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tax scout

Tax Scout | July – September, 2023

Main Stories

Dear Readers,

We are delighted to present the latest issue of Tax Scout, our quarterly update on the recent developments in direct and indirect tax laws for the three months ending September 30, 2023.

In our main story, we have dealt with the indirect and direct tax implication in the online gaming industry and the recent changes that have been notified on this regard. We hope you find the newsletter informative and insightful. Please do send us your comments and feedback at cam.publications@cyrilshroff.com.

Regards,
CYRIL SHROFF

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Tax Implications on the Industry of Online Gaming

Introduction

The online gaming industry has emerged as one of the most promising industry in the global economy, given its explosive growth. The Covid-19 pandemic, which made people to stay indoors, gave further impetus to the industry. Being a major source of recreation, the Indian online gaming industry too grew at a phenomenal pace leading to rapid and significant investments in innovative start-ups. Certain gaming companies have achieved unicorn status and have also been listed on the stock exchange.

With such exponential rise in the industry, the Indian Government has also felt the need to recognise and regulate the industry and tap into its potential. The online gaming industry is considered a burgeoning sunrise sector in India. While some positive changes in regulations have been effected in the recent months to boost this industry, others have posed significant challenges potentially impacting further development of this sector.

Background

Currently, most of the gaming companies are offering both single player and multiplayer games such as fantasy sports, strategy games, arcade games, action and adventure games, online version of board and card games, etc. The increased usage of internet across all age groups, coupled with declining bandwidth costs, has indirectly promoted 'pay to play' and 'real money' games. Some of the games even include monetary transactions such as buying virtual products in the nature of enhancement features or winning prize money on games.

The gaming industry has come under scrutiny by various Government agencies after reports surfaced that illegal activities were being carried *via* the online gaming platforms. For example: scrutiny of offshore gambling platforms allegedly involved in unlawful gambling, potential foreign exchange and money-laundering violations, etc.

As a step towards regulating the online gaming at federal level, on April 6, 2023, the Information Technology (Intermediary Guidelines and Digital Media Ethics Code) Rules, 2021 ("**Gaming Rules**") were notified, thereby bringing the sphere of online gaming under the aegis of the Ministry of Electronics and Information Technology. Factors key to the Gaming Rules are represented in the diagram below, and followed by their definition:

a. Permissible online game: defined as a permissible online real money game or any other online game, which is not an online real money game.

b. Online game: defined as a game, which is accessible by the player via computer or an intermediary and is offered over the internet.

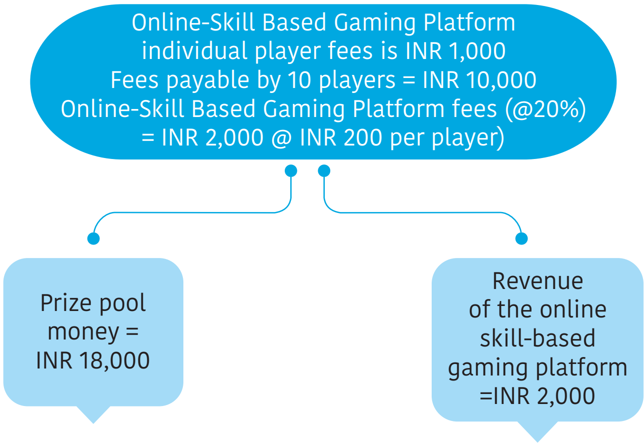
c. Permissible online real money game: defined as an online real money game, which is verified by an online gaming self-regulatory (as defined under the Gaming Rules.)

d. Online real money game: defined as an online game wherein a player, in the expectation of earning winnings[1], makes a deposit in cash or kind.

Therefore, with the advent of the Gaming Rules regulating the online gaming industry has moved one step closer. It will place responsibility on the online gaming platforms to regulate themselves as per the parameters laid down under the Gaming Rules.

Revenue Model of Online Gaming

Multiple models are followed in the online gaming industry, with the rake fee model being widely used. Under this model, the online gaming platform charges a platform fee as well as individual participation fees from the players. After deducting platform fees, the balance amount is pooled in an independent escrow account held by the online gaming platform. The fund is then distributed among the winners in a pre-determined manner. The above-discussed structure is depicted below for better understanding:



In sum, the model adopts the following steps:

a. The players deposit an amount with the online gaming platform for participation in the online game;

b. The online gaming platform retains the participation fee or rake fee for facilitating the online gaming between multiple players and the remaining amount is treated as prize pool money on which the online gaming platform does not exercise any right as the same amounts to an actionable claim for and among the online gaming participants and the platform is merely holding the same in a fiduciary capacity;

c. Subsequently, the winners of the online game is declared, and the entire prize pool money is transferred by the platform to the winners.

Whereas, certain platforms are following the freemium model, where the game is free but activities such as improving performance, prolonging the player's life, skipping levels, etc. are charged or advertisement is the source of revenue.

Game of Skill vs. Game of Chance

The online gaming industry in India was built on a judicial and legislative foundation of the long-established distinction between games of skill and chance. Under the Indian Constitution, states are exclusively empowered to regulate "sports, entertainment and amusements", as well as betting and gambling.

The Public Gambling Act, 1867, which was enacted in British India, prohibited and penalised public gambling, however, it did not penalise common gaming-houses in certain provinces. Currently, certain states like Arunachal Pradesh, Punjab, Madhya Pradesh, Chhattisgarh and Uttarakhand have adopted its provisions in entirety. However, few states like Sikkim[2], Telangana[3], Tamil Nadu[4], Maharashtra[5], Kerala[6], Odisha, West Bengal[7], Assam[8] etc, have enacted state specific legislations to govern the same. Most of these laws exempt games of 'mere skill' from its provisions, thereby legalising them. Whilst the online skill gaming industry has grown and matured in recent years; the threat of legislation, which ignores important and long-standing distinctions between games of skill vis-à-vis chance and seek to impose criminal consequences could create significant uncertainties and may severely disrupt the industry.

1 The term 'winnings', is further explained in the explanation provided to the definition, to mean any prize, in cash or kind, which is distributed or intended to be distributed to a player of the online game based on the performance of the player and in accordance with the rules of the online game
2 Sikkim Online Gaming (Regulation) Act, 2008
3 Telangana Gaming Act, 1974.
4 Tamil Nadu Gaming Act, 1930.
5 Bombay Prevention of Gambling Act, 1887.
6 Kerala Gaming Act, 1960.
7 West Bengal Gambling and Prize Competitions Act, 1957
8 Assam Game and Betting Act, 1970.

Similarly, the taxation of online gaming has been the subject matter of substantial ambiguity due to varying state legislations and contrary views taken by the judiciary. From an indirect tax perspective, the taxation of games such as betting and gambling has been included within List II, i.e. the State List of the Seventh Schedule to Constitution of India that empowers the States to make laws either to prohibit or to regulate such games. Such laws are generally determined by the States according to their own individual socioeconomic requirements. Courts in multiple cases[9] have attempted to define the terms 'betting' and 'gambling' as games of chance as the outcome is generally not based on skill. Additionally, the Madras HC in the case of ***M/s. Junglee Games India Pvt. Ltd.***[10] has held that entry 34 of the Second List of Schedule 7 in the Constitution of India is limited to betting on activities based on chance only which, *inter alia* covers gambling and betting.

Therefore, one can say that the judiciary has interpreted the term gambling and betting in a restrictive manner applicable in cases, wherein the outcome is majorly determined by chance or accident instead of being based on skill and expertise of the player.

Under the indirect taxation regime from the erstwhile service tax to the current GST regime, games played on the online platform have to be analysed to understand whether it a game of skill or game of chance, in order to ascertain liability of the concerned industry player. A game of chance broadly classifies under gambling or betting and game of skill is a game wherein the outcome or the result of the game is also dependent on the skill of the player.

Games of skill involve mental and physical expertise of the player to influence the outcome of such games and, therefore, are currently taxed at a lower rate than games of chance, which determine winners based on chance and probability rather than skill. Several judgments of the Apex Court and various High Courts have held that facts determine the nature of the game (i.e.chance or skill), which has to be specifically analysed and decided on a case to case basis[11]. Additionally, the Apex Court in the case of ***RMD Chamarbaugwala***[12], had held that the skill test to determine if a game amounted to gambling or a game of skill is ascertained by verifying whether success was dependent, to a substantial degree, on exercise of skill or is based on chance. Additionally, the Apex Court[13] also held that while a game of skill was one where success depended principally on superior knowledge, training, attention, experience and adroitness of a player, the element of chance may not be entirely eliminated.

Games like rummy[14] or poker[15] that can be played online as well, have been considered as games of skill, wherein the player requires the skill to memorise cards and analyse other players to be successful.

Another type of online gaming includes fantasy sports games. A typical fantasy sport game generally involves a player to form a fantasy sport team from the given set of sportsmen, with applicable conditions, for a particular sport to be played later that day. The pattern of fee collection and prize money distribution has been mentioned above. The players are ranked based on the performances of their virtual teams, selected by a particular player by using his knowledge about the expertise of every individual sports person..

