it may be stated that the ruling of the SC in Azadi Bachao Andolan case may no longer be relevant for such CTAs.

On the other hand, India's DTAA with the USA highlights the *"prevention of double taxation and avoidance of fiscal evasion"* as the purpose in the preamble. Since the USA is not a party to the MLI, the language of the preamble in the India-USA DTAA will remain unchanged. Another interesting example is that of India's DTAA with Mauritius. As Mauritius has not notified its DTAA with India as a CTA, the MLI does not apply and the preamble language of the Indo-Mauritius DTAA continues to remain unchanged. Accordingly, the ruling of the *Azadi Bachao Andolan* will continue to prevail.

Separately, India's intention while entering into DTAA can also be understood from the text of Section 90 of the IT Act.[11] Section 90 allows the Indian government to enter into DTAAs to prevent double taxation, tackle tax avoidance, and for sharing of information between the countries party to the agreement. It can be argued that the intention to prevent double non-taxation through tax avoidance or evasion is clearly manifested in the IT Act which can be read into while determining the purpose of a DTAA entered by India. However, the judiciary may not agree with this interpretation especially since it has ruled to the contrary in various instances.

b. **Article 7 of the MLI:**

Article 7 of the MLI is another minimum standard provision which requires contracting jurisdictions to adopt one of the three alternate provisions to tackle treaty abuse. As discussed previously, the first option is an extensive PPT provision, second is a PPT supplemented with a SLOB provision, and the third is a mutually negotiated detailed LOB provision with rules targeting treaty abuse measures and other conduit arrangements that lead to non-taxation.

1) **PPT rule:**

Article 7(1) of the MLI provides PPT as the default test. Under this test, treaty benefits shall be denied if it can be reasonably concluded that obtaining benefits under the CTA was one of the principal purposes of the arrangement that directly or indirectly resulted in that benefit. However, such benefits shall not be denied if it is established that the grant of the benefits is in accordance with the object and purpose of the relevant provisions of the CTA. Opting for this option would mean that the PPT will be applicable in place of or in the absence of any existing form of anti-abuse provisions present in the CTA. To understand the applicability of the PPT test, we must analyse the meaning and scope of the terms and phrases used in Article 7(1).

To begin with, let's focus on the term *"benefit"*. While what constitutes to be a benefit under the CTA has not

[11] Section 90. Income Tax Act, 1961.

been defined in the MLI, an explanation can be borrowed from the Action 6: 2015 Final Report published by the OECD ("**Action 6 Report**"). The Action 6 Report defines "*benefit*" to include any limitations on taxation imposed by the source state, reliefs from double taxation, and protection afforded to residents and nationals of the parties under the CTA. Such benefits include provisions relating to tax reduction, exemptions, deferrals or refunds. The scope of the Article is further broadened to include any direct or indirect benefit flowing from the CTA.

Action 6 Report requires the term "*arrangement or transaction*" to be interpreted broadly and include any agreement, understanding, scheme, transaction or a series of transactions, whether or not legally enforceable. Such an "*arrangement or transaction*" can include the creation, assignment, acquisition or transfer of the income, or transfer of the property or right in respect of which the income accrues. Further, any steps taken for the establishment, acquisition or maintenance of a person who derives the income, including the qualification of that person as a resident or any steps that a person may take to establish residence in a jurisdiction are covered under the ambit of "*arrangement or transaction*".

Another interesting feature of the PPT is that unlike commonly used anti-abuse provisions, which may use phrases like the "*primary purpose*" or the "*dominant purpose*", the PPT introduced under the MLI uses the phrase "*one of the principal purposes*". The General Anti Avoidance Rules ("**GAAR**") forming part of the IT Act uses the phrase "main purpose". Accordingly, the PPT introduced under the MLI has a widened scope where the benefit flowing from the CTA need not be the sole or dominant purpose of the transaction or the arrangement, if obtaining benefits was "*one of its principal purposes*" of the transaction, the treaty benefits can be denied. While existing anti-abuse provisions may focus on limiting the flow of benefits under specific articles such as capital gains, dividends or royalties, the PPT will function as a blanket test and cover all kinds of income and benefits under the CTA.[12]

It must be "*reasonable to conclude*" for the competent authority of the contracting jurisdiction that one of the principal purposes of the arrangement or transaction was to obtain the benefits provided under the CTA. The language of the Article brings an element of subjectivity into the test. While Action Report 6 provides that all facts and circumstances surrounding the transaction or the arrangement must be weighed in this decision, the final determination continues to be based on reasonableness. Such language suggests the possibility of different interpretations and additional discretionary power provided to the competent authority to deny available benefits under the CTA.

The article provides an exception to the applicability of the PPT if the benefit is obtained in accordance with the object and purpose of the CTA. This carve-out provided under the article reinforces the importance of the preamble language of the CTA, and how the PPT must be interpreted keeping in mind the object and purpose of the CTA. This also highlights the relevance of the optional language provided under Article 6(3) in deciding the allowability of benefits under the CTA, as in such cases, the PPT would be interpreted in light of the intention of the treaty partners to develop the "*economic relationship*" between them.

2) **PPT + SLOB Rule:**

Article 7(6) of the MLI provides the second alternative involving a SLOB provision to supplement the PPT. Unlike the general test of the PPT, the SLOB provision proposed under the MLI functions as a specific anti-abuse provision which restricts the benefits flowing from the CTA to specific persons. If a contracting jurisdiction opts for this alternative, the person claiming the benefit will be required to satisfy both the PPT and the SLOB rule.

The SLOB provision under the MLI limits the availability of tax benefits only to a resident who is a "*qualified person*" of the contracting jurisdiction at the time that benefit would be accorded. The MLI defines a "*qualified person*" to include a resident who is an individual, or the contracting jurisdiction itself including its subdivision, or publicly-traded company if the principal class of its shares is regularly traded on one or more recognised stock exchanges, or certain charities and pension funds. Further, if at least 50% of shares in a person other than an individual are owned directly or indirectly by a "*qualified person*", then such a person would deem to be a "*qualified person*". However, such ownership requirement must be met for a minimum of half the days of a twelve-month period that including the time when the benefit is claimed.

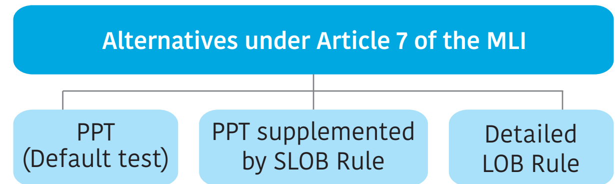
[12] Korving and Hulten. "MLI: Testing the 'principal purpose'" International Tax Review (2018). Available online at https://www.internationaltaxreview.com/article/b1f7n2f6tqcfyx/mli-testing-the-principal-purpose.

The SLOB provision further provides that a resident who is not a qualified person, is entitled to obtain benefits under the CTA if the resident is engaged in the *"active conduct of a business"* and the income emanates from or is incidental to such business. The provision does not define what constitutes an *"active conduct of a business"* but clarifies a list of activities that will not be considered as *"active conduct of a business"*. The Action 6 Report also offers limited guidance on the scope of the phrase. It provides that the term *"business"* must be given the meaning that it has under the domestic law of the contracting jurisdiction. Further, without providing a concrete definition or any guidelines, the Action 6 Report clarifies that for an entity to be engaged in the *"active conduct of a business"*, substantial managerial and operational activities must be conducted by the person responsible for the entity. The provision also could be interpreted differently and thus, accords excessive powers to the competent authority for deciding the available of treaty benefit under the CTA.

A resident who is not a *"qualified person"* or engaged in the "active conduct of a business" is allowed to claim benefits from the CTA if more than 75% of its beneficial interests are owned by *"equivalent beneficiaries"*. The Action 6 Report defines equivalent beneficiaries to be the persons who are entitled to equivalent or more favourable benefits under the domestic laws, or provisions of the CTA, or any other international instrument. Furthermore, if a resident is not a *"qualified person"* and remains ineligible to obtain benefits through the *"active conduct of a business"* test or the "equivalent beneficiary" test, the competent authority is provided with discretionary powers to grant the benefits under the CTA based on the facts and circumstances of the case, subject to the PPT test being satisfied.

3) **Detailed LOB Rule:**

The third alternative involves opting for an extensive and detailed verification of the LOB provision, prepared through bilateral negotiations between the parties to the CTA. The detailed LOB involves mutually agreed upon rules and thresholds for the grant of the treaty benefits keeping in mind the nature and quantity of trade between the treaty partners while ensuring that BEPS minimum standards are met, and treaty abuse is addressed. Parties opting for this alternate may accept option 1 or 2 as an interim measure until such detailed LOB examination is formulated.



India intends to adopt a detailed LOB provision formulated through bilateral negotiations in addition or in replacement of the PPT. India has opted to apply the second alternative, i.e., PPT along with the SLOB provision as an interim measure.

It is important to understand the application of the SLOB provision to appreciate the impact of India's position on its DTAAs. Since the SLOB is an optional provision, it would apply when both parties to the CTA have opted for this alternative and notified the OECD of its application. Notably, a party to a CTA which has opted for the SLOB provision can reserve its right in opting out of the entirety of Article 7 (including the PPT) if the other party has not opted for SLOB. In such a situation where only one party chooses to apply the SLOB provision, compliance with Article 7 may be ensured by allowing either symmetrical or asymmetric application of the SLOB provision by the other party who is not opting for SLOB. In symmetrical application, the other party agrees to the application of SLOB for the CTA with the party that has opted for SLOB. Accordingly, SLOB provisions are applicable for both the parties in addition to the PPT. In case of an asymmetrical application, SLOB provision, along with the PPT, would be applicable only to the party that has opted for the SLOB provision , while only PPT would be applicable to the other party.

In India's case, SLOB will be applicable to CTA with contracting jurisdictions that have opted to apply the SLOB provision, and to CTAs with such contracting jurisdictions that have allowed symmetrical or asymmetrical application of the SLOB provision. Notably, most of India's treaty partners have opted for the first alternative. Further, less than fifteen contracting jurisdictions have decided to apply for the SLOB provision, and contracting jurisdictions allowing symmetrical or asymmetrical application of the SLOB are a handful. Consequently, since India has not reserved the application of the entirety of Article 7, the PPT-which is the default test under the MLI-would be applicable to most of India's CTAs.

Further, in the limited cases where India and the other party to the CTA have opted for the second alternative which involves the SLOB provision supplementing the PPT, like in the case of India's CTA with Russia, both PPT and SLOB will be applicable. Additionally, while contracting jurisdictions like Norway, Iceland, and Denmark have not opted for the second alternative, they have allowed the symmetrical application of the SLOB provision. Accordingly, both PPT and SLOB provision will be applied by both contracting jurisdictions for such CTAs. Notably, Greece has also not opted for the second alternative, but has allowed the asymmetrical application of the SLOB provision. Therefore, while Greece will only apply the PPT rule for granting benefits to residents of India, India will apply both the PPT and the SLOB rules while granting benefits under the CTA to residents of Greece.

For India's DTAAs with countries that have not signed the MLI and with those who have not notified the DTAA with India as a CTA, both the PPT and the SLOB provision under the MLI would be inapplicable. The relationship will continue to be governed by any existing anti-abuse provisions under the DTAA. For example, Article 24 of the India-USA DTAA discusses *"limitation on benefits"*, which functions as an anti-abuse rule by restricting treaty benefits only to the person entitled to such benefits as identified in the Article. Notably, Article 24 will continue to be the applicable provision without any change, as the USA has not yet signed MLI. Similarly, the LOB provision in the India-Mauritius DTAA operating in respect to taxation on capital gains will remain unaffected, as the DTAA has not been notified as a CTA by Mauritius.

IV. Interplay of PPT with Gaar:

The Indian government has taken an aggressive stance on combatting the practice of tax avoidance and tax evasion by introducing stringent rules and amendments in the IT Act. This includes GAAR, which allows the IRA to declare an arrangement as *"impermissible avoidance arrangement"*. Section 90(2A) of the IT Act permits the application of GAAR in addition to any treaty abuse measures that may be present in a DTAA. Accordingly, to obtain benefits under the CTA, an assessee may be required to satisfy both the PPT (or any other alternate chosen) and the GAAR. However, there is a level of duplicity between the PPT under MLI and GAAR, and the distinction between them must be clarified.

Under GAAR, an *"impermissible avoidance arrangement"* is defined as an arrangement entered with the *"main purpose"* to obtain tax benefits. However, as discussed earlier, the threshold to deny benefits under the PPT test is much lower where obtaining tax benefits may only be *"one of the principal purposes"*. Further, the applicability of GAAR requires the arrangement to create rights or obligations that are not at arm's length, or result in the abuse of the provisions of the ITA, or the arrangement must lack commercial substance, or is carried without bona fides purpose. Such requirements are not required to be fulfilled for the applicability of the PPT under the MLI.

Notably, in a clarificatory notification, the CBDT has highlighted that in a situation where tax avoidance can be *"sufficiently"* addressed by the provisions included in the DTAA like a LOB provision, GAAR may not be invoked.[13] Since the scope of PPT under the MLI is broader than the usual LOB provisions, it is possible that GAAR may be invoked in the rarest of circumstances. However, clarity regarding the interplay of MLI and GAAR is required from the CBDT to avoid uncertainty and tax disputes.

V. Concluding Remarks

MLI is a welcome and innovative solution to tackle BEPS practices on a multilateral level. The flexibility granted to each contracting jurisdiction by the MLI has encouraged the wider application of the instrument. Further, the broader scope of its minimum standard provisions has proven to be effective in ensuring that non-taxation practices like treaty shopping are curbed and profits are taxed where economic activities are carried out. MLI has also benefited the MNEs by bringing consistency and predictability to the international tax framework and reducing disputes over the application of provisions under the CTAs.

However, the impact of MLI has been limited owing to the selective and optional nature of most of its provisions, requiring voluntary actions by contracting jurisdictions. Similarly, while the Indian government has taken a proactive stance on the MLI, its tax treaties with major trade partners including USA, Mauritius and China, etc., are still not covered due to lack of enthusiasm shown by them. Accordingly, instances of treaty abuse may continue to take place through such routes. However, in legitimate cases, India may push for bilateral settlements if the other jurisdictions continue to have reservations about joining MLI network.

[13] Central Board of Direct Taxes. Circular No. 7 of 2017. *"Clarifications on Implementation of GAAR Provisions Under the Income Tax Act, 1961"* Published on 27th January of 2017. Department of Revenue, Government of India.

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Delhi HC rules that taxes should not be withheld under Section 195 on reimbursement of salary to expatriate employees

In the case of ***Boeing India Pvt. Ltd.,***[14] the Delhi HC held that payments made to non-resident group entities under a secondment agreement were in the nature of reimbursement of salary expenses and not fees for technical services ("**FTS**") or fees for included services ("**FIS**"). Thus, it was held that no TDS was required to be withheld under Section 195 of the IT Act.

Facts

Boeing India ("**Assessee**") had seconded expatriate employees ("**Expat Employees**") from Boeing USA, Boeing Korea and Boeing Australia (collectively, "**Group Companies**"). Under the terms of engagement ("**Secondment Agreement**"), the Assessee was reimbursing salary costs for the Expat Employees to the aforementioned Group Companies.

During the course of assessment proceedings, the AO, *inter alia*, sought clarification with respect to services performed by the Group Companies and the Expat Employees. From a review of the Secondment Agreement, the AO concluded that an employer-employee relationship had not been established between the Expat Employees and the Assessee and the sums paid to the Group Companies were in the nature of FTS. Accordingly, the AO held that the Assessee had failed to deduct TDS under Section 195 of the IT Act and *inter alia*, made a disallowance of INR 565.8 million under Section 40(a)(i) of the IT Act.[15]

The Assessee had deducted TDS under Section 192 of the IT Act while making payments to the Group Companies. While Section 192 requires an employer to withhold taxes on payment of salaries to the employee, Section 195 requires taxes to be withheld by a taxpayer before making any payment, which is chargeable to tax under the IT Act (not including payments in the nature of salaries), to a non-resident.

On appeal, the DRP confirmed the disallowance made by the AO. Aggrieved, the Assessee preferred an appeal before ITAT Delhi which ordered that the AO's findings be overturned and additions made by the AO to be deleted. The decision of ITAT Delhi was appealed by the IRA before the Delhi HC.

Issue

Whether reimbursement of salary costs for Expat Employees should be disallowed for failure to deduct taxes under Section 195?

Arguments

The Assessee contended that the payments made to the Group Companies were in the nature of reimbursement of salary for the Expat Employees and were not in the nature of FTS or FIS under the IT Act or the applicable DTAA, as the case may be. Thus, it was not required to withhold tax under Section 195 on the same. It was asserted that the Assessee being the real and economic employer of the Expat Employees had the direct control over them according to the terms of the Secondment Agreement, thus establishing an employer-employee

[14] 2022/DHC/004188.
[15] Section 40(a)(i) allows the AO to make a disallowance on a taxpayer's failure to deduct TDS on the expenditure towards inter alia, FTS paid to a non-resident.

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relationship between them. Accordingly, the Assessee had appropriately deducted and deposited TDS, before reimbursing the amount to the foreign entity, under Section 192 of the IT Act.

On the other hand, the IRA argued that the payments were in the nature of FTS and thus, TDS was required to deducted under Section 195 of the IT Act. To buttress its submissions, reliance was also placed by IRA on the decision of the Delhi HC in ***Centrica India Offshore India Ltd v. CIT*** ("**Centrica**") where the HC held that the reimbursement made by an Indian company towards salary of Expat Employees is FTS.[16]

Judgment

The Delhi HC agreed with the decision of ITAT Delhi and held that once the nature of payment has been determined as salary and deduction has been made under Section 192 of the IT Act, Section 195 will not be applicable.

On perusal of the Secondment Agreement, it was found that the employees had willingly agreed to work for the Assessee and were working under the supervision, control and management of the Assessee. Further, the Group Companies had agreed to merely facilitate the payment of salaries in the home countries of the Expat Employees, on behalf of the Assessee, for which they were reimbursed by the Assessee.

The Delhi HC observed that the decision in Centrica was factually distinguishable from the Assessee's case, as in the instant case, the real employer of the seconded employees was the Indian entity and not the overseas entity. Thus, in the present case, the payment made towards salary of the seconded employees should not be construed as FTS or FIS.

Accordingly, the Delhi HC confirmed the finding of ITAT Delhi and held that payments made to the Group Companies were in the nature of reimbursement of salary expenses for the Expat Employees and TDS had appropriately been deducted under Section 192 of the IT Act. Therefore, the disallowance made by the AO was deleted.

Significant Takeaways

The issue relating to the reimbursement of salary as a part of secondment agreements has been often debated before the judicial bodies. This ruling is in line with several other rulings[17] which have ascertained the nature of reimbursement and held it to be salary in cases where it was found that the seconded employees were working under the control and supervision of the Indian entity.[18] Recently, in a similar factual scenario, ITAT Bangalore had ruled that reimbursement made by an Indian company was salary and not FTS, as the seconded employees were working under the control and supervision of the Indian entity. However, at the same time, there also exist decisions such as Centrica, where upon examining the substance of the secondment agreement and nature of work being undertaken by the seconded employees, judicial forums have held a payment made to a foreign company reimbursing the salary costs to be taxable as FTS.

Such variance in cases establishes the fact that while making such payments, the nomenclature of reimbursements will not determine its taxability. The taxability of the payment will be examined in light of the surrounding facts. Thus, it is pertinent to ensure that the terms of the secondment agreements and other documents are thoroughly examined and vetted by tax advisors. Further, it would be advisable to analyse the terms of the secondment agreement amidst the factual backdrop to determine the taxability of such reimbursements. It will be critical to assess the appropriate nature of payments and the relevant compliances to be undertaken.

> **"Tax cannot be withheld under Section 195 if it has already been deducted as salary under Section 192."**

[16] [2014] 44 taxmann.com 300.
[17] Cholamandalam MS General Insurance Co. Ltd., [2009] 309 ITR 356 (AAR); Director of Income Tax, (International Taxation) v. Abbey Business Services India (P.) Ltd., [2020] 122 taxmann.com 174 (Karnataka).
[18] Toyota Boshoku Automotive India (P.) Ltd. v. ACIT, [2022] 145 taxmann.com 141 (Bangalore – Trib.).

Payment made for Google Adwords program are not Royalty or FTS; now covered under Equalisation levy provisions

In the case of ***Google India Pvt. Ltd.***[19]***,*** the Bangalore ITAT held that income arising to a non-resident from the sale of advertisement space on a website was not taxable in India as royalty or FTS and going forward, such income would be covered by EL introduced *vide* FA 2016. From the perusal of the facts of the case, the ITAT also observed that intellectual property ("**IP**") was exclusively owned by Google Ireland Ltd. ("**Google Ireland**") and there was no transfer or license of copyrights in favour of the Indian assessee.

Facts

Google India Pvt. Ltd. ("**Assessee**") was engaged in the business of providing information technology and information technology enabled services to its group companies from India. It was also engaged in rendering marketing and distribution services as a non-exclusive authorised distributor of Google Adwords programme to the advertisers in India under a distribution agreement dated December 12, 2005 ("**Distribution Agreement**") entered with Google Ireland. During the relevant AYs i.e. AY 2009-10 to 2012-13, the Assessee paid distribution fee to Google Ireland and no TDS was deducted on such payment. As per the facts of the instant case, the advertisers in India uploaded Advertisements which were stored in data centres outside India which were later reviewed in accordance with Google policies.

The AO initiated proceedings under Section 201(1) and 201(1A) of IT Act against the Assessee as no TDS was deducted under Section 195 of IT Act and held that such payments were in the nature of 'royalty' on various grounds as discussed below. Appeals were filed before the CIT(A) against the orders passed by the AO. The CIT(A) upheld the orders passed by the AO and held that the payment was for right to use IP as well as trademark and copyright and computer program/process i.e. Adwords program.

The ITAT disposed of all the appeals filed before it against the order passed by the CIT(A) *vide* a common order dated October 23, 2017 wherein it held that payments made by the Assessee under the Distribution Agreement constituted 'royalty' under Section 9(1)(vi) of IT Act and India-Ireland DTAA. The ITAT in its order held that since no proper literature was provided by the Assessee to understand the Google Adwords program, it relied on google search to peruse publicly available material. However, such material relied upon was neither specifically mentioned in the ITAT order nor produced before the Assessee or the IRA despite there being specific provisions to produce additional evidence in the Income-tax [Appellate Tribunal] Rules, 1963 viz Rule 29 and Rule 30. Thus, the additional evidences could have been allowed to be produced as the ITAT has powers to allow any document to be filed before it or any witness to be examined or evidence to be adduced to enable it to pass orders.

The said ITAT order was challenged by the Assessee before the HC on several grounds. Whereas the HC *vide* its judgment[20] dated April 17, 2021, restored the matter to the ITAT for de novo consideration as it held such ITAT order to be violative of principles of natural justice as the ITAT relied on unverified material available in public domain to reach its conclusion without confronting such fresh evidence with Assessee for rebuttal. The Assessee and the IRA were allowed to file additional documents in support of their arguments and any material relied upon by the ITAT was directed to be made available to both the parties. Hence, the present matter was heard by the ITAT.

Issue

Whether income arising from sale of advertisement space on a website would be taxable as royalty or FTS.

Arguments

As per the IRA, the Assessee was granted license to sell or make offer for sale of Adwords program by Google Ireland and the said software program was a copyright within the purview of section 14(b)(ii) of the Indian Copyright Act, 1957, which falls under the ambit of royalty as per Section 9(1)(vi) of IT Act. The distribution rights granted to Assessee would fall within the ambit of the term 'similar property' as per definition of 'royalty' under Section 9(1)(vi) of the IT Act. Further, the Assessee was granted the use of or right to use trademarks as well as the right to use the 'process' embedded in the Adwords program, which would again fall under the ambit of 'royalty' as per clauses (i), (ii) and (iii) of Explanation 2 to Section 9(1)(vi) of the IT Act. Also, imparting of training, knowledge, experience and skill to Assessee's staff by Google Ireland and sharing of confidential information was covered by clauses (iii) and (iv) to Explanation 2 to Section 9(1)(vi) of the IT Act. The IRA also contended that the grant of distribution rights involved use of Google Ireland's servers, which would fall under the ambit of 'industrial, commercial and scientific ("**ICS**") equipment'. Payments made for the use of ICS equipment would also be considered as 'royalty' as per the definition provided in Section 9(1)(vi) of the IT Act. Lastly, the IRA

[19] Google India (P.) Ltd. v. Deputy Commissioner of Income-tax (International Taxation) [IT (TP) Appeal Nos. 1513 to 1516 (BANG.) OF 2013], [2022] 143 taxmann.com 302 (Bangalore - Trib.).
[20] Google India (P.) Ltd. v. CIT (International Taxation) [2021] 127 taxmann.com 36/435 ITR 284 (Kar.).

also argued that obligations of Assessee under the Distribution Agreement, including after sales customers support necessarily entailed the use of IP rights which were provided by Google Ireland under a separate agreement i.e. the service agreement and both these agreements need to be interlinked.

Meanwhile, the Assessee argued that the issue was squarely covered in its favour by the rulings rendered by the ITAT in the case of ***Interactive Avenues (P.) Ltd.***[21], ***ESPN Digital Media (India) (P.) Ltd.***[22], ***Matrimony.Com Ltd.***[23], ***Play Games 24×7 (P.) Ltd.***[24], ***Myntra Designs (P.) Ltd.***[25], ***Urban Ladder Home Decor Solutions (P.) Ltd.***[26], ***Inception Business Services***[27], ***Right Florists (P.) Ltd.***[28], ***Pinstorm Technologies (P.) Ltd.***[29] and ***Yahoo India (P.) Ltd.***[30] The ruling in the above case held that payment for online advertisement space or advertisement hosting services (to Facebook Ireland, Yahoo Hong Kong, Google Ireland, ESPN UK, etc.) was not in the nature of royalty since the 'right to use' of any equipment or process or software - such as the online portal - had not been provided and the payment made was merely for placing the advertisement and its contents on the online platform. The Assessee further argued that rulings relied upon by the IRA were overruled by the SC in the case of ***Engineering Analysis Centre of Excellence (P.) Ltd.***[31] (as discussed below). The Assessee also argued that the phrase '*similar property*' was absent in the definition of 'royalty' in the relevant DTAA and the DTAA overrides the IT Act and, therefore, the IRA's arguments regarding distribution rights being classified as 'similar property' were misplaced.

Decision

The ITAT observed that Google LLC, USA had developed a computerised advertising program known as Google Adwords program which displayed advertisements on Google's search engine. Google Ireland was its exclusive licensee for the whole world except the USA. Google Adwords program provided detailed instructions so that even a person having basic knowledge of computers could create a draft advertisement and target it suitably by using the necessary tools. No payment was made for any use of the Google Adwords program, unless the Ad was clicked by an end-user. Global advertisements were reviewed by an automated system with some subjected to a manual review by one of the service centres of Google Ireland's group entities, located in the USA, Dublin, China, Korea, Japan, and India, which carried out this activity on a cost-plus basis. The Assessee carried out these services in its ITES segment under its Service Agreement with Google Ireland dated April 1, 2004. To accommodate Indian advertisers desirous to pay in INR instead of foreign currency, Google Ireland entered into the Distribution Agreement appointing the Assessee as a non-exclusive distributor of online advertisement space in India. The Assessee was ensured of a specified margin over its cost from Google Ireland.

The ITAT analysed the definition of royalty as per Article 12(3)(a) of India-Ireland DTAA and various clauses of the Distribution Agreement and observed that as per clause 2.1, the Assessee was appointed as a non-exclusive authorised distributor of Google Adwords program. As per clause 2.2, the distributor agreed to market and distribute Adwords program to advertisers within the broad guidelines and as per training provided by Assessee using its own sales force and infrastructure. As per clause 2.3, distributor shall upload all advertiser information that is required by Google Ireland. As per clause 2.6, distributor shall provide after sales services to the advertisers based on the guidelines provided by Google Ireland. Google Ireland owned all rights, title and interest in the Adwords program. Therefore, it observed that ownership of IP in Adwords program was an exclusive property of Google Ireland and none of the rights as per Section 14(a)/(b) and Section 30 of the Copyright Act, 1957 were transferred to the Assessee. The ITAT held that Assessee had only right to use the copyrighted article, which was not royalty as per SC ruling in the case of ***Engineering Analysis Centre of Excellence (P.) Ltd. (supra)*** wherein the difference between a copyright right and copyrighted article was pointed out. The ITAT also held that the use of confidential information, software technology, training documents etc., with foreign entity holding the copyrights that hasn't been transferred or licensed in favour of Assessee company was not royalty.

[21] Interactive Avenues (P.) Ltd. v. Dy. CIT [IT Appeal No. 3130 (Mum.) of 2019, dated 7-7-2022].
[22] ESPN Digital Media (India) (P.) Ltd. v. Dy. CIT [2022] 140 taxmann.com 442 (Chennai - Trib.).
[23] Matrimony.Com Ltd. v. ACIT/DCIT/ITO [IT Appeal No. 1391 (Chny.) of 2019, dated 20-4-2022].
[24] Play Games 24×7 (P.) Ltd. v. Dy. CIT [IT Appeal No. 1533 (Mum.) of 2019, dated 23-3-2022.
[25] Myntra Designs (P.) Ltd. v. Dy. CIT (International - Taxation) [IT Appeal No. 598 (Bang.) of 2020, dated 3-9-2021.
[26] Urban Ladder Home Decor Solutions (P.) Ltd. v. ACIT (International - taxation) [IT Appeal No. 615 (Bang.) of 2020, dated 17-8-2021].
[27] Inception Business Services v. ITO (International - Taxation) [IT Appeal No. 2674 (Chny.) of 2016, dated 18-2-2019].
[28] ITO v. Right Florists (P.) Ltd. [2013] 32 taxmann.com 99/143 ITD 445 (Kol. - Trib.)/[2013] SCC Online ITAT 6870.
[29] Pinstorm Technologies (P.) Ltd. v. ITO [2012] 24 taxmann.com 345/54 SOT 78 (Mum. - Trib.).
[30] Yahoo India (P.) Ltd. v. Dy. CIT [2011] 11 taxmann.com 431/46 SOT 105 (URO)/140 TTS 195 (Mum. - Trib.).
[31] Engineering Analysis Centre of Excellence (P.) Ltd. v. CIT [2021] 125 taxmann.com 42/281 Taxman 19/432 ITR 471.

As for use of or right to use trademarks, other brand features and the process owned by Google Ireland by the Assessee for the purpose of distribution of Adwords program, the ITAT held that the trademark and other brand features were not used independently or de hors the Distribution Agreement, rather they were incidental or ancillary for the purpose of carrying out the marketing and distribution of Adwords program. The ITAT, relying on ruling of the Delhi HC in the case of ***Sheraton International Inc***[32]**,** held that use of trademark, etc., that are incidental to the main service of advertisement without any consideration payable would not constitute royalty.

The ITAT also held that the findings of the AO and CIT(A) on the basis of Section 9(1)(vi) of IT Act were not relevant as the provisions of the DTAA override the provisions of the IT Act. Nor was it necessary to decide whether the Services Agreement and Distribution Agreement were interlinked to each other. The ITAT also referred to the various rulings relied upon by the Assessee such as ***Interactive Avenues (P.) Ltd.(supra), ESPN Digital Media (India) (P.) Ltd. (supra)***, etc. to hold that such payment for advertisements was not in the nature of royalty. The ITAT also relied on international jurisprudence on this issue and observed that the Technical Advisory Group ("**TAG**") set up by the OECD in its 2001 Report recommended taxation of online advertisements under Article 7 of relevant DTAA, which deals with business profits such that profits from online advertisements would become taxable only in case of a PE in the other country and not under the head royalty. The ITAT, relying on the SC's ruling in the case of ***Engineering Analysis Centre of Excellence (P.) Ltd.(supra)***, held that OECD commentary was necessary for interpreting DTAA provisions. The ITAT also relied on High-Powered Committee ("**HPC**") on electronic commerce and taxation, set up by the CBDT, which had also recommended taxing online advertisement under business profits instead of royalty. The ITAT further observed that if sale of online advertisements was already covered under definition of royalty, the need for introducing EL would not arise.

Significant Takeaways

Various decisions of the ITAT as listed above on similar facts have already held that income from sale of advertisement space on a website would not be taxable in India unless there was a PE of the foreign enterprise in India and such payment was also not in the nature of royalty or FTS as 'right to use' the underlying software or process had not been granted, rather the payment was merely for placing of advertisements on the online platform. Further, the ruling of the SC in the case of ***Engineering Analysis Centre of Excellence (P.) Ltd.(supra)*** has drawn a clear distinction between payment for the use of a copyrighted article versus payment for transfer of copyright rights as the former does not constitute royalty as defined under Section 9(1)(vi) of IT Act read with relevant DTAA. It may also be noted that where any term is defined in the relevant DTAA, the definition provided in the DTAA would prevail over the definition provided in the IT Act. Notwithstanding the facts of the instant case, it may be noted that the definition of the term 'royalty' is wider in the IT Act as compared to the relevant DTAA as the phrase 'similar property' used in the IT Act is absent in the definition of the term 'royalty' in the relevant DTAA.

It may also be noted that the ITAT in the instant case appreciated the fact that recent times have witnessed the emergence of dynamic business models that include economic activities carried out in the cyber place in comparison to the PE criteria that requires physical presence. The ITAT also observed that the issue of taxation of online advertisements was already addressed by the introduction of EL *vide* FA 2016, which provided for a 6% levy in the form of withholding by the service recipient on payment made to a non-resident in case of specified services such as online advertisement, provision for digital advertising space or any other facility or service for the purpose of online advertisement. Therefore, going forward, such payments should get covered and come within the purview of EL-related provisions.

“ Payment for Google Adwords program without transfer of any rights in copyright was not royalty. ”

[32] DIT v. Sheraton International Inc [2009] 178 Taxman 84/313 ITR 267.

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Employer is obligated to deposit the employee's contribution on or before the statutory due date

In the case of ***Checkmate Services P. Ltd.***[33]***,*** the SC held that the taxpayers, being employers, were not eligible to claim deduction for the employee contributions towards employee welfare funds like, provident funds, employee state insurance, etc., ("**Employee Welfare Funds**"), where such contributions were deposited after the statutory due date, provided under the relevant statutes.

Facts

The SC was apprised of a batch of matters in appeal, involving a common question, from the judgments of various HCs. The facts leading up to the appeal were that the taxpayers, being employers ("**Assessees**"), had deposited the contribution of their employees towards the Employee Welfare Funds, beyond the due dates prescribed by the relevant legislations, governing the Employee Welfare Funds.

In the instant cases, the AO had considered such employee contributions received by the Assessees as income under Section 2(24)(x). Further, since the deposits were made beyond the statutory due date, the AO also disallowed such deductions under Section 36(1)(va) of the IT Act.

In this regard, it is relevant to note that Section 2(24)(x) of the IT Act deems any sum received by an employer from their employee, as contribution towards any Employee Welfare Fund, as income of the former (i.e. employee contribution). Further, Section 36(1)(va) allows an employer to claim deduction for such sum as referred to under Section 2(24)(x), provided such sum is deposited by them towards the relevant employee welfare fund before the statutory due date.