Taxation of online gaming under GST before October 1, 2023

The levy of GST in the online gaming had become contentious due to potential revenue leakage. The same was on account of two prominent concerns. First question was to determine whether online game was actually a game of skill or a kind of gambling, as that would determine the applicable rate of GST, i.e. 18% in case of game of skill vs. 28% in case of game of chance. The applicable rate of GST for online skill-based game was 18% whereas for game of chance it was 28%. As per the Explanatory Notes to the Scheme of Classification of Services under the GST legislation, the main heading 9984 provided for telecommunications, broadcasting and information supply services. Under the sub-heading 998439, provided for other on-line content, including services such as games intended to be played on internet such as role-playing games (RPGs), strategy games, action games, card games, children's games etc., and the payment for the same was by way of subscription, membership fee, pay-per-play or pay-per view, etc. The sub-heading 998439 categorically did not include online-gambling services, games classified under 99692[16].

[9] All India Gaming Federation vs The State of Karnataka & Ors WP 18703/2021
[10] M/s. Junglee Games India Pvt. Ltd. v. State of Tamil Nadu (2021) SCC OnLine Mad 276
[11] Manoranjithan Manamyil Mandram v. State of Tamil Nadu AIR 2005 Mad 261
[12] State of Bombay v. RMD Chamarbaugwala, AIR 1957 SC 699.
[13] Dr. K. R. Lakshmanan v. State of Tamil Nadu, (1996) 2 SCC 226 (SC; State of Andhra Pradesh v. K. Satyanarayana, AIR 1968 SC 285.
[14] State of Andhra Pradesh v. K. Satyanarayana AIR 1968 SC 825
[15] Indian Poker Association (IPA) v. State of Karnataka 2013 SCC OnLine Kar 8536
[16] 999692 (Gambling and betting services including similar online services) - This service code includes:
i. on-line gambling services; ii. on-line games involving betting/gambling; iii. off-track betting; iv. casino and gambling house services; v. gambling slotmachine services; or vi. other similar services.

Therefore, from the explanatory notes, it appeared that all online skill-based games, except online gambling games, were covered under the heading 9984 and sub-heading 998439. As discussed above in length, the industry had taken the view that online game of skills did not fall under the category of 'gambling', the online platform services operators considered their services to be covered under the heading 9984, which was taxed at the rate of 18%.

The second issue concerned the value of services and, as a result, the amount of GST that was required to be paid. As per Section 15 (1) of the CGS Act, which provided for determining the value of supply on which GST was levied, i.e. GST was levied on the price that the service recipient actually paid or was required to pay for the said supply of services. In other words, GST was levied on the transaction value of the services paid by the service recipient to the supplier of services who were unrelated entities and price was the sole consideration. Rule 31A of the CGST Rules, 2017 ("**CGST Rules**") provided for valuation of supply of services like betting, gambling, lottery and horse racing, etc. The value of supply of actionable claims in the nature of lottery, betting, and gambling, etc. were assumed as 100 % of the face value of the bet or the amount paid to the totalizator.

However, if it was construed as a game of skill, most of the gaming platforms had assumed that GST was payable only on the platform fee/service, i.e. the consideration collected for the sale or facilitation of online gaming services and not on the pooled sum. The concern had been around the absence of defined valuation rules and the confusion about the levy of GST on the entire value in connection to the rake charge. The conundrum was aggravated by the range of games and the possible income structures that were available. The GST framework did not specifically deal with games of skills, etc. Hence, there continued to be a risk of the tax authorities disregarding the distinguishing features between games of skill and games of chance. It is an important aspect because if such games are held to be games of chance, the GST was payable at 28% on the 100% value including the pooled amount collected by such online gaming platforms

The IRA have issued notices to various gaming platform. In one of the instances, the same was challenged before the Karnataka HC in the case of ***Gameskraft Technologies Private Limited***[17] wherein the HC quashed the INR 21000 crore notice issued against the online gaming platform by holding that the rummy played online was a game of skill. The HC made the following observations:

a) That there exists distinct and clear difference between game based on skill and game based on chance, as observed by the Courts in multiple cases[18]. The HC observed that whether the game was played online or physically, with stakes or without, amounts to a game of skill or chance, depends on test of predominance i.e. whether the outcome of game is determined by skill of the player or chance, determines the nature of the game.

b) Section 2(17) of the CGST Act, recognises wagering contracts to be included in the term 'business', however, the same does not imply that betting, lottery, gambling, etc. can be construed as game of skill.

c) GST regime does not define the terms gambling, betting and lottery, therefore, the same should be interpreted in the light of various Supreme Court precedents wherein it has been categorically held that the phrase gambling, betting or lottery does not include games of skills.

d) As per entry 6 of Schedule III of the CGST Act, which provides that actionable claims are neither to be considered as services nor as goods, the same treatment should apply to games of skill and only games of chance such as lottery, betting and gambling will be taxable.

e) The HC observed that taxation of games of skill is outside the scope of the term 'supply' as defined under section 7(2) of the CGST Act and read with Schedule III of the CGST Act.

f) A game which involves both chance and skill, will be determined on the basis if it is substantially and preponderantly a game of skill or a game of chance.

g) Rummy is a game of skill, irrespective of the fact that it is played online or offline, or with or without stake.

h) Other games, played digitally/electronically/online which are substantially games of skill, will be considered as online skill-based games.

I) The games played on the platform of the petitioners do not qualify as gambling or betting and are games of skill.

While the said judgment provided a relief for online platforms, the IRA has appealed before the SC, and the Apex court has issued a stay on the decision.

<u>Taxation of Online Gaming from October 1, 2023</u>

To address these disputes and uncertainties, the GST Council had set up a group of ministers ("**GoM**") to study this issue and

[17] Gameskraft Technologies Pvt Ltd vs DGGSTI [TS-181-HC(KAR)-2023-GST]
[18] All India Gaming Federation vs The State of Karnataka & Ors WP 18703/2021

provide certain recommendations. The GoM suggested that online gaming should be taxed at the higher rate of 28% on the face value of bets. It appears that the intent of the Government was to raise the applicable rate of GST on such online games to discourage gambling-style operandi and also reduce the fact finding exercise of each game whether it is game of skill or game of chance.

In response to the recommendations of the GoM, the Government has amended the GST laws. Effective October 1, 2023, terms such as *'online gaming, online money gaming, specified actionable claims, virtual digital asset'* have now been defined. Additionally, required amendments in the rate notification have also been made to levy tax rate of 28%.

The new provisions establish a specific sub-classification for online games known as online money games ("**OMG**"), where players deposit money with the intention of winning the final prize, which is either money or money's worth. This new definition not only includes all games of skill, chance, but also includes a combination of both, whether legal or illegal under other laws. This change represents a shift from the previous distinctions between gaming and gambling that had been established for the preceding six decades. The intention is to reduce disputes over whether a game is one of skill or chance, making it easier to compute the applicable GST. However, this approach may lead to new legal challenges, particularly concerning the right to conduct games of skill. The government's objective appears to be reducing ambiguity, increasing GST revenue from this growing sector, minimising negative impacts, discouraging gambling-style operations, and addressing addiction issues among young players.

The above discussed amendment also extends the scope of the supplier to include those who organise or arrange the supply of specified actionable claims, including OMG. This demonstrates the Government's proactive approach in closing revenue loopholes. For OMG suppliers located outside India, a special provision requires them to obtain simplified GST registration and discharge their GST liability in India. Failure to comply with the revised GST regime could result in the blocking of public access, making its future business prospects in India unviable.

The addition of Rule 31B and 31C to the CGST Rules, 2017, *vide* an amendment, allows the collection of GST on the total amount paid or deposited with the OMG supplier by or on behalf of the player, in any form. This approach differs from the practice of levying GST only on the value added or the service component, as seen in various other countries. The Government's argument is that the entire amount paid for playing a game includes the rights to play the game and the potential to win, and any amount won by the player later is not subject to GST. However, the rules strictly disallow reductions in valuation for any amounts returned or refunded by the OMG supplier, even if a player makes any deposit by mistake. This could pose challenges for both the platform and the player, who would now have to bear the incremental GST cost.

The above discussed changes have become effective from October 1, 2023. However, some States have not yet updated their State GST laws, while some States such as Maharashtra, Madhya Pradesh, Karnataka, Goa, etc. have amended their respective SGST laws to implement the amendments. These changes clarify the imposition of GST by eliminating uncertainty and ambiguity regarding the definition of gambling in different States and the determination of whether a game is one of skill or chance. The Government's transformation appears to aim at increasing tax revenue in this rapidly growing sector, which contradicts the initial regulatory goal of prohibiting wagering on game outcomes.

<u>Direct Tax Implications</u>

Finance Bill, 2023, which was later passed by the Parliament to form the FA, 2023, introduced a special regime for taxation of winnings from online games. FA, 2023 amended the IT Act to insert section 115BBJ which provided for chargeability of income tax on net winnings from online games at the rate of 30%. Correspondingly, for withholding tax, section 194BA was inserted which made the online gaming platform ("**intermediary**") responsible to withhold tax at the rate of 30%.

Soon after the announcement of the proposed taxation regime and tax rates through the Finance Bill, 2023, the online gaming industry had approached the CBDT and the Prime Minister's Office ("**PMO**") with certain reservations and concerns regarding the proposed taxation regime. One of the major representations made by the industry was that the introduction of such special regime without any clarity on the method of computing taxes would create a lot of ambiguity and create a chaos among the industry players. They feared that such a taxation regime would subject them to a higher degree of compliance which would ultimately affect their scalability and sustainability.

However, CBDT had addressed this issue through its rules[19] and guidelines[20] dated May 22, 2023 and has notified the rules for computing net winnings and clarified the minor nitty-gritties involved in the process.

Computation of net winnings and practical difficulties

The CBDT rules and guidelines provide different methods / formulae for the computation of net winnings for the purpose of income tax and withholding tax. While computing the net winnings under Section 115BBJ for the purpose of income tax, net winnings of a person shall be computed by deducting the not-taxable deposits and closing balance from the withdrawal amount of such winnings.

For the purposes of TDS under Section 194BA, three different formulae are provided. Each formula considers a different scenario. Computation of net winnings is provided for in the case of: (i) when first withdrawal is made during the year; (ii) when subsequent withdrawals are made during the year; (iii) computation at the end of the year.

While the base formula remains the same, the rules provide for a variation in the prescribed formula for calculating net winnings in the case of subsequent withdrawals during the year and computation of net winnings at the end of the year. Both these formulae provide for a variation so that the tax already paid on withdrawals made during the year can be accounted for and no double taxation of the same income may happen.

While the rules prescribe standard formulae for calculating winnings, they still pose a major burden on the online gaming intermediaries. The intermediaries have to take on the added burden of making such complex calculations for each user which ultimately increases their cost of operating. They also get subject to extra compliance burden which may pose a threat of adverse consequences in case of non-compliance and might lead to added legal expenditure. Such technical compliances will also force them to hire professionals for such purposes. This would act as a major barrier to new entrants and hinder growth of the industry as a whole.

To add to the woes, CBDT has also clarified that in cases where users have multiple accounts with the intermediary, then all the accounts of the user are to be cumulatively considered for the purposes of tax computation. It also clarifies that if compiling such data is practically difficult, then such intermediary shall deduct TDS separately for each of its platform for that user. This places a responsibility on the intermediary to conduct further due diligence to identify the different accounts which belong to the same user. This may increase the complexity because the same user might operate different accounts under different username and contact details. In such a case, additional user identification data might be required to be collected by the intermediary creating a lengthy process for both the sides.

The rules further address the issue of bonus, referral bonus, incentives, etc. and clarify that they should be treated as taxable deposits and shall not be allowed to be deducted in the calculation of net winnings. However, the crediting of bonus, incentives, etc. to the user account, which are only for the purpose of playing and cannot be withdrawn by the user, shall be ignored while calculating the net winnings.

Another major obstacle faced from the notification is in cases where the winnings are partly in cash and partly in kind and the part in cash is not sufficient to meet the tax liability. In such instances, the intermediary shall not release the winnings in kind until the winner provides the intermediary with the proof that he / she / it has paid the tax in respect of such winnings. The user is required to provide a copy of the challan evidencing payment of taxes to claim his prize.

The rules also provide that no TDS shall be deducted in case of insignificant winnings. The threshold to determine insignificant winnings is of INR 100 in a month. So, whenever a withdrawal of a person playing online games contains winnings which are below INR 100 for a month then no TDS shall be deducted by the intermediary. The threshold set is extremely low in monetary value and seems to be futile as most winnings are expected to breach the said threshold.

Conclusion

The changes in the recent past to give impetus to the OMG sector. However, with the recent changes introduced *vide* FA, 2023 for income tax and through the amendment introduced to the GST legislation, showcases the Government's resolve not to have a leak in revenue from any end and have tried to tie-up all possible lose ends. The amendments to the Gaming Rules provide to regulate the gaming activities in the online space. However, these are significant changes and one is not sure how these changes shall be perceived by the industry as well as the investor community and one only hopes that this should not become the death knell for a sunrise industry.

These changes may impact the popularity among potential investors and could also discourage foreign investment. The online gaming platforms would also be discouraged from innovation in graphic and technology sector impacting employment and sponsorships in various industries. Small players in the industry might find it extremely difficult to survive thereby leaving the playing field only to a few big players who may try to monopolise their control in the market. A revision of such strict rules might have to be undertaken by the authorities in order to help the OMG industry to flourish. The Government may consider a clear, moderate tax regime to provide impetus and promote upwards growth of the OMG sector. In conclusion, these changes bring both clarity and certainty to the gaming industry while raising certain fundamental existential crisis for them for the near future. Hence, it is imperative for the Government to take a more holistic approach to ascertain what is good for the country and not get persuaded by the myopic revenue loss for the coming few months / years.

DTAA benefit should be given at the time of withholding of taxes in case of non-resident payee

Introduction

In ***M/s Vodafone Idea Limited***[21], Hon'ble Karnataka HC held that DTAA is a sovereign document between two countries and needs to be considered at the time of withholding of taxes. It held that the Explanations 4 to 6 inserted in Section 9(1)(vi) of IT Act were not merely clarificatory, but has expanded the definition of "royalty" under the IT Act and, therefore, cannot be applied to the AYs prior to AY 2013-14. The Hon'ble HC also invoked the legal maxim *"'lex no cogitad impossibilia"* i.e. the law does not demand the impossible and *"impotentia excusat legem"* i.e. when there is disability that makes it impossible to obey the law the alleged disobedience of law is excused, while holding that there was no default for not being able to withhold any tax.

Facts

M/s Vodafone Idea Limited ("**Assessee**") is engaged in providing telecommunication services including providing connectivity to calls originating or terminating outside India. It entered into agreements with non-resident telecom operators ("**NTOs**") for international carriage and connectivity services and paid Inter-Connectivity Usage ("**IUC**") charges in lieu of such services. The Assessee also entered into a Capacity Transfer Agreement to acquire bandwidth capacity from MIS Belgacom International Carrier Services S.A. ("**Belgacom**"), a Belgian entity, on Europe India Gateway ("**EIG**"), which is a submarine cable system connecting several countries including India.

The AO *vide* his order dated January 28, 2013 held that the Assessee was an assessee in default under Section 201 of IT Act for non-deduction of TDS on payments made to NTOs and Belgacom in respect of IUC charges and bandwidth charges for AYs 2008-09 to 2015-16. The AO held such income to be in the nature of royalty or FTS in hands of non-resident payees. In appeal filed against such order, the CIT(A) dismissed the said appeal and held the payments made to NTOs were in the nature of "royalty". The CIT(A) did not adjudicate on the issue of FTS. Appeals were filed before the Hon'ble ITAT Bangalore against such order.

The Hon'ble ITAT Bangalore *vide* its rulings dated December 30, 2014[22] and November 28, 2019[23] held that amendment in definition of royalty under IT Act by way of insertion of Explanations would also result in an amendment of the DTAA, thus holding that the Assessee was liable for its default in not withholding TDS on payment of IUC charges and bandwidth charges. The ITAT also held that DTAA benefit cannot be considered at the time of making payment to a non-resident. The ITAT held that IUC charges and bandwidth charges paid by Assessee constituted royalty in view of the inclusion of the terms "right" & "process" in the clarificatory Explanations 2, 5 and 6 of Section 9(1)(vi) of the Act and, therefore, TDS was deductible under Section 195 of IT Act. Against this finding of the ITAT, appeals were filed before the Hon'ble Karnataka HC.

Issue

1. Whether DTAA benefit can be taken into account at the time of making payment to a non-resident payee?

[21] M/s Vodafone Idea Limited (formerly known as M/s Vodafone Mobile Services Ltd. and also includes Vodafone South Ltd. which stands merged with Idea Cellular Ltd.) Vs. DDIT, International Taxation, Circle-1(1) & Ors. [(ITA No. 160, 161, 162, 163, 164 of 2015) & (ITA Nos. 64, 65, 66 of 2020)]

[22] ITA No. 449 to 453, 1814 to 1818 & 734 of 2013 for A.Y. 2008-09 to 2012-13

[23] ITA No. 1160-1161/Bang/2015 and 2818/Bang/2017 for A.Y 2013-14 to 2015-16.

2. Whether payer shall not be liable for TDS default for AYs 2008-09 to 2012-13 on the basis of a subsequent amendment carried out in Section 9(1)(vi) of IT Act by insertion of Explanation 4 and 5 w.r.e.f. June 1, 1976?
3. Whether insertion of Explanations 5 and 6 to Section 9(1)(vi) of IT Act for "royalty" w.e.f. June 1, 1976 would also result in an amendment of the DTAAs?
4. Whether payment of IUC charges to NTOs and payment to acquire bandwidth capacity in foreign countries is taxable as royalty under IT Act due to inclusion of the terms "right" & "process" in Explanations 2, 5 and 6 of Section 9(1)(vi) of the Act?
5. Whether TDS shall be levied at a higher rate of 20% as per Section 206AA of IT Act, due to non- furnishing of PAN by the payee?

Arguments

The Assessee relied on the ruling of Hon'ble SC in the case of ***GE India Technology Centre Pvt. Ltd.***[24], which had held that the provisions of the DTAA shall also be relevant while determining the rate of withholding of TDS. As for the characterisation of the payments under consideration as "royalty" by the IRA, the Assessee argued that payments were made for "use" of a process or an equipment and such payment did not constitute royalty as also explained by the Hon'ble SC in ***Engineering Analysis Centre of Excellence Pvt. Ltd.***[25] and Hon'ble Bombay HC in ***Reliance Infocom Ltd.***[26]

It may be noted that the Hon'ble SC in the case of ***Engineering Analysis Centre of Excellence Pvt. Ltd (supra)*** had explained that consideration for the "use" of a computer software does not constitute royalty. Where a payment is made for use of a software or a copyrighted product over which the payer has no exclusive rights, no copyright is parted with as in the present case and it does not constitute royalty unlike a transaction where rights in a "copyright" are acquired by the payer.