Section 43B of the IT Act allows employers to claim deduction for contributions made by them to the employee welfare fund, subject to actual payment of such contributions on or before the date of filing returns (i.e. employer contribution). Otherwise, such deduction can be claimed in the year in which such payment is actually made.

The Assessees unsuccessfully appealed the order of the AO before the ITAT, arguing that the deductions pertaining to employee contributions to Employee Welfare Funds are governed by the provisions of Section 43B of the IT Act, which allows deductions for such contributions deposited before the filling date.

Subsequently, the Assessees approached their respective jurisdictional HCs. While the HCs of Bombay, Himachal Pradesh, Calcutta, Guwahati and Delhi rendered a verdict in favour of the Assessees, the HCs of Gujarat and Kerala ruled in favour of the IRA and upheld the disallowance of employee contributions under Section 36(1)(va). Considering a division of opinion, special leave to appeal was granted.

Issue

Whether the Assessees were entitled to claim deduction for employee contributions deposited with the relevant Employee Welfare Fund, after the statutory due date?

[33] [2022] 143 taxmann.com 178 (SC).

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Arguments

It was argued by the Assessees that the employer contributions and employee contributions were required to be made in a composite manner and accordingly, Section 43B should apply to both, employee as well as employer contributions. It was further argued that since Section 43B, which allows contributions to be made before the due date for filing tax returns to be considered for deduction, starts with a non-obstante clause, it should override the statutory due date mentioned under Section 36(1)(va). Reliance was placed on ***CIT v. Alom Extrusions***[34] to submit that the amendment made by Finance Act 2003 restored the limit under Section 43B from statutory due date under the EPF Acts to the filing date under the IT Act and thus, the deductions with respect to employee contributions should be governed by the latter.

On the other hand, the IRA argued that the IT Act differentiates between deductions with respect to employer contributions and employee contributions. Accordingly, the IT Act stipulates distinct provisions (i.e., Section 36(1)(va) and Section 43B), each having a different due date, for the purposes of claiming deduction with respect to the relevant contributions. The IRA traced the objectives and history of both these sections stating that each had different objectives. Thus, it was argued that the deduction with respect to employee contributions exclusively fell within the ambit of Section 36(1)(va) of the IT Act. Therefore, no deduction should be available to the Assessees for the employee contributions deposited after the statutory due date.

Judgment

The SC upheld the views of the Gujarat HC and Kerala HC and held that employee contributions are required to be made before the statutory due dates as provided under the EPF Acts to avail deduction under Section 36(1)(va).

The SC held that there were certain differences between Sections 36(1)(va) and 43B of the IT Act, each laying down different conditions which need to be adhered to claim deduction. The SC noted that Section 43B and similar provisions spell out special provisions, laying down the mechanism for assessments and expressly prescribe the conditions for disallowances. Section 43B deals with conditions which are enforced by the IRA and need to be complied with by the taxpayer to be able to secure a valid claim for deduction. However, provisions like Section 36(1)(va), which deals with deduction for professional or business expenditure, enumerate various conditions that are required to be fulfilled to claim deduction. Failure to fulfil the enumerated conditions under Section 36(1)(va) would lead to disallowance of the deduction claim.

In light of this background, the SC undertook a detailed analysis of these provisions and contrasted the history and objectives of Section 36(1)(va) with those of Section 43B. SC noted that Section 36(1)(va) was introduced with effect from AY 1988-89, along with an amendment to the definition of income under Section 2(24), which reflected that the amount received by an employer from their employees, for contribution towards any Employee Welfare Fund, should be treated as income. Since these incomes were not earned but received and held in trust by the employers, Section 36(1)(va) was inserted to allow them deductions in respect of such income only if the employee contributions were deposited before the statutory due date. Contrastingly, Section 43B was introduced to address the mischief of taxpayers who claimed deduction merely on the basis of an accounting entry in the books of account, following the mercantile system of accounting, but did not actually deposit the contributions.

The SC further observed that Section 43B earlier required contributions made by employers to be deposited by the filing date. However, with the introduction of Section 36(1)(va), the cut-off period for claiming deductions for employee as well as employer contributions was made uniform under both the sections, i.e., contributions were required to be made before the statutory due date. However, on recommendations of the Kelkar Committee, in 2003, the cut-off period for Section 43B was restored to the filing date.

Based on these legislative developments, the SC observed that the legislature has historically treated employer and employee contributions separately. Accordingly, the SC held in light of the legislative developments and the objectives of provisions of Section 36(1)(va) and Section 43B of the IT Act, it was clear that employers' contributions, i.e., contributions made from employers' income, should be allowed as deduction if the same was paid before the filling date under the IT Act. On the other hand, contributions deducted from the employees' salary and held in trust by the employer would be allowed as a deduction only if the same is deposited before the statutory due date provided under the EPF Acts. The SC held that there is a significant difference in the nature of the two contributions discussed above and such distinction should be borne in mind while interpreting the provisions of Section 36(1)(va) and Section 43B of the IT Act. Thus, the SC held that the provisions of Section 36(1)(va) imposes an obligation on the employer to deposit the employees' contributions before the statutory due date as provided under the EPF Acts.

Separately, it differentiated the ruling of ***Alom Extrusions*** stating that, in the said case, the Court had not considered the differences between these provisions and had discussed the

[34] (2009) 319 ITR 306.

limited scope of the curative amendment which restored the date under Section 43B to the filing date.

The SC further relied on principles of statutory interpretation and stated that it is trite law that taxation statutes ought to be construed strictly. Further, if any provision enables deductions or exemption on complying with certain conditions, such conditions should be strictly complied with. Hence, the SC held that employee contributions ought to be deposited by the statutory due date to claim deduction under Section 36(1)(va) of the IT Act and the provisions of Section 43B would not override it.

Significant Takeaways

Within the ambit of principles of statutory interpretation, this ruling shed light upon the difference in tax treatment and distinct nature of employer contributions and employee contributions towards Employee Welfare Funds.

It is to be noted that this judgment arose in the context of AYs prior to 2021-2022. By way of Finance Act 2021, with effect from AY 2021-2022, certain clarificatory explanations were inserted/given in sections 36(1)(va) and 43B. Explanation 2 to Section 36(1)(va) clarified that section 43B was inapplicable and deemed to have never been applicable for purpose of determining 'due date' under Section 36(1)(va). Whereas, explanation 5 to Section 43B clarified that this provision was inapplicable and deemed to have never been applicable to a sum received by any taxpayer from their employees under Section 2(24)(x). The amendments provided that 'due date' for the purposes of Section 36(1)(va) would mean only the dates

provided under the relevant EPF Acts. These amendments were prospective in nature. Therefore, a view was taken to state that the legislature intended to invoke 36(1)(va) of the IT Act and disallow the expenditure if the employee contributions were deposited after the due date prescribed under the EPF Acts from AY 2021-22 onwards.

However, SC had provided retrospective applications to these amendments by reversing certain contrary decisions rendered by certain Hcs. It is likely that the IRA might re-open assessments for such taxpayers and disallow such deductions. It is important for the taxpayers to review their tax position and make the requisite corrections to avoid any potential adverse consequences.

> **"Employee's contribution should be deposited before the due date, as per the applicable employee welfare regulations."**

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SC upholds airlines liable to deduct TDS on supplementary commission of travel agents

The SC in ***Singapore Airlines Ltd.***,[35] held that the airlines were liable to deduct TDS under Section 194H of the IT Act on indirect payments made by them to their travel agents.

Facts

Singapore Airlines, KLM Royal Dutch Airlines and British Airways PLC (collectively referred to as the "**Assessees**") were operators in the airline industry. The Assessees engaged the services of several travel agents ("**Agents**") to sell airline tickets ("**Tickets**") to various customers. During the relevant period, the International Air Transport Association ("**IATA**") was responsible for setting a ceiling limit on the price of the Tickets ("**Base Fare**") that could be charged from the end customers. The Assessees had their discretion to sell the Tickets to the Agents at a price lower than or equal to the Base Fare ("**Net Fare**") to the Agents. The arrangement between the Assessees and the Agents ("**Agency Agreement**") was also regulated by the IATA.

The Agents could sell the Tickets to the end customers at a price higher than the Net Fare, but not higher than the Base Fare ("**Final Fare**"). For their services, the Agents were entitled to receive commission at a rate of 7% of the Base Fare ("**Standard Commission**"). Further, the difference between the Final Fare and the Net Fare was also pocketed by the Agents ("**Supplementary Commission**").

Section 194H of the IT Act obligates a payer to deduct TDS at the rate of 5% of the amount paid on the payments that are in the nature of nature of 'commission' or 'brokerage'. Consequently, the IRA sent notices to the Assessees and also carried out surveys for identifying defaults on TDS deductions under the said provision vis-a-vis the amount paid as Supplementary Commission. The Assessees were declared 'assessees in default' under Section 201 of the IT Act and required to pay interest in accordance with Section 201(1A) of the IT Act. Further, penalty proceedings were initiated against them under Section 271C of the IT Act.

The Assessees' appeals before the CIT(A) were rejected on merits. On further appeal, the Delhi ITAT set aside the assessment orders passed by the IRA and held that Supplementary Commission was income in nature of proceeds of sale of the Tickets and not commission received from the Assessees. Thus, Section 194H of the IT Act was not applicable.

The IRA appealed before the Delhi HC, which set aside the ITAT's order by holding that the Supplementary Commission earned by the travel agents was linked with the existing principal-agent relationship between the Assessees and the Agents and thus, were in the nature of commission. Accordingly, the responsibility of deducting TDS under Section 194H of the IT Act fell on the Assessees when the Supplementary Commission was rendered to the accounts of the Agents. Aggrieved, the Assessees filed an appeal before the SC.

Issue

Whether the Assessees were responsible for deducting TDS under Section 194H in respect of the Supplementary Commission earned by the Agents?

Arguments

The Assessees contended that they had no control over the Final Fare and were not involved in the sale of the Tickets to the end customers. They argued that two separate transactions took place in the instant case, first between the Assessees and the Agents, and the second between the Agents and the consumer. While the Standard Commission accrued to the Agents pursuant to their dealings with the Assessees, the Supplementary Commission was earned by them pursuant to their own independent dealings with the customers. Thus, both transactions constituted two distinct legal relationships.

It was further argued that 'commission' under Section 194H of the IT Act was defined as payment made in the course of 'services rendered'. However, in the instant case, the actions undertaken by the Agents vis-à-vis the Supplementary Commission were of their own accord and without the knowledge of the Assessees, thus no services were being rendered to the Assessee by the Agents.

The Assessees further argued that since, they had no sight of the Final Fare set by the Agents, they could not practically deduct TDS on the Supplementary Commission earned by the Agents. No actual payment was being made by the Assessees to the Agents with respect to the Supplementary Commission. They only received information regarding the Final Fare on an aggregate bi-monthly basis (and not after each transaction).

The Assessees further relied on Section 216 of the Indian Contracts Act, 1872 ("**ICA**"), which provides that a principal is entitled to claim benefit of a transaction from their agents if such agents acts on their own account, instead of acting on behalf of their principal. In the instant case, the Agents were acting on their own accord and without the knowledge of the principal (i.e., the Assessees) and were covered under Section 216 of the ICA.

[35] Singapore Airlines Ltd. v. CIT Delhi, [2022] 144 taxmann.com 221 (SC).

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Lastly, it was submitted that the Agents had already filed their tax returns and paid applicable taxes on the amount of Supplementary Commission. Hence, even if the Assessees are construed as 'assessees in default' under Section 201, no additional tax could be collected from them.

The IRA, on the other hand, contended that the overall relationship between the Agents and the Assessees was that of principal-agent and the Agents were acting on behalf of the Assessees while also dealing with the end customers. The IRA also submitted that the language of Section 194H covered both 'direct and indirect' payments to an agent. Thus, it was inconsequential whether the Supplementary Commission was directly paid by the Assessees to the Agents or not.

Further, the Assessees had access to data which enabled them to delineate the amount of Standard Commission and Supplementary Commission, and thus, they did not need to deduct the TDS every day, rather they could practically assemble the amounts together and make a comprehensive TDS deduction at the end of the month. Lastly, it was contented that the taxing of the auxiliary amounts in the hand of the Agents did not cure the default by the Assessees in deduction of TDS.

Decision

The SC agreed with the decision of the Delhi HC and held that the Assessees were required to deduct TDS under Section 194H of IT Act on the Supplementary Commission accrued to the Agents.

The SC observed that 'commission' was defined under Section 194H of the IT Act to include any payment received or receivable, directly or indirectly, by a person acting on behalf of another person. Thus, the existence of a principal-agent relationship was *sine qua non* for the attraction of Section 194H.

Reference was placed on Section 182 of the ICA, which defines the terms 'principal' and 'agent'. Reliance was also placed on the decisions of the SC in ***Lakshminarayan Ram Gopal and Sons Ltd. v. The Government of Hyderabad***,[36] ***Gordon Woodroffe & Co. v. Sheikh MA Majid & Co.***,[37] and ***Bhopal Sugar Industries Ltd. v STO, Bhopal***,[38] where the key features of a contract of agency were expounded. Accordingly, it was observed that the determination of whether the Agents were acting on behalf of the Assessees or independently was dependent on whether the Agency Agreement was in substance a contract of sale or contract of agency.

The SC examined the Agency Agreement and observed that it created a principal-agency relationship between the Assessees and the Agents since:

i) Title in the Tickets remained with the Assessees at all times and did not pass to the Agents;

ii) The Agents were authorised to sell Tickets to the end customers on behalf of the Assessees;

iii) The sale of the Tickets by the Agents was done under the pretext of them being the property of the Assessees;

iv) The Assessees remained liable for any inadequacy of services rendered to the end customers pursuant to the sale of the Tickets; and

v) The Assessees even agreed to indemnify the Agents for any loss/ damage arising to them pursuant to such inadequacy.

Thus, the Agency Agreement clearly highlighted that the Agents were acting on behalf of the Assessees and providing services to the end customers with their prior authorisation. Further, the Assessees were responsible for providing full and final compensation to the Agents for their services and there was no distinguishment in terms of stages of transaction involved in the sale of the Tickets. Thus, the arrangement between the Agents and the end customers was not a separate and distinct arrangement but part of the activities undertaken by them pursuant to the Agency Agreement.

It was further observed that there was no distinction between indirect and direct payments under Section 194H of the IT Act. Thus, the SC held that even on indirect payments stemming from the end consumers, the Assessees would remain liable to deduct TDS under the IT Act. The accretion of the Supplementary Commission to the Agents was nothing but an accessory to the principal-agent relationship established under the Agency Agreement.

The SC further took note of several previous contradictory rulings on whether that TDS was required to be deducted by airlines on Supplementary Commission. In this respect, the SC discussed whether it was prudent for the Assessees to deduct TDS on the Supplementary Commission. The SC observed that while the Assessees did not have control over the Final Fare charged by the Agents, the Agency Agreement specified that all charges collected by the Agents from the end customers, including the Supplementary Commission, were kept in trust by the Agents on behalf of the Assessees, until proper accounting was made. Further, the Assessees had access to information regarding the aggregate amount of Supplementary Commission collected by the Agents and the entire Final Fare (including the Supplementary Commission) remained the property of the Assessees. Thus, it was feasible for them to deduct TDS on the

[36] (1955) 1 SCR 393 (SC).
[37] 1966 Supp SCR 1 (SC).
[38] (1977) 3 SCC 147 (SC).

Supplementary Commission and treat the net amount as income of the Agents. In doing so, the Court overruled an earlier decision of the ***Bombay HC in CIT v. Qatar Airways***.[39]

Thus, the SC concurred with the Delhi HC and held that the Assessees had failed to fulfil their TDS obligations under Section 194H. Having held the same, the SC also observed that in the instant case, the requisite taxes have already been paid by the Agents and the Assessees could not be treated as 'assessees in default' under Section 201(1) of the IT Act and recovery proceedings could not be initiated against them for any shortfall. However, interest may be levied under Section 201(1A) of the IT Act for the period between the date of default in deduction of TDS and the date on which the Agents actually paid income tax on such amounts. With respect to penalty proceedings under Section 271C of the IT Act, the SC observed that the Agents had 'reasonable cause' for failure to deduct TDS due to the existence of contradictory rulings during the relevant FY. Thus, the penalty proceedings were quashed.

Significant Takeaways

The SC in this case has clarified that TDS under Section 194H of the IT Act is attracted in case of indirect payments as well due to the expansive definition of the term 'commission'. Prior to this decision, the applicability of TDS on supplementary commission earned by travel agents from the engagement with airlines, was regarded as a complex and litigative issue wherein contrary rulings have been rendered by several HCs. The SC has finally laid this controversy to rest and held that TDS will be attracted on supplementary commission since it is essentially in the nature of (indirect) commissions received by such agents.

The SC also held that the existence of a principal-agent relationship is *sine qua non* for attraction of TDS liability under Section 194H of the IT Act. The existence of a principal-agent relationship will be a factual determination, which may vary from case-to-case.

This decision rendered by the SC would have far reaching implications since it was held that as long as the title of tickets remained with the airlines with respect to the tickets sold by the travel agents, the income generated by the travel agents should be considered as 'commission'. It is worthwhile to highlight that travel agents adopt multiple business models in their ticket bookings and, in most of such cases, the prices are unilaterally determined by the agents without any involvement of the airlines, akin to how a trader operates. It remains to be seen whether all such income should be brought under the umbrella of 'commission' as per the rationale of this decision.

> **"SC upholds that TDS under Section 194H is required to be deducted by airlines on supplementary commission of travel agents."**

[39] 2009 SCC Online Bom 2179.