The Assessee also argued that the payments did not constitute "royalty" as per the definition of royalty in the applicable DTAA and such definition cannot be expanded by way of amendment in the IT Act. The Assessee also pointed out that ITAT in the present case had relied on earlier rulings in the case of Viacom18 Media (P.) Ltd. whereas the Hon'ble ITAT Mumbai in its latest ruling in case of same assessee i.e. ***Viacom 18 Media (P.) Ltd.***[27] held that definition in the DTAAs cannot be enlarged by way of amendment in the definition of royalty under Section 9(1)(vi) of IT Act.

The Assessee also argued that for a payment to be characterised as royalty, the grantor of a right should be denuded from that property and it should vest completely with the recipient. The amendment brought by the Finance Act, 2012 by insertion of Explanation 5 removed the second condition whereas the first condition remained unchanged and the NTOs did not denude themselves of utilising the process in the present case and, therefore, the payment did not constitute royalty. The Assessee also relied on ruling of the Hon'ble Delhi HC in the case of ***Asia Satellite Telecommunications Company Ltd.***[28] wherein the Court made a distinction between transfer of rights in respect of property and transfer of rights in the property.

Further, the Assessee argued that the NTOs did not have any presence in India and no part of their telecom network was located in India and in the absence of any PE in India, their income was not taxable in India.

On the issue as to whether tax shall be withheld at a higher rate of 20% due to non-furnishing of PAN No. by the payee, the Assessee relied on Karnataka HC ruling in the case of ***Wipro Ltd.***[29] and ***Vodafone India Ltd.***[30] in which it was held that the rate given under the DTAA overrides the rate given under Section 206AA of IT Act.

The Assessee also argued that it has been provided with "grant of rights" and not "transfer of rights" as it merely avails these services. In order to characterise the payment as "royalty", it has to be covered by the definition of royalty as per para 3 of Article 12 of the India Belgium DTAA.

On the other hand, the IRA argued that if TDS was deductible at lower or a nil rate in a particular case, a lower or nil deduction certificate ought to have been obtained under Section 195 or 197 of IT Act. In case the payer had not obtained such a certificate, the onus was on the payer to establish his case and the ITAT had correctly held that the Assessee had failed to discharge its obligation to withhold. The IRA further argued that the payments made by Assessee constituted "royalty" as per clauses (I), (ii) and (iii) of Explanation 2 to Section 9(1)(vi) of IT Act, reinforced by the clarificatory amendment brought by the government through insertion of Explanation 6 to Section 9(1)(vi) of IT Act. The IRA also

[24] GE India Technology Centre Private Limited Vs. CIT[2010] 327 ITR 456 (SC)
[25] Engineering Analysis Centre of Excellence (P.) Ltd . Vs. CIT [2021] 125 taxmann.com 42 (SC)
[26] CIT Vs. Reliance Infocom Limited [ITA No. 1395/2016]
[27] ACIT, International Taxation Vs. Viacom 18 Media (P.) Ltd [2022] 134 taxmann.com 243 (Mumbai - Trib.), ACIT, International Taxation Vs. Viacom 18 Media (P.) Ltd [2022] 140 taxmann.com 268 (Mumbai - Trib.)
[28] Asia Satellite Telecommunications Company Limited Vs. Director of Income Tax [ITA No. 131, 134 of 2003]
[29] CIT v/s. Wipro Limited [ITA No. 181/2019 dated 29 November 2022]
[30] CIT vs. Vodafone India Ltd. [ITA No. 120/2020 dated January 17, 2023]

contended that the underlying agreements nowhere stated that the income was not taxable.

The IRA observed that the definition of royalty under IT Act is in consonance with the various DTAAs entered into by India. It controverted the Assessee's argument that DTAA did not cover "equipment royalty" by contending that the issue in the present case pertained to "process royalty". It relied on the underlying agreements between the Assessee and NTOs which granted the Assessee access to the network and process running on the telecom network of the NTOs which involved use of highly complex technical "process". Therefore, IRA held that the payment constituted royalty, notwithstanding the amendment carried out in Section 9(1)(vi) of IT Act as it did not enlarge the scope of the term.

Decision

The Hon'ble Karnataka HC relied on the ruling of the Hon'ble SC in the case of ***GE India Technology Centre Pvt. Ltd.(supra)*** and held that DTAA provisions shall also be considered while applying withholding tax provisions as DTAA is a sovereign document between two countries. With respect to insertion of Explanations 4, 5 and 6 in Section 9(1)(vi) of IT Act by Finance Act, 2012 w.r.e.f. June 1, 1976, the Hon'ble HC concurred with the ruling of the Hon'ble SC in ***Engineering Analysis Centre of Excellence Pvt. Ltd. (supra)*** that an expanded definition of "royalty" by way of retrospective amendment would not imply that the payer shall be expected to do the impossible and hence, would not apply to prior AYs 2008-09 to 2012-13. Therefore, Assessee shall not be liable to deduct TDS for these AYs. It also held that where the definition under the DTAA is more beneficial, benefit of the DTAA shall be available at the time of withholding of TDS.

On the issue that whether the payments constitute "royalty", the Hon'ble HC held that the said issue had already been decided in favour of the taxpayers by the ITAT in the subsequent years that these payments did not constitute royalty and TDS was not deductible, which was not refuted by the revenue's counsel based on Mumbai ITAT's ruling in case of ***Viacom 18 Media (P.) Ltd. (supra)***. Hence, the Hon'ble HC decided the said issue also in favour of the Assessee.

The Hon'ble HC further held that since it was already admitted that NTOs and Belgacom did not have any PE in India, their income cannot be taxed in India. Further, the HC concurred with the judgment in the Wipro Ltd.(supra) to say that the rate stipulated under the DTAA overrides the rate under Section 206AA of the IT Act, and held that the higher tax rate of 20% was not relevant. Accordingly, the Hon'ble Karnataka HC reversed the rulings of the ITAT dated December 30, 2014 and November 28, 2019.

Significant Takeaways

It may be appreciated that whether a payment is in the nature of "royalty" has been subject to litigation in numerous cases. The Hon'ble Delhi HC in the case of ***Asia Satellite Communications Co. Ltd.***[31] observed that the term "royalty" in Section 9(1)(vi) of IT Act deals with the transfer of "rights in respect of property" and not transfer of "right in the property". In the first category, the rights are purchased which enables usage of such rights, while in the second category, no purchase is involved and only the right to use has been granted. Thus, the definition of the term 'royalty' in respect of a copyright, literary, artistic or scientific work, patent, invention, process, etc., does not extend to the outright purchase of the right to use an asset. In case of royalty, the ownership of the rights remains with the owner and the transferee is permitted to use the rights in respect of such a property. In case of ***Asia Satellite Communications Co. Ltd. (supra)***, only access to the broadband was given and not the control of the satellite transponder, and hence, it was held that the payment was not in the nature of royalty. The said decision was subsequently followed by the Hon'ble Delhi HC in case of ***New Skies Satellite Bv***[32] and by the Hon'ble Bombay HC in the case ***Neo Sports Broadcast (P.) Ltd.***[33]. The present judgement of the Hon'ble Karnataka HC would further help to settle this issue and conclude tax litigation in case of a number of assessees. For instance, post this ruling, the reassessment proceedings initiated in case of ***Al Telekom Austria Aktiengesellschaft***[34] on the same issue of royalty on account of IUC charges, were quashed.

> **"The provisions of theDTAA override those of the IT Act and unilateral amendments to the domestic tax regulations do not automatically result in the amendment to the DTAAs."**

[31] Asia Satellite Communications Co. Ltd v. DIT [2011] 9 taxmann.com 168/197 Taxman 263/332 ITR 340.
[32] DIT v. New Skies Satellite BV [2016] 68 taxmann.com 8/238 Taxman 577/382 ITR 114 (Delhi).
[33] Pr. CIT v. Neo Sports Broadcast (P.) Ltd. [2019] 107 taxmann.com 17/264 Taxman 323.
[34] Al Telekom Austria Aktiengesellschaft Vs. DCIT IT(IT)A Nos. 336, 338 & 339/Bang/2023.

Foreign tax credit will be available, even if not actually paid

Introduction

The Delhi HC in the case of ***Polyplex Corporation Ltd.***[35] held that Foreign Tax Credit ("**FTC**") would be available for taxes payable in Thailand, even though such receipt is statutorily exempt in Thailand, as per tax sparing provision embedded in India-Thailand DTAA.

Facts

Polyplex Corporation Ltd ("**Assessee**") is an Indian company which has a wholly owned subsidiary ("**Subsidiary**") in Thailand. During AY 2010-11 to AY 2013-14, the Assessee had earned dividend income from its Subsidiary. While offering the same to tax in India at the rate of 30%, the Assessee had claimed FTC under Article 23 of the Indo-Thai DTAA for tax at the rate of 10% payable in Thailand on dividend. However, the statutory regime in Thailand exempted dividend earned by the Assessee and hence, no taxes were actually paid in Thailand.