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Gains on revaluation of assets to partners' capital accounts would fall within the ambit of the term 'otherwise' used in Section 45(4) of IT Act

In ***Mansukh Dyeing and Printing Mills***[40], the Hon'ble SC analysed the provisions of Section 45(4) of IT Act and held that the term 'otherwise' used in Section 45(4) of IT Act inserted *vide* FA 1987 takes into its sweep not only the cases of dissolution but also the gain on revaluation of assets is credited to the partners' capital accounts which would be in effect a distribution of assets and would constitute a 'transfer' for the purposes of calculation of capital gain.

Facts

M/s Mansukh Dyeing and Printing Mills ("**Assessee**") was a partnership firm consisting of four partners engaged in clothing business involving dyeing, printing, processing, manufacturing and trading. Under a family settlement dated May 2, 1991, share of one of the partners having a 25% share was reduced to 12% and the balance 13% was allotted to three new partners (i.e. 11%, 1% and 1%, respectively). Thereafter, during the next FY, three partners retired from the partnership firm and the same was reconstituted with the three new partners and one of the old partners. On November 1, 1992, the firm was reconstituted and three more partners were introduced. On January 1, 1993, the assets of the firm were revalued such that an amount of INR 17.34 crore was credited to the partners' capital accounts in their profit sharing ratio, post which two of the partners even withdrew part of their capital i.e. approximately INR 20 to 25 lacs.

The Assessee's case was reopened for reassessment for AY 1993-94 under Section 147 of IT Act and an addition was made for INR 17.34 crore as short-term capital gains under Section 45(4) of IT Act. The AO held that the revaluation of assets was on account of increase in value of land and building by INR 17.34 crore in AY 1993-94 which was credited to the partners' capital accounts and constitutes a 'transfer' liable to capital gains tax under Section 45(4) of IT Act. The CIT(A) upheld the order passed by the AO and held that there was a clear distribution of assets to the partners as such amount was also withdrawn by the partners subsequently and the firm has relinquished its interest in the assets which constituted a 'transfer' in the AY 1993-94.

The Hon'ble ITAT relying on the ruling of the ***Hon'ble SC in the case of Hind Construction Ltd.***[41] reversed the order of the CIT(A) and held that revaluation of the assets of the firm and crediting the revaluation gain to partners' capital accounts did not involve any transfer. It held that the decision in the case of ***A.N. Naik Associates and Ors.***[42], relied upon by the IRA, shall not be applicable. Since in that case, assets were transferred to a retiring partner by way of a retirement deed.

Thereafter, the Hon'ble Bombay HC *vide* its judgment dated June 24, 2013 upheld the orders passed by the Hon'ble ITAT by deleting the addition on account of short-term capital gains in the hands of the Assessee.

Being aggrieved by the order of the HC, the IRA approached the SC pleading before it to reverse the HC decision.

Issue

Whether credit of gain on revaluation of assets to partners' capital accounts would fall within the ambit of the term 'otherwise' used in Section 45(4) of IT Act and constitute a 'transfer'?

Arguments

The IRA argued that the credit of the revaluation amount of INR 17.34 crore into partners' capital account was in effect distribution of the assets of the firm. The new partners had huge amounts in their capital accounts immediately after joining, which were available for withdrawal. Therefore, such amounts credited to their accounts due to revaluation was a 'transfer' as per Section 45(4) of IT Act. The said provision was introduced *vide* FA 1987 and simultaneously Section 47(ii) was omitted, which exempted a 'transfer' by way of distribution of capital assets as it helped assessees to avoid capital gains tax on distribution of assets on dissolution and Section 45(4) was brought to plug this loophole. The IRA also argued that the ruling of the SC in the case of ***Hind Construction Ltd. (supra)*** relied upon by the Assessee was considering provisions prior to insertion of Section 45(4) of IT Act and hence would not be applicable. Whereas the ruling in the case of ***A.N. Naik Associates and Ors. (supra)*** would be applicable as the Bombay HC interpreted the term 'otherwise" used in Section 45(4) and held that it takes into its sweep not only cases of dissolution but also cases of subsisting partners of a partnership, transferring assets in favour of a retiring partner.

Whereas the Assessee argued that crediting the surplus on account of revaluation to partners' account does not constitute a 'transfer' under Section 45(4) of IT Act as the following two conditions would need to be fulfilled:

[40] *The Commissioner of Income Tax – 23 Vs. M/s. Mansukh Dyeing and Printing Mills [CA No. 8258 of 2022 and 8259 of 2022 (SC)].*
[41] *Commissioner of Income Tax, West Bengal Vs. Hind Construction Ltd. [(1972) 4 SCC 460].*
[42] *Commissioner of Income Tax Vs. A.N. Naik Associates and Ors., (2004) 265 ITR 346 (Bom.).*

a. transfer by way of distribution of capital assets; and
b. transfer should be either on account of dissolution of partnership firm or otherwise.

Whereas there was neither any distribution or transfer of capital assets nor dissolution or otherwise of partnership firm in the instant case and only a notional surplus was credited to the capital account of partners and not any real income. There can be no income merely due to revaluation of the capital assets unless capital assets are also transferred as the former is only a notional book entry.

The Assessee relied on the ruling of the SC in the case of ***Hind Construction Ltd. (supra)***. The Assessee distinguished the ruling in the case of ***A.N. Naik Associates and Ors. (supra)*** on the basis that in that case the assets of the partnership firm were transferred to a retiring partner as per retirement deed and a family settlement entered into and the Hon'ble Bombay HC held that Section 45(4) for capital gains would get attracted as the term 'otherwise' also includes cases of a subsisting partnership transferring assets to a retiring partner.

Decision

The Hon'ble SC analysed the provisions of Section 45(4) of IT Act and held that the contention of the Assessee that there was no distribution of assets in the present case as required under Section 45(4) of IT Act, but merely transfer of revaluation amount to partners' capital account was misplaced. The term 'otherwise' used in Section 45(4) of IT Act inserted *vide* FA 1987 takes into its sweep not only the cases of dissolution but also cases of subsisting partners of a partnership, transferring the assets in favour of a retiring partner as duly held in Bombay HC ruling in the case of ***A.N. Naik Associates and Ors. (supra)***.

In the said case, the Hon'ble Bombay HC held that the expression 'otherwise' can be read 'ejusdem generis' with 'dissolution of partnership' and that the purpose of introducing Section 45(4) would be defeated if the term 'otherwise' includes only dissolution or deemed dissolution and not distribution of assets to retiring partner. The Bombay HC also held that the expression 'otherwise' has to be read 'ejusdem generis' with the words 'distribution of capital assets' and thus, would include transfer of capital assets to a retiring partner.

The Hon'ble SC in the present case also held that the credit of the assets' revaluation amount of INR 17.34 crore to the capital accounts of the partners can be said to be 'in effect' distribution of the assets constituting a 'transfer' falling within the ambit of the term 'otherwise' in Section 45(4) of IT Act. Further, the Hon'ble SC observed that its earlier decision in the case of Hind Construction Ltd. (supra) cannot be relied upon since it was passed prior to insertion of Section 45(4) in IT Act. Therefore, the Hon'ble SC reversed the decisions of the ITAT and the HC.

Significant Takeaways

The aforesaid ruling of the Hon'ble SC may put an end to the ongoing litigation on distribution of assets to a retiring partner or partner(s) in the form of dissolution or revaluation of assets, etc. However, it may be noted that the FA 2021 has brought in significant amendments to the provisions of Section 45(4) of IT Act such that w.e.f. AY 2021-22 onwards:

- Any money or FMV of capital assets or both distributed at the time of reconstitution of a partnership firm would be taxed in the hands of the partnership firm as capital gains.
- The cost of acquisition for computing such capital gains would be amount lying in the capital account of the partner at the time of reconstitution of the firm.

As per memorandum to FA 2021, such amendment would help to remove uncertainty regarding applicability of the aforesaid sub-section to a situation where assets are revalued or self-generated assets are recorded in the books of accounts. Therefore, there is more clarity in the language in respect of taxability of distribution of capital assets to partners of a firm at the time of reconstitution of a partnership firm. The term 'reconstitution' of a partnership firm for the purpose of said provision is defined in Section 9B of the IT Act as a situation where one or more partners exit the firm or are admitted to the firm or there is a change in the respective share(s) held by one or more partners of a firm.

> **"Credit of gain on revaluation of assets into partners' capital accounts amounts to distribution of assets."**

HC holds that capital expenditure incurred on development of software in existing business is allowed as revenue expenditure upon abandoning the software

The Bombay HC in the case of ***Trigent Software Ltd.***[43] held that capital expenditure incurred on development of software in the existing line of business is allowed as a revenue expenditure while calculating taxable income under the IT Act, in the year in which the project in abandoned.

Facts

Trigent Software Limited ("**Assessee**") was engaged in the business of software development solution and management. For AY 2006-07 and AY 2007-08, the Assessee filed return of income declaring its total income. However, for both the AYs, the AO reopened the assessment proceedings under Section 143(3) read with Section 147 of the IT Act, and made addition of INR 7.09 crore and INR 82 lacs (approx.), respectively and debited to the profit and loss account under the head 'Exceptional Items'. The said amount was incurred in connection with the development of a new product and was treated as a part of capital work in progress for the AYs 2004-05 to 2007-08. The development of this software was abandoned subsequently and the Assessee then claimed the whole capital work in progress as revenue expenditure in AY 2006-07 and AY 2007-08.

The CIT(A), allowed the subsequent appeal before it by the Assessee, holding that the expenditure for the development of a new product was in the Assessee's existing line of business and the deduction should be allowed. Relying on the decisions of Delhi HC in the case of ***Indo Rama Synthetic (I) Ltd.***[44] and the Mumbai ITAT in the case of ***IL&FS Education & Technology Services Pvt. Ltd.***[45]**,** the CIT(A) held that though the Assessee had also shown the expenditure as capital work in progress for AY 2004-05 to 2007-08, the deduction had to be allowed as a revenue expenditure in the year in which the project in question was abandoned.

The IRA filed an appeal before the ITAT, but the same was also dismissed placing reliance on the abovementioned cases and the CIT(A)'s views were upheld. Being aggrieved, the IRA approached the HC.

Issue

Whether the capital expenditure incurred by the Assessee in connection with the development of new products allowed as revenue expenditure when the project was abandoned?

Arguments

The IRA submitted that the expenditure should not have been allowed as revenue expenditure as the Assessee itself had treated the said expenditure as capital in nature and had entered the same in its books of accounts as 'Capital work in progress'. Further, since the expenditure was incurred in connection with the development of a new product, it was in the nature of capital expenditure and hence, should not be allowed as revenue expenditure.

On the other hand, the Assessee vehemently contested the IRA's contentions and argued that the amount shown as CWIP was indeed a capital expenditure. However, when the Assessee decided to discontinue that line of activity, there was no option but to claim it as a revenue expenditure. In support of its claim, it placed reliance on the SC judgment in the case of ***Empire Jute Co. Ltd.***[46]***, EID Parry India Ltd.***[47] and Indo Rama Synthetic (I) Ltd. (supra).

Decision

The HC noted the finding of *Empire Jute Co. Ltd.* that there is no straight jacket formula for deciding the allowance or non-allowance of an expenditure and every case has to be decided basis its own facts keeping in mind the purpose for which expenditure has been incurred. If the benefit of an expenditure is of capital nature, then the expenditure cannot be allowed as revenue expenditure. However, if the advantage of an expenditure consists merely in facilitating the Assessee's trading operations or enabling the management and conduct of the Assessee's business to be carried out more efficiently or more profitably, while leaving the fixed capital untouched, the expenditure would be on revenue account, even though the advantage may endure for an indefinite future.

The HC also referred to the judgment in case of Indo *Rama Synthetic (I) Ltd.,* which gave guidance in deciding the allowability of an expense. It was held that if the expenditure

[43] Pr. Commissioner of Income Tax-5 v. Trigent Software Limited [TS-941-HC-2022(BOM)].
[44] Indo Rama Synthetic (I) Ltd. v. Commissioner of Income-tax [2011] 333 ITR 18 (Delhi).
[45] IL & FS Education & Technology Services Pvt. Ltd. v. ITO ITA No.765, Mumbai (2009) dt. 10-04-2013.
[46] Empire Jute Co. Ltd. v. Commissioner of Income Tax 1980 124 ITR 1 (SC).
[47] CIT v. EID Parry India Ltd. 257 ITR 253.

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was incurred for starting a new business, which was not carried out by the taxpayer earlier, then such expenditure would be considered as capital in nature and the materialization of the project would be irrelevant.

As against the above, if the expenditure incurred was in respect of the same business, which was already carried on by the taxpayer, even if it was for the expansion of the business, i.e., to start a new unit and there was unity of control and a common fund, then such an expense would have to be treated as business expenditure. It was held that in such a case whether a new business/asset came into existence or not would be a relevant factor, i.e.:

i) if there was no creation of a new asset, then the expenditure incurred would be of revenue nature; and

ii) if the new asset came into existence which was of an enduring benefit, then such expenditure would be of a capital nature.

The above view was also followed in the case of ***Tata Robins Fraser Ltd.***[48]

Applying the above ratio to the facts of the instant case, the HC highlighted that as the Assessee is engaged in the business of development of software solutions, its work in the field of development of a new software was nothing but an endeavour in its existing line of business of developing software solutions. When the product which was being developed never came into existence, no new asset could have given enduring benefit and hence, the project was abandoned. Such an expenditure can only be considered as a revenue expenditure and the views taken by the CIT(A) and ITAT were upheld.

Significant Takeaways

The HC held that there is no fixed method to identify if the expenses are characterized as capital or revenue and whether the same are allowable or not. The facts and circumstances of each case would play a determining role in such situations. The HC in the instant case has taken a position that expenses incurred on software development for the existing business, which was later abandoned, is to be considered as a revenue expenditure. However, in the case of ***Chemplast Sanmar Ltd.***[49], the Madras HC had even extended the argument and ruled that even if expenses incurred by the assessee are towards a new line of business being contemplated, and the said line of business is abandoned later, the expenses incurred in connection with the new line of business would be considered as a revenue expenditure due to the fact that the new venture was managed from common funds, and there was unity of control for all project lines in the hands of the assessee.

It is interesting to note that while taking the above position, the Madras HC had relied on an earlier case of Delhi HC in the case of ***Jay Engineering Works Ltd.***[50], wherein it was appreciated that though the product line was new, there was necessary unity of control leading to an inter-connection, inter-dependence and inter-lacing of two ventures.

Thus, different positions have been taken by different HCs on this issue in different cases relying on different reasons. Notwithstanding the above, it is important for the taxpayer to demonstrate the unity of control and common funds being used for the expenses in relation to the new line of business contemplated by the taxpayer.

> **“ Expenditure incurred on abandoned software that was being developed for the existing line of business, is revenue expenditure. ”**

[48] Commissioner of Income-tax, Ranchi v. Tata Robins Fraser Ltd. [2012] 211 Taxman 257 (Jharkhand).
[49] Chemplast Sanmar Ltd v. Assistant Commissioner of Income-tax [2018] 97 taxmann.com 347 (Madras).
[50] Jay Engineering Works Ltd. v. Commissioner of Income-tax, Delhi-III [2008] 166 Taxman 115 (Delhi).

Delhi HC lays down principles with respect to issuance of reassessment notices

In the case of ***Suman Jeet Agarwal***,[51] the Delhi HC held that the date of issuance of a reassessment notice for the purposes of Section 149 of the IT Act, should be the date of dispatch of such notice.

Facts

The Delhi HC was apprised of a batch of matters pertaining to determination of date of issuance of reassessment notices, issued under Section 148 of the IT Act, through electronic means. This dispute surrounding the date of issuance of reassessment notice arose in the backdrop of the revamp of the procedure to conduct reassessments *vide* FA 2021. Prior to the FA 2021, the IRA could reopen past assessments if they had a reason to believe income had escaped assessment. Further, notice of reassessment could be issued within five or seven or seventeen years from the end of the relevant FY, as the case may be ("**Erstwhile Reassessment Regime**"). However, FA 2021, *inter alia*, laid down a mechanism for a pre-notice enquiry to be followed prior to issuance of reassessment notices. Further, the FA 2021 restricted the time period for re-opening assessment, under normal circumstances, to four years (from five years under the Erstwhile Reassessment Regime) from the end of the FY. Additionally, the FA 2021 extended the reassessment time limit to 11 years in cases where the income escaped assessments is likely to exceed INR 5 Million ("**New Reassessment Regime**").

Considering the operation date of the New Reassessment Regime was to become effective from April 1, 2021, the IRA, in order to claim the longer reassessment period under the Erstwhile Reassessment Regime, generated reassessment notices on March 31, 2021 for FYs 2012-13, 2013-14, 2015-16 and 2016-17.

The common thread of facts running through these matters pertained to the reassessment notices, which though were generated by the jurisdictional AO, through the Income Tax Business Application ("**ITBA**"),[52] on March 31, 2021, were despatched to the relevant taxpayers ("**Assessees**") only after April 1, 2021. A related issue was that some notices were digitally signed, while others were not.

If these notices were considered to have been issued on or after April 1, 2021, the Assessees could avail benefit of the New Reassessment Regime and notices issued for AYs prior to AY 2018-2019 would be barred. Furthermore, under the New Reassessment Regime, stamped by the decision of the SC in ***Ashish Agarwal,***[53] such reassessment notices are to be considered as show-cause notices giving an opportunity to the taxpayer to explain why reassessment proceedings should not be initiated. However, if they were considered to have been issued prior to April 1, 2021, they would be governed under the Erstwhile Reassessment Regime.

In this context, the Assessees filed a writ petition before Delhi HC to seek clarity with respect to the limitation period applicable to them. Based on the possible scenarios dealing

[51] ITA No. 782/2021 [Delhi].
[52] A system launched by the CBDT to facilitate proceedings under the IT Act using electronic means as an interface between the tax authority and the taxpayer.
[53] [2022] 138 taxmann.com 64 (SC).

with date of issuance and mode of despatch, the HC grouped the notices as follows:

i) Notices which were dated March 31, 2021 or before but were digitally signed and received by the Assessees on or after April 1, 2021 ("**Category A**").

ii) Notices which were dated March 31, 2021 or before but were not digitally signed and were received by the Assessees on or after April 1, 2021 ("**Category B**").

iii) Notices which were dated and digitally signed on or before March 31, 2021 but received by the Assessees on or after April 1, 2021 ("**Category C**").

iv) Notices which were dated and digitally signed on or before March 31, 2021 but were not served upon the Assessees. The Assessees were later made aware through the income tax portal ("**Category D**").

v) Notices which were dated March 31, 2021 or before but were manually signed and despatched through speed post on or after April 1, 2021 ("**Category E**").

Issues

Considering the quantum and nature of notices being dealt with, the following issues were formed:

i) Whether the generation of notice on ITBA by the AO on March 31, 2021, without despatching it, qualifies as 'issuance' under the IT Act?

ii) Whether 'despatch' as referred to in Section 13 of the Information Technology Act, 2000 is essential for issuance of notice through email, for the purposes of the IT Act?

iii) Whether the time taken by the ITBA's email software system in despatching the emails to the Assessees shall be ignored for the purposes of determining the date of issuance of notice and whether such notices will be deemed to have been issued on March 31, 2021?

iv) Whether the digital signature of the AO is required for the issuance of a valid notice?

v) Whether merely uploading notices on the income tax portal of the Assessees, and not serving them through email or post, constitutes valid transmission under the IT Act?

vi) Whether a notice issued to an unrelated email address of the Assessees constituted a valid service?

Arguments

The Assessees placed reliance on various cases and argued that dispatch is an essential condition for valid issuance of a reassessment notice. It was further argued that Section 149 (i.e., the provision which stipulates the timelines for issuing re-assessment notices) does not create a distinction between the authority or software issuing the notice. It merely states that the notice has to be issued within the time limit, outside of which the notice is time barred. Therefore, the time taken by ITBA should be attributable to the AO, for the purposes of

determining the date of issuance of notices. The Assessees also asserted that communication of notice is a prerequisite for a valid issuance of a notice under Section 282A of the IT Act.

On the other hand, the IRA asserted that once the notice is generated through ITBA and the Document Identification Number ("**DIN**") is allotted, the AO has no control over the notice and the same cannot be amended by it. Therefore, *inter alia*, it was argued that for purpose of Section 149 of the IT Act, the date of generation of notice on ITBA should be considered as the date of issuance. It was also argued that the time taken by ITBA cannot be attributed to the AO as they are distinct entities, and once notices are generated, it is beyond the control of the AO. The IRA also added that there was a delay in dispatching the notices on account of certain technical glitches in the ITBA and such time should not be considered for the purposes of determining the date of issuance. Placing reliance on R.K. ***Upadhyaya v. Shanabhai P. Patel***[54], which held that service of notice was not a condition precedent for satisfying the condition of 'issued' it was further contended that service of notice upon the Assessees was not a condition for determining if a notice had been validly issued under Section 149.

Furthermore, the IRA also submitted that as per Section 282A(2) of the IT Act, a notice should be considered to be validly authenticated if such notice contains the name, jurisdiction and designation of the tax authority. Thus, it was argued that affixation of digital signatures of the AO, was not a prerequisite for valid issuance of a notice.

Decision

With respect to the first issue, the HC held that the mere generation of notices on ITBA would not be considered equivalent to issuing of notice under Section 149. The HC held that for the purposes of a reassessment proceeding to be valid, the reassessment notice should be 'issued' within the prescribed timelines. The HC relied on various decisions[55] and upheld the well settled principle that unless a notice is dispatched, the same cannot be said to be issued. The HC also drew support from various HC decisions, where the courts had held the date of triggering an email (in case of notices sent through email) to be the date of issue of the notice. Thus, the HC held that setting up of the ITBA system does not mitigate the legal requirement of dispatching a notice and unless there is any overt act on part of the AO to dispatch a notice once generated and signed. Accordingly, such notice cannot be said to have been issued.

The HC clarified that even as per the instructions[56] issued by the CBDT, with regards to administration of proceedings through ITBA, the AO is required to undertake overt acts for issuing a notice, after the same has been generated. Thus, the HC also rejected the argument of the IRA that once a notice is generated on the ITBA, the AO has no control over it.

Therefore, the notices generated on March 31, 2021, but despatched after April 1, 2021, were held to have been issued after April 1, 2021.

Further, with regard to issue 2 and 3, the HC noted that Notification No. 02/2016 dated February 3, 2016 and Notification No. 04/2017 dated April 3, 2017, issued by the Principal Director General of Income Tax (Systems), categorically mentioned that the time and place of despatch and receipt of electronic communications made by the IRA shall have the same meaning as provided in Section 13 of the Information Technology Act, 2000. Accordingly, the HC held that Section 13 of the Information Technology Act, 2000 would be applicable to issuance on notices under the IT Act. In this regard, the HC, relying on various cases laws,[57] observed that under Information Technology Act, 2000, dispatch of an electronic record would occur when it enters a computer resource outside the control of the sender. Accordingly, it held that a reassessment notice would be considered to be dispatched once an email from the ITBA is triggered and leaves the last server of ITBA.

The Court also debunked the argument of the IRA that on March 31, 2021, there was delay in dispatching the notices on account of certain technical glitches in the ITBA. Based on the programming of ITBA, illustrated by representatives of the IRA, the HC determined that the delay on March 31, 2021 was not caused by any glitches in the software but due to huge volumes of notices being issued. The HC noted that the AO and the IRA were aware of the programming of ITBA and the fact that the notices are dispatched in a controlled manner, i.e., in batches. Accordingly, the AO should have factored these facts at the time of re-opening the assessments.

With regard to issue 4, the HC held that in absence of any specific provision mandating affixation of the digital signatures of the IRA on reassessment notices, Section 282A of the IT Act would apply. Accordingly, the HC observed that pursuant to Section 282A of the IT Act, affixing the digital signature was not mandatory for issuing a valid notice, and an unsigned notice would be deemed to have been authenticated, as long as it

[54] R.K. Upadhyaya v. Shanabhai P. Patel, (1987) 3 SCC 96.

[55] Smt. Parveen Amin Bhathara v. the Income Tax Officer, [2022] 143 taxmann.com 353 (Madras); Kanubhai M. Patel (HUF) v. Hiren Bhatt or His successors to office, [2011] 12 taxmann.com 198; Daujee Abhushan Bhandar (P.) Ltd. v. Union of India, [2022] 136 taxmann.com 246.

[56] ITBA Assessment Instruction No. 2 [F. No. System/ITBA/Instruction/Assessment/16-17/177 dated 01.08.2016] and ITBA Assessment Instruction No. 3 [F. No. System/ITBA/Instruction/Assessment/177/16-17/177 dated 03.02.2017].

[57] Daujee Abhushan Bhandar (P.) Ltd. v. Union of India, [2022] 136 taxmann.com 246; Advance Infradevelopers (P.) Ltd. v. Adjudicating Authority, [2021] 127 taxmann.com 197.

contained the name, designation and jurisdiction of the issuing authority.

With respect to the issue of sending the notice incorrectly to an unrelated email address, Delhi HC held that serving of a notice on an unrelated email address would not constitute a valid service and that notices should be issued in accordance with procedure established by law. Likewise, in the case of uploading the notice of the tax portal, the HC held that the IRA ought to have intimated the Assessees to constitute a valid service. However, the Court did not quash such notices as the Assessees were eventually made aware of them. Accordingly, the HC held that the date when the Assessees became aware of the notice should be considered as the date of issuance of notice.

Significant Takeways

Ever since the advent of faceless assessments, there have been many questions in the minds of taxpayers, surrounding the date of issuance of assessment/reassessment notices, issued through electronic platforms. In light of the same, this judgment of the Delhi HC is significant as it provides clarity surrounding the date and time of issuance of notices through the ITBA.

This decision also sheds light upon the technological software and processes adopted by the IRA in generation, despatching and issuing of notices, thus providing a detailed understanding of the newly-introduced technological tools and platforms.

This decision is a welcome ruling as it affirms the principle of law that the date of despatch for physical notices and date of triggering of email for digital notices is to be considered as the date of issue of notice.

This decision also succinctly deals with the employment of technology to tax proceedings and it is hoped that this ruling can serve as a guiding light to understand the processes and implications of other related proceedings which can be initiated under the IT Act.

> **“ Mere generation and signing of a reassessment notice, without its dispatch would not constitute an issuance. ”**

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Delhi HC upholds Daikin's eligibility for depreciation on intangible assets

The Delhi HC in the case of ***Daikin Shri Ram Aircon Pvt. Ltd.,***[58] held that depreciation under Section 32(1)(ii) of the IT Act could be claimed on business and marketing rights acquired, since it constitutes a valuable intangible asset. It was further held that registration of intellectual property rights was not sine qua non for claiming depreciation under the IT Act.

Facts

Daikin Shri Ram Aircon Pvt. Ltd. and Daikin Air Conditioning India Pvt. Ltd. ("**Assessee**") are engaged in the business of manufacturing and trading air conditioners and water coolers. Even though the matter pertained to two different taxpayers, the issue in both the judgments related to depreciation, and thus, the same were heard together. The Assessee entered into a business purchase agreement with Usha International Ltd. ("**UIL**") for purchase of marketing and business rights ("**Marketing Rights**") as well as goodwill ("**Goodwill**") for a period of 20 years. A consideration of INR 20 million was paid by the Assessee to UIL pursuant to such transfer. The entire amount (i.e., the consideration paid for the Marketing Rights as well as the Goodwill) was capitalised by the Assessee in its books of accounts under the head of 'goodwill' and depreciation was claimed on the same under Section 32 of the IT Act.

Separately, the Assessee also *inter alia*, purchased intellectual property rights (including brand logo, patents and trademarks) ("**IPRs**") from SIEL Aircon Ltd. for a consideration of INR 110 Million. Depreciation was also claimed on the IPRs under Section 32 of the IT Act.

The AO rejected the claim for depreciation on both 'goodwill' and IPRs on the ground that (i) 'goodwill' is not covered under the definition of 'intangible assets' under the IT Act; (ii) and IPRs were not registered under the relevant intellectual property laws, respectively. On appeal by the Assessee, the CIT(A) reversed the order of the AO and allowed depreciation to the Assessee.

Against this order of the CIT(A), the IRA appealed before the Delhi ITAT. The ITAT partly upheld the order of the CIT(A) with respect to proportionate depreciation on the amount of consideration paid for the Marketing Rights but denied relief to the Assessee in relation to depreciation on Goodwill. Aggrieved with the partial relief granted by the CIT(A) to the Assessee, the IRA further appealed before the Delhi HC.

Issue

Whether the Assessee was eligible to claim depreciation on the Marketing Rights as well as IPRs?

Arguments

The Assessee contended that the Marketing Rights were exclusive and valuable in nature, and hence, constituted a capital asset eligible for depreciation under Section 32 of the IT Act. The Assessee further relied on the decision of the SC in ***Mysore Minerals v. Commissioner of Income Tax***[59] and ***Dalmia Cements (Bharat) Ltd. v. Commissioner of Income Tax***[60] to argue that it was already settled that registration of intellectual property was not a condition precedent in order to claim depreciation under Section 32 of IT Act. Thus, the AO erred in denying depreciation on the IPRs.

The IRA, on the other hand, contended that firstly, 'goodwill' was not an 'intangible asset' and secondly, the payment of consideration with respect to the IPRs was not recorded in the transaction documents and thus, depreciation could not be claimed on such amount.

Decision

The HC held that there was no infirmity in the findings of the ITAT since:

i) the Marketing Rights were acquired by the Assessee for valuable consideration;

ii) the said rights were exclusive in nature;

iii) the said rights were enduring in nature, spanning for a period of 20 years; and

iv) the rights had been capitalised as an intangible asset in the books of the Assessee.

Thus, depreciation on the Marketing Rights was rightly allowed by the ITAT. Simply because the Marketing Rights had been recorded as 'goodwill' under the books of accounts of the Assessee and did not disentitle the Assessee from claiming depreciation on the said assets. Moreover, depreciation on the Marketing Rights as well as on IPRs had been accepted by the IRA in the subsequent years since the IRA did not file appeal against order of ITAT for those years, and thus, the same should also be allowed on the principle of consistency.

[58] Commissioner of Income Tax v. Daikin Shri Ram Aircon Pvt Ltd and Commissioner of Income Tax Delhi -IV v. Daikin Air Conditioning India Pvt. Ltd. TS-831-HC-2022 (DEL).
[59] Mysore Minerals v. Commissioner of Income Tax, [1999] 106 Taxman 166 (SC).
[60] Dalmia Cement (Bharat) Ltd. v. Commissioner of Income Tax, Delhi, [2001] 247 ITR 267 (SC).

With respect to the IPRs, the HC agreed with the contention of the Assessee that this issue was already settled, basis the judgments of Mysore Minerals and Dalmia Cements (both supra). The payment of consideration with respect to the IPRs was not under dispute. Further, ownership of the IPRs could be asserted by the Assessee even in the absence of registration/ assignment of the same in its name. The intent of the legislature in enacting Section 32 of the IT Act was to provide benefits to persons who have dominion over the assets and utilise them for the purposes of their business or profession. Thus, the Assessee was entitled to claim depreciation with respect to the IPRs as well.

Significant Takeaways

It may be relevant to note that while the instant case pertained to AY 2001-02 and AY 2002-03, the definition of 'assets' in Explanation 3 to Section 32 of the IT Act has been amended *vide* FA, 2021 to exclude 'goodwill' from the purview of intangible assets. The present definition reads as follows:

"…intangible assets, being know-how, patents, copyrights, trademarks, licences, franchises or any other business or commercial rights of similar nature not being goodwill of a business or profession."

Thus, effective April 1, 2021, the 'goodwill' of a business or profession is not considered a depreciable asset and is specifically excluded from the definition of an asset for depreciation purposes. However, this decision may have persuasive value for pending litigation for the earlier years on this issue.

However, in the instant case, while the entire purchase consideration was recorded as 'goodwill', the ITAT made a distinction between the valuable Marketing Rights and the amount paid for Goodwill. The ITAT, in its ruling, clarified that Goodwill is not a right which can be used as a tool to generate business, and hence, no depreciation can be claimed with respect to such amount. While the Delhi HC did not specifically discuss this issue, the order of the ITAT was upheld by the HC. It must also be submitted that this decision of the ITAT could be regarded as a violation of the earlier decisions of the Courts including those of the SC.

This ruling may provide relief to taxpayers who have recorded other valuable intangible assets as 'goodwill' in their books of account. Even after the amendment to the definition that excluded 'goodwill' from 'intangible assets', depreciation should be allowed on asset that is in the nature of a business or commercial right but has been categorised as goodwill in the books of accounts. Irrespective of the nomenclature used in the books of accounts, the above is applicable provided the taxpayer is able to substantiate and justify that the intangible asset is not goodwill.

> **"Exclusive business rights and IPRs purchased for valuable consideration constitute an intangible asset eligible for depreciation under Section 32(1)(ii) of the IT Act."**

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The IRA cannot auction the imported goods of the corporate debtor post declaration of moratorium under IBC

In the case of ***Ram Swarup Industries Ltd.***[61]***,*** the SC has upheld the order of the NCLAT that provided that the RP has the right to have control over the goods of the Corporate Debtor which are in possession of the IRA.

Facts

Ram Swarup Industries Ltd. ("**Respondents/Corporate Debtor**") had imported two machines claiming the benefit under the EPCG scheme, as applicable under FTP 2004-2009. The goods were delivered in Durgapur in April 2009. However, as the IRA did not accept the customs duty calculated by the Respondent, it undertook an assessment of the value of the imported goods and arrived at a figure of approximately INR 14 million along with applicable interests, and directed the Respondent to pay via an order dated April 12, 2010.

As the Respondent did not discharge the customs duty, the goods remained uncleared for home consumption. In 2014, the IRA initiated an action regarding the disposal of uncleared imported goods. Aggrieved by same, the Respondent filed a writ petition before the Calcutta HC, which *vide* order dated September 10, 2014, dismissed the writ petition. Thereafter, the IRA attempted to auction the imported goods in the year 2016 but failed to do so even after three attempts due to non-participation of buyers. The IRA, *vide* letter dated February 16, 2017, granted three months to clear off the imported goods by paying the pending customs duty, and when it didn't move, the IRA attempted a fourth auction on January 19, 2018 *vide* letter dated August 30, 2017.

In the interim, the Respondent had submitted the application for CIRP to the adjudicating authority and the same was accepted on January 8, 2018 ("**CIRP Order**") and a moratorium was imposed. The Corporate Debtor, *vide* letter dated January 16, 2018, had communicated to the IRA about initiation of the CIRP process, which was received by the IRA on January 20, 2018. An application under Section 14 of IBC was filed before the NCLT praying to restrict the IRA in proceeding with the e-auction of the imported goods, and the same was allowed *vide* order dated July 3, 2018.

Aggrieved by the same the IRA filed an appeal before the NCLAT, which *vide* order dated June 20, 2019 ("**NCLAT Order**"), held that no interference was required against the order of the NCLT.

Aggrieved by the NCLAT Order, the IRA filed an appeal before the SC.

Issue

i) Whether the goods lying with the IRA during the moratorium can be auctioned.

ii) Whether the RP have the right to control the assets of the Respondents which were in possession of the IRA.