During the course of assessment proceedings, the AO declined FTC, which was confirmed by the CIT(A). The Assessee then appealed before the ITAT, which held that tax sparing was a concept which was embedded in several DTAAs including Indo-Thai DTAA, and allowed the FTC at the rate of 10% to the Assessee for the dividend income received from the Subsidiary. Aggrieved by the order of ITAT, the IRA filed an appeal before the Delhi HC.

Issue

Whether FTC should be allowed in India against taxes payable in Thailand, but was not actually paid, due to a specific exemption available in Thailand?

Arguments

The IRA argued that firstly, the AO was correct in declining the FTC since the Assessee had not actually paid any taxes on dividend in Thailand which, as per the IRA, is a pre-requisite to avail the benefit of Article 23 of the Indo-Thai DTAA. Secondly, the IRA argued that any exemption relied upon by the Assessee to not pay tax on dividend distributed by the Subsidiary could have been extended to the Subsidiary, but not to the Assessee. Thus, the Assessee's reliance on the same could not be accepted, and for the Assessee such dividend would be taxable income. Lastly, the IRA contended that the ITAT had erred in interpreting the provisions of Thai law which were pure questions of fact and hence, should have instead remanded the matter to the AO.

On the other hand, the Assessee argued that the concept of tax sparing for FTC was present in several DTAAs India has signed, such as with Oman, Jordan and France and is not unique to Thailand. Under such tax sparing provisions, FTC may be claimed by an Indian resident even for the tax which, though payable in Thailand, was exempt on account of incentives granted by the Thai Government. Similar benefit would also be available to residents of Thailand for income taxable, but exempt, in India. The Assessee also relied upon the Investment Promotion Act B.E. 2520 (1997) of Thailand to argue that it had been granted an exemption from corporate income tax vis-a-vis its net profit under section 31 and the dividend distributed under section 34 of the Investment Promotion Act. The Assessee also brought up Section 70 of the Revenue Code B.E. 2481 (1938) of Thailand which levies tax at the rate of 10% on companies incorporated under foreign law, with respect to assessable income which emanates from, or is received in Thailand. Since under Article 10 of the India-Thailand DTAA, tax could only be levied on dividend distributed by the Subsidiary, the Assessee is entitled to FTC of 10% as opposed to a higher tax rate of 30%.

Decision

The Delhi HC held that "tax payable" would typically mean taxes that are owed or due but not paid. However, the meaning of the expression "Thai tax payable" or "Indian tax payable" has to be found in the definition embedded in the relevant DTAA. On examining the scope of Article 23 of Indo-Thai DTAA, the HC held that it exemplified mutuality of interests in giving stimulus to investment for securing economic development in both countries. Accordingly, the Delhi HC upheld the ITAT's decision that the Assessee was entitled to claim FTC in respect of dividend income received from its Subsidiary, in respect of "Thai Tax Payable", on which it would have had to pay the tax, but for the exemption accorded to it under Thai Investment Protection Act. Were it not for this exemption, tax would have been payable at 10% for which FTC could have been claimed by the Asseesee.

The Delhi HC also held that even though foreign law was usually an issue of fact, no proof was required in the present case since the Revenue Code and the Investment Promotion Act were specifically mentioned in Article 23(3) of the Indo-Thai DTAA. Thus, the Delhi HC rejected IRA's case that FTC could not be claimed since no tax had been actually paid by Assessee in Thailand. The HC also recognised that the concept of tax sparing is embedded in several DTAAs which have been executed by

[35] Principal Commissioner of Income Tax v. Polyplex Corporation Ltd [2023] 152 taxmann.com 479 (Delhi).

India, such as with France, Jordan and Oman, apart from Thailand and held that the mechanism is engrafted in the DTAAs to incentivize investment for economic development in the respective countries.

Significant Takeaways

This judgement provides another win for the taxpayers by upholding the applicability of tax sparing credits for claiming FTC under the DTAAs. A similar view was taken by the ITAT in ***Strides Pharma Science Ltd.***[36] in case pf Indo-Cyprus DTAA and the Delhi HC in ***Krishak Bharati Cooperative Ltd.***[37] dealing with the India-Oman DTAA. Most importantly, the SC has also confirmed this position in the case of ***Krishak Bharti Cooperative Ltd.***[38] wherein it dismissed the appeal filed by the IRA and allowed the taxpayer to take benefit of the tax sparing provisions under the India-Oman DTAA. However, the SC had conducted a factual analysis of whether dividend could be included within the scope of FTC, and allowed it only when a letter from the Ministry of Finance in Oman was produced as evidence to prove that dividend income was contemplated within the scope of FTC.

“ FTC on tax payable on dividend income allowed based on concept of 'tax sparing. ”

[36] Strides Pharma Science Ltd. v. Deputy Commissioner of Income-tax [2022] 141 taxmann.com 430 (Mumbai - Trib.)
[37] Principal Commissioner of Income-tax v. Krishak Bharati Cooperative Ltd [2017] 80 taxmann.com 326 (Delhi)
[38] Principal Commissioner of Income-tax-10 v. Krishak Bharti Cooperative Ltd [2023] 154 taxmann.com 318 (SC)

De novo proceedings to be conducted to determine real nature of transaction

Introduction

In the case of ***Dhadha Pharma Pvt. Ltd.,***[39] the Madras HC held that merger/amalgamation cannot be used as a guise to evade income tax by claiming exemption under section 47(vi) of the IT Act.

Facts

Tamil Nadu Dadha Pharmaceuticals Ltd. ("**TNDPL**") was a joint venture between Tamil Nadu Industrial Development Corporation Ltd. ("**TIDCO**") and the Dadha Group ("**Assessee**") whereby TIDCO owned about 25% shares in TNDPL, and the Assessee owned about 26%. Sun Pharma Industries Limited ("**SPIL**"), wanted to acquire shares in TNDPL. As per a Memorandum of Understanding executed between Assessee and TIDCO, the Assessee had a peremptory right to purchase the shares of TNDPL. Since SPIL could not directly acquire the shares of TNDPL, they funded the Assessee to acquire the shares of TIDCO in TNDPL.

The Assessee purchased the shares from TIDCO out of the funds given by SPIL. However, SPIL had paid INR 168.6 million (i.e., at the rate of INR 290 per share) to the Assessee for the shares, through transfers of large amounts of cash. Additionally, SPIL also paid interest of INR 9.465 million on delayed payments to the Assessee. In the meanwhile, merger schemes were also sanctioned between TNDPL and SPIL by the Gujarat HC and the Madras HC, leading to a merger between SPIL and TNDPL.

A search was conducted at the premises of the Assessee and based on the review of the releant papers and documents, this understanding between the Assessee and SPIL was discovered. Pursuant to this, block assessment proceedings were initiated against the Assessee. The AO was of the opinion that the scheme of merger was merely a device to avoid tax in order to claim exemption under section 47 for the huge sums transferred by SPIL to the Assessee. The AO held that the funds received by the Assessee from SPIL were undisclosed income which were liable to be taxed as capital gains. On appeal, the CIT(A) partly allowed the appeal of the Assessee. On further appeal, the Chennai ITAT reversed the order of the AO and held that the amount could not be taxed as capital gains, since the transaction was covered under section 47. Aggrieved by the decision of the ITAT, the IRA filed an appeal with the Madras HC.

Issues

Whether the amounts paid by SPIL to the Assessee prior to the amalgamation are liable to be taxed?

Arguments

The IRA submitted that funds for acquiring the shares of TNDPL from TIDCO were transferred by SPIL to the Assessee by way of interest free loans and advances, deposits and trade free advances. However, as per the merger scheme no such loan was required to be advanced by SPIL to acquire shares from TIDCO. However, payments under such loans and advances and interest payments were continuously made by SPIL to the Assessee even subsequent to the approval of the merger scheme by the HCs. This was evident from the fact that the cash payments made were for the transfer of shares. The capital gains which arose out of the transfer of shares by the Assessee along with the interest income, which was received for delayed payments should have been disclosed by the Assessee and offered to tax.

The Assessee contended that there existed a genuine merger between SPIL and TNDPL and thus, no sale of shares took place, owing to the exception under Section 47. Although there was a discussion regarding sale of shares, it was not executed and only remained as a discussion between the relevant parties. The Assessee contended that no share transfer forms were executed, the merger scheme was duly approved by the concerned HCs and were also published in the newspapers. No objections had been raised against the merger which was duly approved by the Courts and due process of law was followed. The merger constituted an amalgamation under the provisions of the IT Act which was outside the purview of capital gains tax as per the exemption provided under Section 47 of the IT Act.

Decision

The Madras HC held that the merger was used as a smoke screen to avoid the taxation on the transfer of shares and also to claim benefit of the exemption available under Section 47 of the IT Act. The HC looked at the scheme of Section 47(vi) of the IT Act which provides for capital gains exemption in case of capital assets transferred by the amalgamating company to an amalgamated company and observed that a merger results in the allotment of shares as per the share exchange ratio contemplated in the scheme of merger, and unless the scheme itself mentions a cash component, there is no requirement of such cash transfers. Further, the HC also observed that a mirage of amalgamation

[39] CIT v. Dadha Pharma (P.) Ltd., [2023] 153 taxmann.com 106 (Madras HC).

was performed before the relevant HCs, since they were not made aware of the underlying transactions. The cash payment was made independent of the amalgamation and was done prior to it. Thus, in the instant case, the merger was not an amalgamation implicatory which was eligible to claim exemption under Section 47(vi). Accordingly, the HC held that the amount received by the Asseseee was undisclosed income as per section 158B(b) of the IT Act and directed that a fresh assessment should be made by the AO based on information and documents made available to it.