Arguments

The IRA submitted that the RP has the right to control over items which were (i) assets of the Corporate Debtor; (ii) there exist ownership rights and (iii) were recorded in the balance sheet of

[61] Commissioner of Customs v. Ram Swarup industries Limited Civil Appeal No. 3543 of 2020.

the Corporate Debtor. Further, the IRA submitted that the right to control was co-terminus with that of the Corporate Debtor. It argued that the Respondent did not acquire complete ownership as the imported goods were not cleared for home consumption. The IRA placed reliance on the case of ***Dytron Ltd.***[62] wherein the Calcutta HC, on a similar circumstances dealing with authority of liquidator under erstwhile Companies Act,1956, held that unless the importer pays off the statutory duties in respect of the imported goods and the imported goods were cleared by the authorities for consumption, the imported goods would not form part of assets available for distribution.

Additionally, the IRA urged that the rights of the importer over the imported goods were relinquished by virtue of Section 48 of the Customs Act, wherein the IRA is permitted to dispose-of uncleared imported goods. As the Respondent has failed to discharge customs duty after repeated reminders and warnings for disposal, they had the right to auction the same.

On the other hand, the Respondent argued that the CIRP was initiated on January 8, 2018 *vide* the CIRP Order and a moratorium was declared under Section 14 of the IBC. The IRA ordered an e-auction of the imported goods on January 19, 2018 *vide* letter dated January 15, 2018, post the commencement of the moratorium.

The Respondent urged that by virtue of Section 238 of IBC, the provisions of IBC would prevail over any other statute. Therefore, the moratorium imposed under Section 14 of IBC would override the auction process initiated by the IRA under Section 48 read with Section 150 of the Customs Act. Additionally, the invoices of the imported goods in question were in the name of the Respondent and the ownership of the imported goods was never challenged by the IRA.

Decision

The SC summarily held that there were no grounds for interference and, therefore, the order passed by the NCLAT was upheld and an appeal filed by the IRA was dismissed.

The detailed order passed by the NCLAT provided that the title over the imported goods was with the Respondent and no other third party, therefore, the RP had the power to take custody of the imported goods. It observed that Section 48 of the Customs Act dealt with procedure in case goods were not cleared for home consumption within the prescribed timeline. The same did not provide that ownership would change as importer has not relinquished the title. Therefore, the Explanation to Section 18 of IBC which provides for a situation where RP cannot hold right over an asset was inapplicable as the ownership was with Respondent and only possession was with IRA. Hence, RP had right to take control and custody of the imported goods. The NCLAT also held that the assets cannot be alienated or disposed-off by the IRA due to the moratorium imposed under Section 14 of the IBC. The NCLAT observed that the CIRP was initiated on January 8, 2018 and the IRA was not right in initiating the auction process after having the knowledge of CIRP being initiated, even though the imported goods were lying with them since April 2009.

Significant Takeaways

The aforementioned ruling affirms that a moratorium is applicable on any kind of proceeding including auction of uncleared imported goods. The decision also deals with the important aspect that the title of goods, even when they were in the possession of IRA due to non-payment of customs duty by the importer, lies with the importer and not the IRA. The judgment re-affirms that provisions of the IBC will override Customs Act in case of inconsistency. However, it must be noted that this view of the NCLAT, subsequently approved by the SC, is contrary to the view taken by the SC in the case of ***Rainbow Papers***[63]. In the said case, the IRA was considered at par with the secured creditors due to the affirmative action of attaching the properties of the corporate debtor before the initiation of CIRP. It is pertinent to note that in the aforementioned case, the IRA could have confiscated the property under Section 126 of the Customs Act as the Respondent had not paid the due customs duty; however, the IRA did not and, therefore, the Respondents had the title over the imported goods. 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 have title over the assets of the assessee unless the underlying assets have been attached by them prior to the invocation of the IBC proceedings.

> **“The ownership of imported goods in the possession of IRA due to non-clearance still remains with the importer.”**

[62] Collector of Customs v. Dytron (India) Ltd. MANU/WB/0334/1998.
[63] State Tax Officer v. Rainbow Papers Limited, 2022 (9) TMI 317 SC.

Pre- GST exemption of 100% excise duty for new or expansion of units cannot be automatically available under GST regime on account of doctrine of promissory estoppel

In the case of ***Hero Motocorp Ltd.***[64]***,*** the SC held that the doctrine of promissory estoppel cannot be invoked against the Government while it is discharging its duties under governmental, sovereign or public acting capacity. Rescinding of pre-GST exemption was not arbitrary or irrational as tax regime was completely overhauled.

Facts

Hero Motocorp Ltd. and Sun Pharma Laboratories Ltd. ("**Appellant(s)**") established new industrial units in Uttarakhand and Sikkim, respectively for availing the benefits of exemption of 100% outright excise for a period 10 years. The exemption was available to new industrial units and existing industrial units on their expansion from the date of commencement of commercial production. However, prior to implementation of GST, the GST Council *vide* a meeting held on September 30, 2016 recommended that if a concerned State or the Central Government decides to continue any existing exemption/incentive, then such exemption / incentives should be administered by way of a reimbursement mechanism. Consequently, the exemption was rescinded *vide* Notification No. 21/2017-CE dated July 18, 2017 ("**2017 Notification**") issued under Section 174 (2) (c) of the CGST Act.

Subsequently, the Central Government notified the Budgetary Support Scheme *vide* notification dated October 5, 2017, wherein it provided for reimbursement of the Central share of CGST and IGST to the affected units for the remaining period. The share of the Central Government determined under the Budgetary Support Scheme was at 29% of IGST and 58% of CGST.

Due to reduction in indirect tax benefit against 100% excise exemption, the Appellants filed writ petitions before their jurisdictional HCs (i.e. in Delhi Hc[65] and Sikkim HC[66]). The HCs dismissed the writ petitions and no favourable order was passed. Aggrieved by the HC Orders, the Appellants approached the SC for addressal of their grievances.

Issue

Whether the UOI can be directed to continue to provide exemption as represented by it through earlier notification, which has been subsequently rescinded post the change in legislation?

Arguments

The Appellants submitted before the SC that an explicit representation was made by the UOI regarding excise duty exemptions to new industrial units being set up or old industrial units being expanded in the states of Uttarakhand, Himachal Pradesh and Sikkim. The Appellants submitted that relying on the said promise made by the UOI, the Appellants had altered their position and established new industrial units. Rescinding of the exemption has altered the position which was injurious to the Appellants. Therefore, it argued that the UOI, by virtue of the doctrine of promissory estoppel, was estopped from resiling from the promise and representation made by them.

Further, the Appellants submitted that the Central Government's share in the refund as per the Budgetary Support Scheme was 58% of CGST, which was decided arbitrarily and irrationally. They argued that even in earlier regimes, the Centre levied and collected certain taxes such as excise and the State Governments were entitled to certain proportion of such revenue, but full exemption from payment of duty was granted by the Centre. The Appellants urged that the scheme announced in 2003 would stand on a higher pedestal than the statutory provision or notifications passed under a legislation. Therefore, the Appellants argued that the same should be followed under the GST regime as well and 100% exemption should be provided to the Appellants instead of the 58% exemption granted by the Central Government. The Appellants also submitted that as per Section 11 of the CGST Act, the UOI have the power to issue a notification and grant the exemption to the Appellants. Alternatively, the Appellants suggested that if the UOI were unable to provide 100% exemption due to share of state Government involved, the benefit for the exemption could be extended in order to achieve the real aim behind the exemption policy which was for promoting industrial growth and employment in such region.

On the other hand, the UOI submitted that the doctrine of promissory estoppel cannot be invoked or applied against the Central Government, especially in cases where the material change in the circumstances and the larger public interest requires withdrawal of exemption. The UOI submitted that by the 101st Constitutional Amendment, which implemented the GST laws, there was emphasis on pooled sovereignty, wherein State and the Centre share equal responsibilities. The UOI also submitted that Article 279A of the Constitution of India provides for establishment of GST Council, which makes recommendations to both the State and Union regarding rate of taxes and cesses to be levied under the GST regime.

The UOI highlighted that the earlier regime was origin based, however, GST regime is destination based. Under the old regime

[64] Hero Motocorp Ltd. v. Union of India Civil Appeal No. 7405 of 2022 (arising out of SLP (Civil) No. 12397 of 2020) with Civil Appeal No. 7406 of 2022 (arising out of SLP (Civil) No. 11978 of 2021).
[65] Writ Petition (Civil) No. 505 of 2020.
[66] Writ Petition (Civil) No. 47 of 2018.

the Centre collected 100% sales tax, excise duty, etc. and the State collected 100% proceeds under VAT. Hence, the old regime was not uniform whereas under the GST regime both State and the Centre have become partners as they both charge the same rate of tax. The UOI submitted that the only common fact between the old and the GST regime is that the Centre still continues to fund the State.

Additionally, the UOI argued that the Appellants have neither challenged the validity of the 2017 Notification (which rescinds the excise duty exemption) nor the proviso to Section 174 (2) of the CGST Act (which provides that any incentive given in earlier regime would not continue as privilege, if same is rescinded). Therefore, the appeal for maintainability of writ filed by the Appellants was not tenable under law. Further, the UOI submitted that the Central Government was not bound to continue granting the 100% excise duty exemption, however, as a gesture of good faith and following the recommendations of the GST Council, it decided to grant the exemption of 58% to industrial units. The UOI submitted that the Appellants have erred in law by attempting to seek relief from the UOI instead of respective State Governments, who have not passed any budget support schemes so far.

The UOI submitted that the writ of mandamus, as prayed by the Appellants, can only be issued against a statutory body if the existence of it is established that a statutory duty exists on the said statutory body and the same was not discharged or suffered neglect. The UOI submitted that the Appellants have failed to establish that any statutory duty exists on the UOI to provide 100% GST reimbursement.

Decision

The SC after a detailed analysis of its earlier decisions pertaining to application of doctrine of promissory estoppel held that it cannot be applied against the State in its governmental, sovereign or public acting capacity. It observed that the proviso to Section 174 (2) of the CGST Act specifically provided that any incentive given in earlier regime would not continue as a privilege, if the same is rescinded. The SC rejected the estoppel claim of the Appellants and held that the 2017 Notification was issued in pursuance of the statutory mandate as provided under Section 174(2)(c) of the CGST Act, and if the prayer made by the Appellants was granted, then it would amount to permit for estoppel to be operated against the legislative function of the Parliament, which is not permitted under law.

The SC also rejected to issue a writ of mandamus against the UOI since there was no duty cast on the UOI to grant the Appellants 100% refund. Writ of mandamus can be issued in cases where it can be shown that there exists a statute which imposes a legal duty on the statutory authority. Therefore, the writ of mandamus to exercise power under Section 11 of the CGST Act for extending the exemption, cannot be issued.

Further, the SC held that it is a settled principle of law that the Apex Court cannot interfere in the policy matters of the Government unless such policy is found to be arbitrary and irrational. However, the SC also held that even though the estoppel claim of the Appellants was without merit, the Appellants have established that the industrial units relied on Government's promise. Therefore, they do have a case of legitimate expectation and their claim deserves a due consideration. The SC was of the view that individual States should consider reimbursing such industrial units out of their revenue share, as lakhs of people are employed in these industrial units. The SC held that the Appellants have the right to make representations to the respective State Governments and the GST Council may also consider making appropriate recommendation to the State for the same.

Significant Takeaways

This decision discusses and reaffirms that the limitation of doctrine of promissory estoppel cannot be applied against the Government when the Government is discharging its legislative function. The ruling clarifies that where the Government had made representations or promises earlier and later invoked the same in exercise of its legislative function and in the interest of larger public, then the doctrine of promissory estoppel cannot be invoked. However, the judgment also makes an important observation that in cases where the aggrieved has altered its position on a promise made by the Government, then the aggrieved party has a legitimate expectation. Courts have a huge responsibility to ensure that in each and every case, depending on the facts and circumstances of such case, whether or not the doctrine of promissory estoppel or legitimate expectation was applicable. As on date, only Jammu & Kashmir had implemented reimbursement policy for industries. Hopefully, other states would also follow and promote industrial development.

> **"The Government is not bound by the doctrine of promissory estoppel when it is discharging its legislative functions."**

No GST can be recovered during search proceedings

In the case of ***M/s Vallabh Textiles***[67], the Delhi HC held that payments by a taxpayer during the search of the taxpayer's premises are permissible only when voluntarily and an acknowledgment of having received the payment has been issued by the proper officer.

Facts

M/s Vallabh Textiles ("**Petitioner**") is engaged in the business of trading ready-made garments and sale on behalf of third parties for a commission. The IRA, on the basis of intelligence received, conducted a search at the Petitioner's premises from February 16, 2022 to February 17, 2022. The IRA was of the view that the Petitioner on behalf of Empire Apparels Private Limited and M/s Navrang Enterprises ("**Third Parties**") sold ready-made garments in cash during the period July 2017 to February 2022 period. The IRA stated that it discovered a ledger which contained details of cash sales, the details of recipient, transportation details, date of sale, etc. Further, other physical books and documents were also discovered which contained detail of goods cleared clandestinely. Simultaneous searches were also conducted in premises of the Third Parties. Statements of several other persons were recorded during the search proceedings. Thus, the IRA contended that the Petitioner had failed to disclose the cash transaction as well as pay requisite GST on the commission earned by it. As per the claims of the IRA, the Petitioner made sales worth INR 149.90 crore against which it received a commission in cash worth INR 7.50 crore (at the rate of 5%). During the search made in the Petitioner's premises, the Petitioner deposited an amount of INR 1,80,10,000 which included tax, interest and penalty at odd night hours before the search proceedings were concluded. The Petitioner filed a writ petition in the Delhi HC claiming that the amount deposited during search was due to coercion.

Issue

Whether the amount deposited by Petitioner during search proceedings was permissible?

Arguments

The Petitioner submitted that the amount deposited by them during the search was not a voluntary act as it was deposited during the proceeding and at night hours. The CCTV cameras were turned off during the search proceedings. The signature of Petitioner was obtained on statements and documents by coercion at the time of recording of the statement. The representative of Petitioner was detained and was permitted to leave only after the signatures on the documents were appended. The Petitioner had communicated to the IRA that the signatures and statement obtained were due to coercion exerted on him. The summon proceedings were also not recorded. The IRA also failed to supply copies of documents collected or relied upon by them, which is in contravention of Section 67(5) of the CGST Act. The said provision allows taxpayers to make copies of document seized, except where making such copies, in the opinion of the proper officer, would prejudicially affect the investigation.

The Petitioner urged that the two independent witness that were present during the search proceedings were related to the IRA, therefore, violating the instructions laid down by the CBIC-GST-Investigation Wing *vide* Instruction No. 1/20-21[GST-Investigation] dated February 2, 2021. The said instruction provides that search must conducted in presence of two or more independent witnesses, preferably inhabitant of same locality.

The Petitioner also argued that any deposit of tax during search proceeding was in violation to Rule 142 (1A) of the CGST Rules as the IRA did not issue any notice ascertaining the tax liability, interest and penalty. Petitioner contested that even if the amount deposited by them during search was self-ascertained, as per Rule 142 of the CGST Rules, the IRA was required to issue an acknowledgment prescribed in form GST DRC-04 in relation to accepting the payment made by the Petitioner, however, the same was not issued by the IRA. However, the representatives of the Petitioner continued to receive summons for enquiry. In case of self -ascertainment, no SCN can be issued by IRA. Thus, action of IRA was inconsistent with the GST legislation. The Petitioner also submitted that the amount deposited during search is in violation of the instruction issued by the GST-Investigation Wing *vide* Instruction No. 01/2022-2023 dated May 25, 2022 ("**Instruction**"), wherein it is clarified that under no circumstances the authorities can recover tax dues during the search proceedings.

On the other hand, the IRA submitted that since the Third Parties had voluntarily deposited the GST during the search for cash sales, it shows that the Petitioner had also deposited the said amount voluntarily. The Petitioner had accepted in their statement that the goods of the Third Parties were sold in cash for commission and it had not discharged GST on the same. The IRA also submitted that the claim of the Petitioner of coercion was an afterthought as the Petitioner did not raise such a concern during the search and investigation proceeding which occurred between the month of February and April.

[67] M/s Vallabh Textiles v. Senior Intelligence Office & others [TS-667-HC(DEL)-2022-GST]

Decision

The Delhi HC reviewed the demand and recovery provision in detail and concluded that the legislation provides for procedure in case of self-ascertainment and voluntary payment. It stated that although the payment made by the Petitioner has been recorded in GST DRC-03, however, the IRA did not provide any acknowledgment of having accepted the payment as per the process laid down under Section 73 of the CGST Act read with Rule 142 of the CGST Rules. Therefore, the HC observed that the submission made by the IRA that the Petitioner has deposited voluntarily was invalid. Additionally, the Delhi HC held since the said deposit was made in four tranches and during late hours search proceedings, it showcases that it wasn't a voluntary act undertaken by the Petitioner.

Further, the Delhi HC made reference to the judgment of Gujarat HC in the case of ***Bhumi Associates***[68], wherein the Gujarat HC had directed the CBIC to provide instructions in relation to recovery of tax made during search proceedings, consequent to which CBIC- GST- Investigation Wing, in-line with the judgment of the Gujarat HC, issued the said Instruction. It observed that the deposit taken by the IRA during the search proceedings was violative of the Instructions issued by the CBIC. The IRA should have advised the Petitioner to deposit the GST dues after the search proceedings has been concluded, as laid out in the aforementioned judgment of the Gujarat HC.

The HC observed that the rationale behind Gujarat HC laying down the structure for the guidelines was to safeguard the taxpayers from undue harassment and to provide reasonable amount of time to them to seek legal advice before making the deposit. The Delhi HC stated that the instructions issued by the Gujarat HC *vide* the case of *Bhumi Associates* was binding on the IRA. Therefore, the Delhi HC directed CBIC to align the Instruction completely with the directions issued by the Gujarat HC in the case of *Bhumi Associates*. Further, the Delhi HC held that the deposit made by the Petitioner was not voluntary, therefore, the IRA was directed to return INR 1,80,10,000 along with interest.

Significant Takeaways

This ruling emphasises the relevance of Instructions issued by the CBIC and reaffirms that the IRA was bound by it. Where a procedure envisaged in the statute and the rules and *via dicta* pronounced in a judgment by the Court of law, IRA was required to follow the same without any exception. The ruling also analyses the rights of the taxpayer during a search-proceedings and discussed safeguards available to them. The HC, through its order directing the IRA to refund the taxes collected illegally along with interest, has also tried to warn the IRA that if instructions are not followed, they can be penalised for their contrary actions. It can be hoped that post this order, no undue harassment of the taxpayer would occur. Failure to adhere to the guidelines to establish element of terror by the IRA goes against the fundamentals of taxpayer-friendly regime.

“ No recovery of taxes can be made by the IRA during a search. ”

[68] Bhumi Associates v. Union of India (MANU/GJ/0174/2021).

The customs duty liability can be fastened only as per the Customs Act and not contractual obligations

In the case of ***M/s Mustan Taherbhai***[69], the SC held that the purchaser of the ship, who has bought it for breaking and scrapping, cannot be held as importer under the Customs Act solely on the basis of the Memorandum of Agreement ("MoA") between two private parties.

Facts

M/s Mustan Taherbhai ("**Respondent**") entered into a MoA dated March 22, 1997 with M/s Shipping Corporation of India ("**SCI**") for sale of vessel named 'M.V. Vishwa Yash' manufactured by M/s Hindustan Shipyards Ltd. The SCI had received permission for breaking the vessel from the Director General of Shipping ("**DGS**"). The MoA provided that the delivery of the vessel was to be given to the Respondent on 'as is where is' basis and the liability regarding payment of custom duty was solely of the Respondent.

When the ship reached the designated port for ship-breaking from another port in India, the IRA did not provide the No-objection Certificate ("**NoC**") until the Bill of Entry ("**BoE**") was filed by Respondent. Hence, in order to clear the ship, the Respondent was forced to file BoE dated May 20, 1997. The BoE was assessed *vide* assessment order dated May 20, and the duty liability was determined to be of around INR 7.8 Million by treating the Respondent as an importer.

The Respondent appealed before the First Appellate Authority, however, it upheld the order. Aggrieved by the same, the Respondent appealed before the CESTAT. The CESTAT allowed the appeal and reversed the order. It held that the Respondent does not qualify as importer and was not bound to pay the levied customs duty. The said order was also confirmed by the HC. Being aggrieved by the HC Order, the IRA filed an appeal before the SC.

Issue

a. Whether the Respondent who has not obtained the permission from DGS, can be termed as 'importer' of the vessel as per the Customs Act?

b. Whether the Respondent was bound to pay customs duty?

Arguments

The IRA submitted that the Respondent was clearing the ship on port for undertaking the breaking activity at the port of Sachana. Hence, the Respondent was an importer as he was the beneficiary. It also urged that as per Clause 3 of the MoA, the liability to pay the custom duty was upon the Respondent. Therefore, the Respondent was liable to pay the custom duty for import of the ship for breaking.

On the other hand, the Respondent argued that it was not responsible to discharge customs duty as it had not imported the ship for breaking. The permission for breaking was obtained by SCI and thus was responsible for payment of the duty. The MoU between Respondent and SCI was not a determining factor for a person responsible to discharge customs duty as the same was governed by the Customs Act and not based on any private arrangement. It also contended that the IRA had issued notice to SCI for recovering the customs duty.

Decision

The SC held that the customs duty is attracted on import of ship only when it is imported for breaking down. Hence, the day on which the DGS grants the permission for breaking of the vessel, the same would be considered as the date of import. Since the permission to break down the ship was obtained by SCI and not by the Respondent, the former was deemed importer of the ship. In this regard, the SC also relied upon its earlier ruling in ***M/s Jalyan Udyog***[70], wherein the SC analysed whether the ship which has already been imported and registered with Indian flag be deemed to be imported when it is to be broken. The SC held that by virtue of the fiction created by the proviso in the notification, "any such vessel subsequently broken up shall be chargeable with the duty which would be payable on her as if it were then imported to be broken up", the vessel was deemed to have been imported. It is well settled that where a fiction is created by a provision of law, the Courts must give full effect to the fiction, and as is often said, they should not allow its imagination to be boggled by any other considerations. In the instant case, the SC observed that permission was granted to SCI by the DGS and not to the Respondent. Therefore, the SCI can be considered as an importer. The SC also took note that the IRA had issued protective notice to the SCI to recover the pending customs duty, however, the notice was yet to be adjudicated upon.

[69] Commissioner of Customs (Preventive) v. M/s Mustan Taherbhai Civil Appeal no. 7244 of 2010.
[70] M/s Jalyan Udyog and Another (1994) 1 SCC 318.

The SC also held that the terms of the MoA was of no substance as the MoA was between two individual private parties. The SC observed that solely on the basis of the MoA, the Respondent cannot be said to be an importer. The liability to pay the customs duty would be on the importer under the provisions of the Customs Act only.

Significant Takeaways

The aforementioned decision affirms that the levy of customs duty on a later date was possible even when the ship had already entered into India before and was registered in India according to law. The ruling discusses concept of deeming import even when there was no import in reality. There can be no second import of such ship into India. The decision also implies that the power given by Section 25 of the Customs Act for providing exemption or concessional rate allows the Central Government to even specify conditions which may even relate to a stage subsequent to the clearance of goods clearly shows that the power of exemption can be used even for altering the relevant date of import.

Additionally, it is pertinent to mention that under the Customs Act and applicable rate notification, the entry regarding the import of ship for breaking is still the same, wherein customs duty on the import of vessels is exempted, but vessels imported for breaking are charged with the duty that is payable as if the vessel was imported for home consumption[71]. However, even though the imported vessels which aren't imported for breaking up are exempted from customs duty, they are not exempted from payment of IGST.

> **"The relevant date for payment of Customs duty on import of ship would be the date on which Director General of Shipping grants permission for breaking."**

[71] Entry 551 of Notification 50/2017- Customs dated June 30, 2017.

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Balance in Electronic Credit Ledger can be utilised to pay 10% tax to be paid as a condition for filing an appeal

In the case of ***Oasis Reality***[72], the Bombay HC held that the taxpayer can utilise the ITC available in the ECrL for discharging the 10% disputed tax- amount required to be paid as a pre-condition for filing an appeal under Section 107(6)(b) of the Maharashtra GST Act, 2017 ("**MGST Act**").

Facts

M/s Oasis Reality along with other taxpayers ("**Petitioner(s)**") is in the business of constructing residential complex services. An order was passed against the Petitioner for short payment of GST. The Petitioner wished to file an appeal before the appellate body under Section 107 of the CGST Act read with MGST Act. Section 107(6)(b) of the MGST Act provides that an amount equal to 10% of the disputed tax is required to be paid before filing an appeal. The Petitioners wanted to fulfil the requirement of payment of 10% of the disputed tax by utilising the ITC available in ECrL. However, the appellate commissioner rejected the Petitioner's grant leading to the Petitioner approaching the HC challenging such decision.

Issue

Whether the Petitioner can utilise the amount of ITC available in ECrL to pay the amount payable u/s 107(6) (b) of the MGST Act, to comply with conditions for filing an appeal?

Arguments

The Petitioner contended that the Section 107(6)(b) of the MGST Act mandates the taxpayer filing an appeal against an order to pay 10% of the un-admitted part of the disputed tax and full amount for the admitted part of the tax. Section 49(4) of MGST Act provides that the ITC available in ECrL may be used for payment towards output tax. The definition of output tax only excludes tax payable on reverse charge mechanism. Accordingly, the Petitioner urged that any payment of output tax either self - assessed or as a consequence of a proceeding initiated by the tax authority can be undertaken through debiting ITC from ECrL. Hence, the Petitioner has the right to pay 10% of the disputed amount of GST by debiting the ECrL for satisfying condition of paying 10% tax for filing an appeal.

On the other hand, the IRA argued that the Petitioner cannot pay 10% of the disputed amount of tax via the ECrL as Section 49(4) of the MGST Act restricts the usage of the ITC available in ECrL to be utilised only towards the payment of output tax under the MGST Act or under the IGST Act. Further, the Respondents referred to the case of Orissa HC ***M/s Jyoti Construction***[73] to submit the argument that the credit available in the ECrL of the tax-payer cannot be utilised to discharge the 10% amount as required for filing an appeal.

Decision

The HC noted the relevant provision and observed that as per Section 107(6) of the MGST Act, the liability on the taxpayer to pay 10% of the disputed amount of GST was a pre-condition to filing an appeal by the taxpayer. It took note that the amount does not include penalty, interest or fee imposed *vide* the order by the lower authorities. Section 49 of the MGST Act dealt with payment of tax, interest, penalty, fine, etc. It observed that the electronic cash ledger can be used by taxpayer for depositing tax, interest, penalty, fees, etc. However, ECrL can only be used by the taxpayer for depositing tax under MGST or IGST Act in the manner prescribed. The HC emphasised that Section 107 (6) of the MGST Act uses the phrase "10% of remaining amount of Tax in dispute". The term output tax used in Section 49(4) as defined only excludes tax payable on reverse charge mechanism. Hence, the ITC available in ECrL may be used for payment towards output tax, either self -assessed or as a consequence of proceeding by tax authority.

Further, the Bombay HC held that the case relied upon by the Respondents of Orissa HC in ***M/s Jyoti Construction*** was not relevant as the CBIC *vide* circular dated July 6, 2022[74] ("**Circular**") clarified that any liability or amount payable towards the output tax liability of the taxpayer due to the consequence of an order or direction under the GST laws, can be paid by utilizing the ITC available in the ECrL of the taxpayer. The Bombay HC also observed that the above- discussed clarification does not permit payment of tax payable under the reverse charge mechanism. In the present case, the Petitioner's liability to pay was not towards the tax liability on account of reverse charge, therefore, the Petitioner can pay the said amount by debiting its ECrL.

Significant Takeaways

This decision shall provide relief to taxpayers who wish to appeal against any adversarial order passed by utilising the ITC available in ECrL. Such procedural relaxation would definitely be of assistance as it would prevent blocking of additional cash flows. While the above decision mentions that Orissa HC ruling

[72] Oasis Reality v. Union of India and others (TS-493- HC (Bom)-2022- GST).
[73] M/s Jyoti Construction v. Deputy Commissioner of CT and GST 2021 (10) TMI 524. (Orissa HC).
[74] CBIC circular F. No. CBIC-20001/2/2022-GST dated July 6, 2022.

would not be applicable post issuance of the Circular, the possibility of certain officers not accepting the contents of the Circular cannot be ruled out amid allegations that the Circular allows payment as full and final payment and not for appeal purposes. The Orissa HC decision had clarified that the pre-deposit was not to be considered as an 'output tax' liability of the appellant and, therefore, the ECrL of the appellant cannot be debited in order to fulfill pre-deposit condition. However, the Allahabad Hc[75] has held the contrary by stating that the ECrL can be debited for depositing, which is in line with the Bombay HC decision. Therefore, as seen above, different HCs have taken different interpretations in regard to payment of pre-deposit via ECrL. If the dispute is towards the incorrect availment of ITC, utilising the same ITC for meeting the appeal condition itself could be controversial. Additionally, whether GST credits can be utilised to pay the pre-deposits for appeals to be filed under the erstwhile legislations i.e. CE Act, the Allahabad CESTAT[76], by placing reliance on the case of M/s Jyoti Construction, has held that mandatory deposit cannot be made by way of a debit in the ECrL account of the appellant maintained under the GST regime. Further, the Bombay HC, in the case of ***Sodexo India Services Pvt. Ltd.***[77]***,*** had directed the CBIC to issue clarification in this regard. The CBIC *vide* instruction dated October 28, 2022[78] had clarified that payments through DRC-03 under the GST regime is not valid for making payments of pre-deposit under Section 35F of CE Act and the same should be done as per dedicated CBIC-GST integrated portal[79]. Thus, while the position w.r.t. pre-deposit for erstwhile legislation has been clarified, the same is disputable under GST in different state on account of contrary decisions.

> **“ ITC can be used to pay the pre-deposit amount required before an appeal. ”**

/s Tulsi Ram and Company v. Commissioner 2022 (9) TMI-1256.

76 M/s Johnson Matthey Chemical India Pvt. Ltd. v. Assistant Commissioner CGST and Central Excise, Kanpur 2022 (9) TMI 44- CESTAT Allahabad.

77 Sodexo India Services Pvt. Ltd. v. Union of India writ petition no. 6220 of 2022.

78 CBIC-240137/14/2022-Service Tax Section-CBEC dated October 28, 2022.

79 Circular No. 1070/3/2019-CX dated June 24, 2019.

Admissibility of CENVAT credit transition to GST cannot questioned under the GST provisions

In the case of ***Usha Martin***[80], the Jharkhand HC has held that initiation of proceedings for inadmissible CENVAT Credit of the taxpayer under Section 73 of the CGST Act for violations under the CE Act and FA was beyond jurisdiction.

Facts

M/s Usha Martin Ltd. ("**Petitioner**") has two business division, wire-rope and steel division. It had captive iron and coal mine in Bokano and Brinda-Sesai. CENVAT Credit availed under the erstwhile tax regime i.e. the CE Act and the FA, amounting to INR 8,55,50,111 pertaining to Bokano mines and input services amounting to INR 15,98,697, pertaining to Brinda-Sesai mines were transitioned to the GST regime.

The IRA ("**Respondents**") issued a SCN dated September 13, 2021, demanding recovery of transitioned CENVAT Credit under Section 73(1) of the CGST Act, along with penalty and interest. The Petitioner filed a detailed written response. However, it passed an order under GST legislation confirming the recovery of CENVAT Credit along with interest and penalty. Aggrieved by it, the Petitioner filed the writ petition challenging the lack of jurisdiction.

Issue

i) Whether the Respondent has the power to initiate proceedings and issue SCN under Section 73 of the CGST Act alleging inadmissibility of CENVAT credit transitioned to GST.

ii) Whether a registered person can transition inadmissible CENVAT Credit under erstwhile law to the GST regime under Section 140 of the CGST Act without any checks.

Arguments

The Petitioner contended that the proceedings for wrongful availment of CENVAT Credit cannot be made under GST regime. The same can be questioned only under erstwhile law, i.e. Section 74 of the FA and Rule 14 of the CENVAT Rules.

It submitted that Section 73 of the CGST Act deals with short or no payment of GST or wrongful availment or utilisation of ITC. Since, the present proceedings were in relation to wrongful availment of CENVAT Credit and not ITC, the IRA does not have the jurisdiction to determine admissibility under the GST regime. Section 140 of CGST Act prohibits the transition of CENVAT credit only if; (a) the amount of pre-GST credit was not admissible under the GST regime; (b) returns for 6 months prior to July 01, 2017 under the erstwhile regime have not been furnished, or (c) credit relates to goods, which are manufactured and cleared under the exemption notifications of the Government. In present case, the Respondent has not challenged the transitioning of CENVAT credit due to prohibition under Section 140 of the CGST Act. The Respondent has incorrectly assumed jurisdiction and adjudicated the issue of erstwhile law under the GST provision.

The Petitioner urged that Section 174 of the CGST Act, dealing with repealing and saving provision, provides that any proceedings for recovery of tax, penalty, etc. for matters pertaining to the erstwhile legislations have to be dealt as per erstwhile law, as if they were not repealed or amended. GST provisions do not permit initiation of proceedings under the erstwhile regime.

The Petitioner also argued that the input tax referred in Section 73 of the CGST Act refers to credit availed under CGST Act and not CENVAT credit transitioned from erstwhile regime. Additionally, the Petitioner submitted that the process of verification is of the amount limited to conditions as mentioned under Section 140 of the CGST Act (as discussed above), which bars transitioning of certain credits and not in relation to the genuineness and correctness of the claim amount. No parallel jurisdiction under any of the applicable laws i.e. CE Act or FA and the current GST regime empowering the IRA to proceed on charges of improper availment of CENVAT Credit exist today.

On the other hand, the Respondent submitted that the Petitioner has an alternate and efficacious remedy, in the form of an appeal under Section 107 of the CGST Act. Thus, the writ petition cannot be maintained. On merits, the Respondent argued that CENVAT Credit was ITC as they have been availed through TRAN 1. The Respondent has not exceeded the jurisdiction by initiating proceedings under Section 73 of the CGST Act. Respondent argued that completion of pending case before CESTAT was not required to complete proceeding under Section 73 of CGST Act due to being time bound. The Respondent submitted that the CENVAT credit could not be availed as it pertained to services not rendered to the Petitioner.

The Respondent also made reference to CBEC circular dated February 23, 2018 bearing no. 33/07/2018-GST, which disallowed usage of transitional CENVAT credit in relation to which a SCN has been issued and adjudicated or it was disputed in the last adjudication order or appeal as on July 1, 2017.

[80] Usha Martin Limited v. Additional Commissioner, Central GST and Excise W.P (T) No. 3055 of 2022 (Jharkhand HC).

Decision

The Jharkhand HC observed that the present writ petition was maintainable because where question of law could not be determined in absence of factual matrix, it can be examined under a writ petition. It raised concerns regarding the legality and jurisdiction of the IRA to issue SCN for transitional CENVAT credit under Section 73 of the CGST Act. The HC held that the transitional provision provided circumstances when CENVAT credit was available to be transitioned. It required them to be eligible for credit even under GST legislation. The same was not present in the current case. Further, the HC held that the SCN was worded similarly to the previous SCN issued to the Petitioner under the erstwhile legislations. Hence, the restriction stated in transitional provision was inapplicable.