Significant Takeaways

In order to ensure tax is not evaded and transactions are not structured for the sole benefit of taking advantage of a tax benefit, the IT Act includes General Anti-Avoidance Rules ("**GAAR**") which empower the tax authorities to declare an arrangement to be an impressible avoidance arrangement and, *inter alia*, deny any tax benefit available under the IT Act. In order for GAAR to be invoked, the main purpose of the arrangement should be to obtain a tax a benefit and it should satisfy additional tests. However, in the instant case, the tax authorities denied the tax benefit under section 47 without invocation of GAAR. Further, the CBDT in its Circular No. 7 of 2017 had clarified that where the HC has explicitly and adequately considered the tax implications while sanctioning an arrangement, GAAR will not apply to such arrangement ("**GAAR Clarification**").

While this case presented a unique fact scenario where documents/information was requisitioned pursuant to search proceedings which enabled the tax authorities to initiate block assessment under Section 158BC, even in the absence of such search, taxpayers should be mindful of maintaining sufficient material on record to justify the commercial rationale of a transaction. Even in other cases, despite the GAAR Clarification, the Courts and Tribunals have repeatedly held that sanction of the scheme does not automatically entitle a taxpayer to claim tax benefits, especially where tax benefits have not been deliberated upon by the sanctioning authority.[40] For instance, in the instant case, the HCs were not aware of the underlying transactions taking place between SPIL and the Assessee and could not have examined availability of the benefit under section 47 in light of the same.

Thus, it is an important consideration for the taxpayers to keep in mind that there should be an underlying understanding that commercial exigencies should drive a transaction and taxpayers should not abuse the benefits available under the IT Act.

> **"Mere approval of a merger scheme does not entitle a taxpayer to avail benefit of section 47."**

[40] See In the matter of scheme of amalgamation of Panasonic India Private Ltd and Panasonic Life Solutions India Private Ltd CP (CAA) No. 8.Chd/Hry/2021; DCIT v. Cummins Sales & Services Ltd, MANU/IP/0338/2022.

Oil Rig's period of upgradation and fabrication in connection with the drilling activity relevant for PE threshold

Introduction

The Bombay HC in the case of ***Deep Drilling 1 Pte. Ltd.***[41] dismissed the appeal filed by the taxpayer and held that the day from which the rig entered Indian waters and started undergoing upgradation and fabrication in connection with the drilling activity for exploration, exploitation or extraction of mineral oils, would be included in the calculation of PE threshold for the taxpayer.

Facts

Deep Drilling 1 Pte. Ltd.("**Assessee**") is a company incorporated in and is a tax resident of Singapore. It is engaged in providing services related to drilling units and provide platform well operations. The Assessee entered into an agreement for providing platform well operations and drilling units on June 18, 2010.

Till AY 2010-11, the Assessee consistently offered its revenue for taxation under the presumptive scheme of taxation for income from shipping under section 44BB of the IT Act. However, no income was offered to tax in AY 2011-12. During AY 2011-12, the Assessee had earned contractual income of INR 648,890,227 under a contract with its customer, but did not offer the same to tax since it was in India for 119 days only and hence, it did not have a PE in India.

Though the rig was brought onto Indian land on April 26, 2010, the services and operations related to the contract commenced from December 3, 2010. During this period, the rig was undergoing upgradation and fabrication and positioning so as to meet the requirements specified by the customer as per the agreement. From December 2010 to March 2011, the Assessee was present in India for 119 days.

During the assessment proceedings, the AO observed that the rig was brought into India in April and was undergoing necessary upgrades to meet the requirements customer. Thus, the AO held that the Assessee had a PE since the criteria of 183 days to constitute a PE was met. Accordingly, it was held that the activities rendered by the Assessee were covered under Section 44BB of the IT Act.

The Assessee appealed before the CIT(A) and then before the ITAT but did not get any relief. Aggrieved by the order of ITAT, the Assessee preferred an appeal before the Bombay HC.

Issue

Whether the calculation of presence of 183 days for constituting a PE in India will start from the actual drilling services under the contract begin or from the moment the rig enters the Indian territory, in connection with the exploration, exploitation or extraction of mineral oil?

Arguments

The Assessee submitted that it provided drilling operations in connection with the exploration, exploitation and extraction of

[41] Deep Drilling 1 Pte. Ltd. v Deputy Commissioner of Income Tax (International Taxation) [2023] 153 taxmann.com 377 (Bombay).

mineral oil which would be covered by section 44BB of the IT Act. However, during AY 2011-12, the actual services were provided to the customer from December 3, 2010 till March 31, 2011 (i.e. for a period of 119 days) only. Accordingly, it was contended by the Assessee that the threshold period for establishing a PE did not exceed during the relevant period.

On the other hand, the IRA contended that the Article 5(5) of the India-Singapore DTAA is very widely worded, since it uses the phrase 'in connection with'. If the drilling services are provided for a period of more than 183 days in the FY in India, then the moment the rig enters India, the threshold time period will begin. As the rig was on Indian land since April 26, 2010 and was undergoing necessary repairs to meet the requirements of the contract, it would be assumed to be rendering services to the customer. Thus, the time period for the calculation of 183 days would be met leading to constitution of PE in India. Accordingly, the IRA contended that the Assessee would be liable for taxation under the Section 44BB of the IT Act.

Decision

The Bombay HC upheld the view adopted by the lower authorities and held that if the actual date for initiation of work was December 2010, then there was no point in bringing the rig to India in April 2010. The HC further said that if any general upgradations or modifications were required, then the same could have been made outside India, and post the required upgradations, the rig could have been brought into India. The HC also noted that meetings were conducted by the Assessee with the customer in April 2010 to ensure that the rig is ready for drilling activity in December 2010.

Further, the HC also highlighted that if the argument of the Assessee is accepted, the same could lead to numerous argumentative fallacies such as giving theoretical loopholes to taxpayers wherein they could contend that the rig broke down while rendering services and hence, the period during which the rig was getting repaired should not be counted, the rig was not used during a period of 15 days and hence, it should be excluded while calculating the number of days, etc. The HC frowned upon these suggestions and proceeded to hold that the Assessee had established a PE in India during the relevant period.

Accordingly, the Bombay HC held that upgradations, repairs and positioning work was ongoing since April 2010 for the customer and hence, the presence of rig in India for the calculation of the time period for rendering services should be considered from April 2010 only. Thus, it was held that the Assessee had constituted a PE in India during AY 2011-12 and its receipts were subject to tax under section 44BB of the IT Act.

Significant Takeaways

Article 5(5) of the India-Singapore DTAA mentions the following:

> *"Notwithstanding the provisions of paragraph 3 and 4, an enterprise shall be deemed to have a permanent establishment in a contracting state and to carry on business through that permanent establishment if it provides* ***services or facilities in that contracting state for a period of more than 183 days in any fiscal year in connection with*** *the exploration, exploitation or extraction of mineral oils in that contracting state."*

The phrase "in connection with" has been interpreted by the Bombay HC in a wide and liberal manner, and has tried to not leave any scope for any planning by the taxpayer with a view to avoid paying any tax in India.

In this context, Uttarakhand HC in the case of ***R&B Falcon Offshore Ltd.***[42] had held that the word 'used' in Article 5 of the India-US DTAA clarified usage of an installation or structure for exploration of natural resources and only if it was so used for the prescribed period, it can be considered as constitution of PE in India. The mere fact of the same being ready for use would not count. Further, the review petition filed by the IRA in this case before the Uttarakhand HC was dismissed.[43]

Article 5 of India-US DTAA is worded differently and hence, the constitution of a PE should be interpreted differently. Moreover, another important fact that those rigs were 'ready for usage'. In the present case, although the rig was in working condition, it was being modified to suit the specific requirements of the customer which essentially means that the upgradation as well as positioning could be considered to fall under the ambit of providing services or facilities in connection with the exploration proposed to be undertaken by the Assessee in India.

However, ITAT Mumbai in the case of ***Kreuz Subsea Pte Ltd.***[44] had clearly laid down that the threshold limit under the India-Singapore DTAA would be calculated from the date of actual commencement of installation activity. The ITAT also held that

[42] Director of Income-tax (International Taxation) v R&B Falcon Offshore Ltd [2014]223 Taxman 266(Uttarakhand.
[43] Director Income Tax v R&B Falcon Offshore Ltd 2015 SCC OnLine Utt 2471.
[44] Kreuz Subsea Pte Ltd v Deputy Director of Income-Tax (International Taxation) [2015]42ITR(T)11(Mumbai).

this actual date should be reckoned from the date the preparatory activities began leading to the performance of the core business activity.

It is evident from the above that there are conflicting decisions by different HCs on similar issue, depending on the variance in the relevant facts in each case. Hence, an independent analysis shall have to be carried out, especially considering the language used in the relevant DTAA to ascertain whether a PE has been constituted in India or not. In the present case, the Bombay HC drew adverse inference against the Assessee with respect to its presence in India for undertaking the operations. It may thus, be inferred that the arrangement may not have been properly analysed by the taxpayer before getting the rig to Indian waters. Hence, this reinforces the need to carefully review and analyse the facts and various grounds and arguments based on which the tax implications under the IT Act read with the DTAA should be carried out.