The HC also observed that whether the CENVAT Credit could be availed or was permissible to be transitioned was not within the authority of the Respondent to decide under the GST regime. As per the HC, proceedings under Section 73 of CGST Act can be initiated in cases of non-payment, short-payment or erroneous refund of tax or wrongly availing and utilising ITC available under the GST regime. It was inapplicable on transition of CENVAT Credit. Therefore, as per the HC, the Respondent's act of issuing the SCN under Section 73 of the CGST Act was not correct in the eyes of law. The HC observed that Section 174 of the CGST Act provides for repeal of the erstwhile laws i.e. the CE Act will not affect any other proceedings, inquiry, etc. in respect of any such duty, tax, etc. Such proceedings, other than legal proceedings may be instituted, continued or enforced as if these erstwhile legislations had not been repealed.

The HC also observed that repeal of existing laws upon coming of the new GST regime did not leave a vacuum for the past transactions which were not closed. The HC also stated that for a violation in the erstwhile law, conducting parallel proceedings could not have been envisaged by the legislature i.e. at the behest of the jurisdictional IRA under the erstwhile laws and at the same time under the current GST regime. As per the HC, if the proceedings for inadmissible CENVAT Credit is permitted under the GST regime, it will lead to chaos and uncertainty not only in the minds of the common person, but also the tax authorities. The HC quashed the adjudication proceedings as being without jurisdiction. However, the HC did state that the Respondents have the liberty to initiate the same proceedings under the provisions of the erstwhile law i.e. CEA and FA read with the CENVAT Rules against the Petitioner for the relevant tax period.

Significant Takeaways

This decision provides clarity to the taxpayers and the tax authorities and explains under what scenarios proceedings under Section 73 of the CGST Act can be initiated. It also clears the air around the issue that disputes relating to CENVAT Credit i.e. admissible to be availed or permissible to be transitioned cannot be undertaken under the GST provisions. The officers have limited power to verify the transition and the amount mentioned in the forms. With respect to a registered taxpayer's right to claim or if credit is eligible to be availed in the first place, it has to be determined under the erstwhile laws. Thus, any SCN issued by IRA disallowing transition of credit under Section 73 or 74 of CGST Act would be incorrect. This may provide certainty to the taxpayers and help them avoid unwarranted litigations.

> **“ SCN under CGST Act cannot be issued for admissibility of transitional credit available under erstwhile legislations. ”**

CBDT amends the definition of 'non-reporting financial institution' in rule 114F of the IT Rules

CBDT *vide* Notification no. 112/2022 dated October 7, 2022 has amended the definition of 'non-reporting financial institution' provided in rule 114F, in sub-rule (5) of the IT Rules. Notably, Section 285BA of the IT Act provides the reporting requirements of a 'non-reporting financial institution' for registering and maintaining books of account or other documents containing a record of any reportable account.

Under the amended definition, the following financial institutions shall be termed as a 'non-reporting financial institution' only in case of any US reportable account. These include:

i) a financial institution with a local client base;

ii) a local bank; and

iii) a financial institution with only low-value accounts.

Additionally, the definition of 'Treaty Qualified Retirement Fund' in Explanation (D) has been amended to make it specific to the USA.

CBDT notifies rule along with forms for recomputation of income without allowing the claim for deduction of surcharge or cess

Explanation 3 to Section 40(a)(ii) of the IT Act was inserted by the FA 2022, providing that the term 'tax' includes and shall be deemed to have always included any surcharge or cess, by whatever name called, on such tax. Accordingly, the claim of surcharge or cess will be considered as Income Tax and not allowed as a deduction while computing the income chargeable under the heads 'profits and gains of business or profession'. Sub-section (18) was also inserted to Section 155 of the IT Act providing that if any deduction in respect of any surcharge or cess, disallowed under Section 40 of the IT Act, has been claimed and allowed, such claim shall be deemed to be under-reported income of the assessee for the purpose of Section 270A(3) of the IT Act.

However, the proviso to sub-section (18) provides an exception whereby if the assessee makes an application to the AO, requesting for recomputation of the total income without allowing the claim for deduction of surcharge or cess and pays the amount due, such claim shall not be deemed to be under-reported. For the implementation of the above provisions, the CBDT *vide* notification No. 111/2022 dated September 28, 2022 prescribed rule and forms for the assessee to make such application with the AO for re-computation of the total income and subsequent payment of taxes. The rules that became effective from October 1, 2022 include:

i) The need for the assessee to file the application in Form 69 electronically on or before 31 March 2023;

ii) On receipt of such application, the AO will recompute the total income and issue notice under Section 156 of the IT Act for the relevant years and for the subsequent years if the order for such year results in variation in carry forward of loss, or allowance for unabsorbed depreciation, or credit for tax. The order shall also specify the time period for payment of tax, if any;

iii) The requirement to furnish the details of payment of taxes by the assessee in Form No. 70 to the AO within 30 days from the date of making the payment.

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CBDT provides partial relaxation from electronic submission of Form 10F to certain non-resident taxpayers

The CBDT *vide* Notification F. No. DGIT(S)-ADG(S)-3/e-Filing Notification/Forms/2022/9227 dated December 12, 2022 granted partial relaxation to non-resident taxpayers, not having PAN, from electronically filing Form 10F until March 31, 2023.

Form 10F may be required to be furnished by taxpayers along with their tax residency certificate for the purpose of claiming relief under any applicable DTAA. Typically, Form 10F is filled-in and signed manually by non-residents and physically submitted to the tax authorities. However, earlier this year, the CBDT made it mandatory to submit Form 10F electronically, through the income-tax e-filing portal. It is further relevant to note that it is mandatory to have a PAN before any filings can be made through the income-tax e-filing portal. Accordingly, this posed a practical challenge for non-resident taxpayers, who otherwise do not possess a PAN in claiming DTAA benefits.

Recognising the difficulties faced by such taxpayers, the CBDT has exempted non-resident taxpayers from electronically furnishing 10F until March 31, 2023, provided the following conditions are satisfied:

i) The non-resident taxpayer does not have a PAN; and

ii) The non-resident taxpayer is not required to obtain a PAN under the provisions of the IT Act.

Such non-resident taxpayers can continue to file Form 10F manually.

CBDT proposes common Income-tax Return form and invites inputs from the public

Different categories of taxpayers are presently required to furnish their Income-tax returns (“**ITR**”) in varying forms (i.e., ITR-1 to ITR-7). Further, the process of filling-in the ITR is cumbersome and time-consuming. To streamline this process, the CBDT, *vide* Notification F No. 370133/16/2022-TPL has proposed an overhaul of the current system by merging ITR-1 to ITR-6 as a common ITR. Some of the key features of the proposed new filing system are given below:

i) Taxpayers required to furnish ITR-7 will not have the option to file the common ITR;

ii) Taxpayers required to furnish ITR-1 or ITR-4 will have the option of continue to make filings in the present format or file the common ITR;

iii) All other taxpayers will only make filing under the common ITR; and

iv) The common ITR will be customised for the relevant taxpayer and will only display fields which are required to be filled-in by the taxpayer.

The CBDT has also shared a draft of proposed common ITR and invited inputs from stakeholders. It is expected that a revamp of the current filing system would bring ease of filing returns and reduce the filing time of individuals and non-business-type taxpayers.

REGULATORY INDIRECT TAX UPDATES

CCI replaces NAA

The CBIC *vide* Notification No. 23/2022 – Central Tax dated November 23, 2022, has empowered the CCI to handle anti-profiteering cases w.e.f. December 01, 2022 to examine whether ITC availed by any registered person or the reduction in the GST rate has actually resulted in a commensurate reduction in the price of the goods or services or both supplied by him.

Payment in INR in case of exports

The DGFT *vide* Notification No. 43/2015-2020 dated November 9, 2022 amended FTP 2015-2020 to permit invoicing, payment and settlement of export proceeds in INR as per an RBI Circular. The RBI Circular provides that INR payment may be made from the balances in the designated special vostro account of the correspondent bank of the partner country.

Clarification on refund-related issues

The CBIC *vide* Circular No. 181/13/2022-GST dated November 10, 2022 has clarified that the refund applications filed for claiming refund of ITC on account of inverted duty structure before July 05, 2022 would be dealt with as per the formula that existed before the amendment (i.e. it would not take into account input services.)

Further, it has been clarified that restriction to avail refund in case of certain goods falling under chapter 15 and 27 such as soya bean oil, ground nut oil, edible oils and coal would be applicable in respect of all refund applications filed on or after July 18, 2022.

Benefit of Project Import not applicable to solar sector

The CBIC *vide* Notification No. 54/2022-Customs dated October 19, 2022 has amended the scope of 'All Power Plants and Transmission Projects' in the Project Import Regulations, 1986, to exclude solar power plant and projects. Thus, the solar modules or inverter imported into India would not be subject to concessional rate for Project Import scheme.

Pre-deposit for filing appeal under erstwhile indirect tax laws cannot be made through GST ledger

The CBIC *vide* Instruction CBIC-240137/14/2022- Service Tax dated October 28, 2022 has clarified that pre-deposit requirement for appeal under Service Tax and Central Excise cannot be made through Form DRC-03.

Work from home (WFH) in SEZ unit

The Ministry of Commerce and Industry has amended Rule 43A of SEZ Rules *vide* Notification No. G.S.R. 868 (E) dated December 08, 2022, to allow SEZ units which provide Information Technology and Information Technology enabled services to allow 100% of its employees, contractor to WFH till December, 2023. It further provides the following:

a. There would be no need to obtain permission of Development Commissioner for opting for WFH, however, an intimation has to be sent via email. Similarly, units already availing WFH under earlier regime, are required to send intimation by email till January 31, 2023.

b. The SEZ unit would have to maintain the lists of employees who have been permitted to work from home or from any place outside the Special Economic Zone and shall be submitted for verification whenever it is required by the Development Commissioner.

c. The Unit would have to ensure that the export revenue of the resultant products or services to be accounted for by the Unit to which the employee is tagged.

d. The temporary removal of such duty-free goods shall be allowed for a period commensurate with the validity of the facility for WFH or anywhere outside the SEZ.

IGST refunds of risky exporters

The CBIC *vide* Instruction No. 04/2022-GST, dated November 28, 2022, has described the procedure to followed by department in relation to refund of integrated tax paid on the goods exported out of India. It refers to retrospectively amended Rule 96 of the CGST Rules, w.e.f. July 01, 2017 to provide for withholding of IGST refund in cases where there is requirement of verification of credentials of the exporter based on data analytic of Directorate General of Analytics and Risk Management ("**DGARM**").

The system generated refund application of identified risky exporters would be transmitted to jurisdictional GST officer from ICEGATE to GSTN portal along with reasons for withholding and risky exporter's verification report (if any). The jurisdictional officer would have to follow the provisions of Rule 89 of CGST Rules and ascertain the genuineness of the exporter and verify the correctness of the availment and utilisation of ITC by the exporter. Post exercising the due diligence, it would be required to pass a detailed speaking order and provide a feedback to DGARM if it can remove the alert generated on the risky exporter.

Issuance of SCNs and recurring SCNs in case of an enforcement action

Various State GST department have issued guidelines to the field formations of State Tax, in relation to the authority regarding action consequential to issuance of SCN and recurring SCN in case of an enforcement action initiated against the taxpayer assigned to Centre, by the State authorities and vice versa. The guidelines laid down are as follows:

a. Both state and central tax authorities have the power to take enforcement action against the taxpayer located in the State irrespective of the administrative jurisdiction;

b. Refund matters would be handled by the jurisdictional tax authority administering the taxpayer;

c. Recurring SCNs having same issues would be handled by jurisdictional officer. Such officer has access to the records and returns of the taxpayers and to verify if same grounds for issuance of SCN still exist for other period.

CBIC has issued multiple clarifications under GST post 48th GST Council Meeting

a. *Limitation of re-determination of tax liability where notice issued under Section 74 of the CGST Act is unsustainable*: The CBIC *vide* Circular No. 185/17/2022-GST dated December 27, 2022 has clarified the limitation period applicable for re-determination case. Where the charges of fraud, suppression of facts, etc. have not been established against the notice for an SCN issued under Section 74 (1) of the CGST Act, the appellate authority or tribunal may instruct for redetermination of demand. The order for demand is required to be passed within a period of two years from the date of communication of the direction of the appellate tribunal/authority. It has also been clarified that the re-determination would occur for taxes short paid or not paid, or input tax credit wrongly availed or utilised or that of erroneous refund for which SCN was issued within the general limitation period, i.e. within two years none months from the due date of furnishing the financial returns for that particular FY for which such tax has not been paid or short paid or ITC wrongly availed or utilised. The rest of demand covered in extended period would be dropped.

b. *Recovery of statutory GST dues of a corporate debtor under IBC*: The CBIC *vide* Circular No. 187/19/2022-GST dated December 27, 2022 has clarified where the GST proceedings have been finalised against the corporate debtor under IBC reducing the amount of statutory dues payable by the corporate debtor to the government, the order would be covered under the term 'other proceedings' in Section 84 of CGST Act and it would be governed by said provision. The jurisdictional Commissioner shall issue an intimation in FORM GST DRC-25 reducing such demand.

c. *GST liability on no claim bonus ("**NCB**") deducted by insurance companies*: The CBIC *vide* Circular No. 186/18/2022-GST dated December 27, 2022 has clarified that NCB is pre-agreed discount and shall be allowed to be not included in the value of supply. The same cannot be

considered as supply of service of agreeing to the obligation to refrain from the act of lodging a claim.

d. *Requirement of e-invoicing*: The circular also clarified that where certain sectors have been exempted from the duty of mandatory generation of e-invoices , the exemption is available for an entity as a whole and not limited to only certain supplies made by the said entity.

e. *Availability of ITC where there is difference in ITC availed in Form GSTR-3B as compared to Form GSTR-2A for FY 2017-18 and 2018-19*: CBIC *vide* Circular No.183/15/2022-GST- GST Policy Wing dated December 27, 2022 has outlined the procedure for handling availability of ITC when same is not appearing in Form GSTR 2A in following circumstances:

   i. the supplier has failed to file FORM GSTR-1 for a tax period;

   ii. failed to report a particular supply in FORM GSTR-1; and

   iii. incorrect GSTIN or declared as B2C supply.

   In such case, the proper officer shall ascertain fulfillment of the following conditions:

   i. recipient has tax invoice or debit note issued by the supplier;

   ii. recipient has received the goods or services or both;

   iii. recipient has made payment for the amount towards the value of supply, along with GST payable thereon, to the supplier; and

   iv. To verify if GST on the said supply has been paid by the supplier to the Government.

   Further the Circular provides that in cases:

   i. Where the difference in ITC claimed exceeds INR 5 lakh, the registered person is required to provide a certificate from the chartered accountant or cost accountant of the supplier certifying the supplies in respect of the said invoices; and

   ii. Where the difference is up to INR 5 lakh, the registered person is required to provide the certificate from the concerned supplier showcasing said supplies have actually been made by him and the tax on said supplies has been paid by the said supplier.

   The Circular provides that it would only be applied to ongoing proceedings in the form of audit/scrutiny/investigation, etc. for FY 2017-18 and 2018-19, or in cases where the adjudication or appeal proceedings are still pending. It is clarificatory in nature and will be applied as per the facts and circumstances of each case.

f. *Manner for filing for refund by unregistered persons*: The CBIC *vide* Circular No. 188/20/2022-GST dated December 27, 2022 has prescribed procedure for claiming refund in cases where agreement for supply of services for construction of flat/ building has been cancelled or long-term insurance policy has been terminated. The procedure is as follows:

   i. Obtain a temporary registration in State/UT where the supplier is located. Separate registration of suppliers in different state;

   ii. File application for refund in FORM GST RFD-01 on the common portal under the category 'Refund for unregistered person'. Upload any other document(s) to support his claim that he has paid and borne the incidence of GST and that the said amount is refundable to him;

   iii. In case of different suppliers, separate applications for refund has to be filed;

   iv. A Refund can be claimed only in cases where the time period of issuance of credit note under Section 34 of the CGST Act has been expired;

   v. The date for claiming refund is two years from the relevant date. The relevant date would be date of issuance of letter of cancellation of the contract/ agreement for supply by the supplier;

   vi. No refund is available in cases where the refund amount is lesser than INR 1,000; and

   vii. Refund in proportion to the amount paid back by the supplier to the unregistered person.

GLOSSARY

ABBREVIATION	MEANING
AAR	Hon'ble Authority for Advance Rulings
AO	Learned Assessing Officer
AY	Assessment Year
Customs Act	Customs Act, 1962
CBDT	Central Board of Direct Taxes
CBIC	Central Board of Indirect Taxes and Customs
CCI	Competition Commission of India
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
CIRP	Corporate Insolvency Resolution Process
CIT	Learned Commissioner of Income Tax
CIT(A)	Learned Commissioner of Income Tax (Appeal)
DGFT	Directorate General of Foreign Trade
DRP	Dispute Resolution Panel
DTAA	Double Taxation Avoidance Agreement
ECrL	Electronic Credit Ledger
EPCG	Export Promotion Capital Goods
FA	Finance Act
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

GLOSSARY

ABBREVIATION	MEANING
INR	Indian Rupees
IRA	Indian Revenue Authorities
IT Act	Income-tax Act, 1961
ITAT	Hon'ble Income Tax Appellate Tribunal
ITC	Input Tax Credit
ITO	Income Tax Officer
IT Rules	Income-tax Rules, 1962
Ltd.	Limited
NAA	National Anti-Profiteering Authority
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
RP	Resolution Professional
SC	Hon'ble Supreme Court
SCN	Show-cause Notice
SEZ	Special Economic Zone
SLP	Special Leave Petition
TDS	Tax Deducted at Source
USA	United States of America
UOI	Union of India
VAT	Value Added Tax

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