> **“ Time spent for fabrication, upgradation and positioning work should be included in the timeline for analysing constitution of PE in India. ”**

SC reinstates order of the Settlement Commission granting immunity from penalty and prosecution and orders against judicial interference

Introduction

The SC has reinstated the order of the Income Tax Settlement Commission ("**Commission**") which granted immunity from penalty and prosecution for non-disclosure of lease income and held that frequent interference with the orders of the Commission should be avoided, since there are limited grounds on which a judicially review of such orders are permissible .

Facts

Kotak Mahindra Bank Limited (formerly, "M/s ING Vysya Bank Limited") ("**Assessee**") is a Public Limited Company carrying on the business of banking with its registered office in Bangalore. Apart from the business of banking, the Assessee also carries out a leasing business approved by RBI. Thus, the Assessee derives its income from banking and leasing transactions.

For AY 1997-98 to AY 1999-2000, the Assessee was subjected to assessment proceedings wherein the main issue pertained to leasing activity. The Assessee had disclosed assets given on lease as financial lease and used to show only the interest component and offered it to tax. However, the Assessee was wrongly claiming depreciation on the leased assets even though it was not the owner. Based on this background , for AY 1994-95 to AY 1996-97, reassessment proceedings were initiated additions were made and even penalty was levied under section 271(1)(c) of the IT Act, with an allegation that the Assessee had concealed its income.

During the pendency of appeals before CIT(A) for the aforesaid AYs, the Assessee approached the Commission for determination of taxable income and seeking immunity from prosecution and penalty. The IRA challenged the jurisdiction of the Commission by a writ filed before a single judge of the Karnataka HC. The single judge held that the matter could be decided by the Commission as per the applicable law. The Commission determined the additional income at INR 1.96 billion and granted immunity from penalty and prosecution since to the Assessee since it had co-operated in the proceedings and made true and full disclosures.

The IRA challenged the Commission's order before Karnataka HC. A single judge of Karnataka HC found the Commission's order of granting immunity from levy of penalty as vague and contrary to settled principles of law on the basis that the burden to prove non-concealment or wilful neglect was not discharged by the Assessee through evidences. Thus, Karnataka HC remanded the matter of immunity from penalty back to the Commission for reconsideration.

The Assessee filed an appeal against this decision before the Division Bench of Karnataka HC, which was dismissed. Being aggrieved by this, the Assessee filed the present appeal before the SC.

Issue

The SC framed the issue as follows, *"Whether the Division Bench of the High Court was right in affirming the findings of the learned Single Judge, to the effect that the Settlement Commission ought not to have exercised discretion under Section 245H of the Act and granted immunity to the Assessee de hors any material to demonstrate that there was no wilful concealment on the part of the Assessee to evade tax and on that ground, remanding the matter to the Commission for fresh consideration?"*

Arguments

The Assessee argued that the Commission is the sole judge of the adequacy and the nature of evidence placed before it and the HC ought not to have interfered with its decision. Further, the Assessee argued that the conclusion of the AO in the assessment order is nothing but his own assertion and ought not to have been relied upon by the HC as the last word on the matter.

The Assessee contended that Section 245C contemplates full and true disclosure of income to be made before the Commission only, since if true and full disclosure had been made to the AO, there would be no need to go before the Commission. The Assessee also argued that Section 245C does not contemplate any explanation or evidence that requires to be offered and that the HC had erred in holding that there is a statutory requirement of concealment of particulars before the AO for the Commission to exercise its powers under Section 245H of the Act. Accordingly, the Assessee prayed for the order of the HC to be set aside and the order of the Commission to be restored.

On the other hand, the IRA argued that there is a marked difference between the terms "discovered" and "disclosed" in as much as what was "discovered" by the AO during assessment proceedings could not form part of what was "disclosed" by the Assessee in the application filed before the Commission. The IRA submitted that in the present case, what was "disclosed" in the application was similar to what was "discovered" by the AO, Section 245C was not applicable since there was no new disclosure by the Assessee. Further, the IRA argued that the Commission had not considered whether the Assessee had wilfully concealed his income to evade tax before granting immunity under Section 245H(1), and thus the matter had been rightly remanded by the HC for fresh consideration. The IRA also relied on ***Ajmera Housing Corporation v. Commissioner of***

Income Tax,[45] to argue that the Assessee ought to have disclosed income which was not reflected in the return of income ("**ROI**"). However, this was not done in the present case since the Assessee has not disclosed any income which was not reflected in the ROI, but has only brought to the notice of the Commission the income that had escaped assessment, which was subsequently discovered by the AO. The IRA also submitted that the legislative intent of Chapter XIX-A of the IT Act as per the holding in ***Commissioner of Income Tax v. B.N. Bhattacharjee***[46] was to not provide shelter for tax dodgers by providing them with immunity from facing the consequences of tax evasion. Lastly. The IRA argued that in ***Commissioner of Income Tax vs. Express Newspapers Ltd.***,[47] where for similar facts of the Assessee not disclosing income before the AO, the SC had held that the conditions of Section 245C had not been met and the Commission could not have entertained the application. Thus, the IRA argued that the appeal be set aside and the judgment of the Karnataka HC be affirmed.

Decision

The SC restored the order of the Commission which granted immunity from penalty and prosecution to the Assessee. The SC observed that *"the precondition for granting immunity is that the applicant must have co-operated in the proceedings before the Commission and made a 'full and true disclosure' of his income and the manner in which such income has been derived"*. In the present case, the SC found that the Commission had adequately applied its mind and validly exercised its discretion to proceed with the application, hence, the HC ought not to have interfered. Regarding the legislative intent, the SC held that frequent interferences with the orders or proceedings of Commission should be avoided since there are limited grounds on which it can be judicially reviewed.

The SC observed that while exercising power under Section 245H read with Section 245C of the IT Act, the Commission had to consider three facts: (i) CIT's report under Section 245D(1), (ii) disclosure made before the Commission as to income and its source, and (iii) any other relevant evidence produced either by the Assessee or by the IRA. The SC rejected IRA's contention that material disclosed before Commission must be something different from what was discovered by the AO. The SC also relied on ***Jyotendrasinhji v. S.I. Tripathi***[48] to hold that sufficiency of details placed before Commission are beyond the scope of judicial review except where the order contravenes provisions of the IT Act or causes prejudice to the opposite party or is based on fraud, bias, or malice. Further, the SC also relied on ***Ashirvad Enterprises v. State of Bihar***[49] to observe that there is no straight jacket formula that would universally apply, for grant of immunity, but the Commission may consider the two factors of full and true disclosure of income and co-operation in the proceedings.

Significant Takeaways

The SC made an interesting finding that scrutinising reasoned orders *"may erode the confidence of the bonafide assessees"* and lead to a multiplicity of litigation. By interpreting the legislative intent as wanting to avoid multiple and prolonged litigation when settlement was possible, the SC has decided in favour of the taxpayer and allowed tax claims to be settled instead of being contested at each level. The SC also relied on important precedents like ***Jyotendrasinhji (supra) and Ashirvad Enterprises (supra)*** to reiterate that there are limits on the powers of judicial review that can be exercised by courts as long as the Commission has made a well-reasoned order after considering all the facts.

However, it must be noted that though CBDT had wound up the Settlement Commission with effect from February 1, 2022, one can argue that the same principles ought to apply to interim boards set up to resolve pending cases. Thus, though this case has limited precedential value for new cases, the pending cases may still be relied upon and the principles brought out in this judgment. Further, it can also be relied in other cases to substantiate the importance of other special measures adopted by the CBDT to minimise litigation and allow various relief to the taxpayers.

> **" the Settlement Commission is the sole authority to ascertain whether the Assessee had made a 'full and true and whether it had cooperated during the proceedings. "**

[45] Ajmera Housing Corporation v. Commissioner of Income Tax, (2010) 8 SCC 739.
[46] Commissioner of Income Tax v. B.N. Bhattacharjee, (1979) 4 SCC 121.
[47] Commissioner of Income Tax v. Express Newspapers Ltd., (1994) 2 SCC 374.
[48] Jyotendrasinhji v. S.I. Tripathi, 1993 Supp (3) SCC 389.
[49] Ashirvad Enterprises v. State of Bihar, (2004) 3 SCC 624.

Reassessment proceedings cannot be initiated based on a subsequent AAR Ruling

Introduction

In the case of ***Usha Eswar***,[50] the Bombay HC held that section 148 of the IT Act placed an obligation on the AO to personally form a belief that income had escaped assessment based on tangible material which had sufficient nexus with the transaction in question. A contrary ruling of the AAR rendered subsequently could not be the sole basis on which such proceedings could be initiated.

Facts

Mrs. Usha Eswar ("**Assessee**"), now deceased, was an individual resident of the United Arab Emirates ("**UAE**") who was paying taxes in India as a non-resident. She had been carrying on business in Dubai, as a sole proprietor of two concerns. She had invested in shares and debentures issued by Indian companies as well as units issued by mutual funds registered in India ("**Indian Investments**").

The Assessee had filed an application before the AAR seeking clarity on the issue of taxability of income earned from her Indian Investments. The AAR gave its ruling on December 13, 1996, wherein it relied on its earlier ruling in the case of ***M.A. Rafik,***[51] and held as follows: (i) capital gains were not taxable in India, (ii) dividends were taxable at the rate of 15%, and (iii) interest was taxable at the rate of 12.5%, in the hands of a UAE resident in terms of the India-UAE DTAA ("**AAR Ruling**").

Relying on the AAR Ruling, the Assessee filed her return of income for various FYs. Subsequently, she was served with reassessment notices under section 148 of the IT Act for FYs 1996-97 to AY 1999-2000 since, the IRA stated that it had reasons to believe that income chargeable to tax had escaped assessment for the relevant FYs, on the ground that income has escaped assessment as the benefits of the India-UAE DTAA were wrongly given to the Assessee.

Aggrieved, the Assessee's husband (on behalf of the Assessee) filed a writ petition challenging legality and validity of notices issued under section 148 before the Bombay HC.

Issue

Whether the reassessment proceedings initiated by the IRA had followed the due procedure of law?

Arguments

The IRA argued that the AAR Ruling was only relevant for FY 1994-95. It highlighted that while the AAR Ruling had relied on ***M.A. Rafik (supra)***, the AAR in a subsequent ruling in the case of ***Cyril E. Pereira,***[52] concluded that the benefit of Article 4 of the India-UAE DTAA would not be available where the applicant was not chargeable to tax in the UAE. As the tax laws of the UAE did not levy any personal income-tax on individuals, therefore, they could not be considered as tax residents of the UAE in terms of the India-UAE DTAA. Thus, the IRA argued that the ruling in ***Cyril E. Pereira (supra)*** was applicable to the Assessee.

The Assessee argued that the reassessment notices were issued without satisfying the jurisdiction condition necessary to make a re-assessment. The IRA was required to have reasons to believe that income had escaped assessment and such reasons must be formed based on tangible material which had a rational nexus to the formation of belief. In the instant case, there were no objective materials or facts available with the AO based on which a reasonable person could form a belief that income had escaped assessment. Merely because the AAR is the case of another applicant had taken a different view, cannot be a sufficient ground to initiate reassessment proceedings.

Further, the AAR Ruling was binding on the Assessee and on the IRA in terms of section 245S of the IT Act while the subsequent ruling was not. The SC in ***Azadi Bachao Andolan,***[53] had observed that the view taken by the AAR in Cyril E. Pereira (supra) was flawed. The expression used in Article 4 of the India-UAE DTAA was *'liable to taxation therein'* and not *'pays tax'*. Thus, what was relevant was the legal liability to pay and not actual payment of tax. A person who enjoyed a specific exemption under the taxation statutes of a country was nevertheless liable to tax. Therefore, the notices were liable to be set aside.

Decision

The Bombay HC noted that a similar issue came up for consideration in the case of ***Prudential Assurance Co. Ltd.***[54],

[50] Mrs. Usha Eswar v. Union of India [2023] Writ Petition No. 1106 of 2003 (Bombay HC).
[51] Mohsinally A. Rafik [1995] 213 ITR 317 (AAR).
[52] [1999] 239 ITR 659 (AAR).
[53] Union of India v. Azadi Bachao Andolan & Anr. [2000] 263 ITR 706 (SC).
[54] Prudential Assurance Co. Ltd. v. Director of Income-tax [2010] 191 Taxman 62 (Bombay HC).

wherein the Bombay HC, after considering the scope of a ruling given by the AAR held that such ruling was binding on the taxpayer and the IRA in relation to the transaction for which the ruling was sought. A subsequent ruling of the AAR could not displace the binding character of the ruling rendered by the AAR in the case of a specific taxpayer.

Relying on the said ruling, the Bombay HC held that the IRA had manifestly exceeded its jurisdiction by issuing a reassessment notice basis a subsequent ruling of the AAR. The AAR Ruling was binding on the Assessee and the IRA in respect of the transaction for which it was sought and the subsequent ruling in ***Cyril E. Pereira (supra)*** could not displace the AAR Ruling. The AAR Ruling could only be displaced on a change in laws or facts, as per the mandate of section 245S(2) of the IT Act, neither of which had happened in the instant case.

The Bombay HC also accepted the Assessee's contention that the SC's decision in ***Azadi Bachao Andolan (supra)*** had explicitly observed that the view taken in ***Cyril E. Pereira (supra)*** was erroneous. Accordingly, the Bombay HC held that the IRA could not form a view that income had escaped assessment merely on the basis of a subsequent ruling of the AAR. The re-opening of assessment in the instant case was invalid and had ignored the plain provisions of the law. Thus, the reassessment notices were quashed and set aside.

Significant Takeaways

This ruling has reiterated the principle that reassessment proceedings can only be initiated based on cogent material available with the AO at the time of recording his reasons for reopening, after the AO has formed a personal belief that income chargeable to tax has escaped assessment. While the Bombay HC in this case held that a subsequent AAR ruling is not cogent material based on which such a belief can be formed, it is relevant to note that the AAR has been replaced by the Board for Advance Rulings ("**BFAR**"). Unlike the AAR, the rulings of the

BFAR are not binding on either party, i.e., the applicant or the IRA. The provisions of section 245S were made specifically inoperational *vis-à-vis* any ruling pronounced on or after September 1, 2021.[55] Thus, while subsequent BFAR rulings may similarly not be the basis on which reassessment proceedings can be initiated, taxpayers may also not be able to rely on any rulings rendered by the BFAR in their own case, in order to justify a position taken while filing their return of income.

Further, the meaning of the expression 'liable to tax' under India's DTAAs has frequently been a subject matter of controversy. The Bombay HC, like several decisions before it, has reiterated that in order to determine whether a person is 'liable to tax', it is immaterial whether such person actually pays tax or not. The India-UAE DTAA was amended in 2007 to provide for source based taxation in case of capital gains arising on alienation of shares and to specifically provide that for an individual to be a resident of UAE, they should be present in the UAE for at least 183 days in the calendar year concerned. Thus, these issues have been laid to rest in the context of the UAE.

" Relying on a subsequent decision of the AAR in a different case cannot be the sufficient basis to initiate reassessment proceedings. "

[55] Notification No. 97 /2021/F.No. 370142/31/2021-TPL (Part II) dated September 1, 2021, https://incometaxindia.gov.in/communications/notification/notification_97_2021.pdf

Interest income earned by clubs from fixed deposits in banks is not exempt from tax

Introduction

In the case of ***Secundrabad Club Etc.,***[56] the SC held that the interest income earned by clubs through fixed deposits ("**FDs**") in banks would not be subject to the principle of mutuality, irrespective of the banks being corporate members or not.

Facts

A batch of SLP's arising against judgments given by the Andhra Pradesh and Madras HC had been clubbed together since they involved common questions of law and facts. The Secunderabad Club, Madras Gymkhana Club, Madras Cricket Club, Coimbatore Cosmopolitan Club, Madras Club, M/s Wellington Gymkhana Club and M/s Coonoor Club ("**Appellant Clubs**") had deposited surplus funds in FDs in various banks, The IRA had made additions with respect to interest earned by the Appellant Banks on the FDs which were confirmed by the HCs. Aggrieved, the Appellant Clubs appealed before the SC.

Issue

Whether the interest earned by the Appellant Clubs on FDs would be taxed in their hands or not?

Arguments

The Appellant Clubs submitted that the precedent laid down by the SC in the case of ***Bangalore Club***[57] ("**BC case**") and relied on by the HCs was not a binding precedent and needed to be reconsidered in the light of the earlier order of the SC in the case of ***Cawnpore Club***[58] ("**Cawnpore Club**"). In the case of the ***Bankipur Club***[59] a particular set of appeals, related to taxability of income from property let out and interest received from fixed deposit receipts, National Savings Certificate, etc.., were delinked and were to be dealt with in Cawnpore Club. As per the Appellant Clubs, the order of the SC in Cawnpore Club laid down that the since the doctrine of mutuality was applicable, the income earned by the clubs from investments made out of its own surplus funds would not be taxed. The SC in the BC case, however, had laid down that, interest from FDs kept with corporate members of the club was eligible to be taxed in the hands of the assessee clubs, ignoring the principle of mutuality. Thus, there was a direct conflict between the two judgements, and both were decisions of two-judge benches of the same Court. Accordingly, the Appellant Clubs contended that the BC case was per incuriam inasmuch it did not consider the decision in Cawnpore Club.

From the year 2004 till 2013, i.e., the year of the BC case, all interest earned by FDs, Post Office Deposit, etc. was exempted from being taxed in the hands of the club since, it was the surplus income earned without any profit motive and used exclusively for the benefit of the club and its members. However, post 2013 the prevalent view was disrupted, and Cawnpore Club was disregarded. Other cases affirming the view taken in Cawnpore Club were cited, and it was laid down that the consistency of understanding surrounding the matter had been diluted by the BC case. It was further contended that there was complete identity between the members and the clubs, and that the principle of mutuality had not been disrupted, since the interest generated on the deposit would ultimately be used for the benefit of the members. Thus, the reasoning given in the BC case was flawed and needed to be reconsidered by a larger bench. The Appellant Clubs also contended that they do not earn any profits that can be included within the scope of the definition of income. They referred to section 56 of the IT Act and said that 'income from other sources' is in the nature of revenue receipt, however, in the context of the Appellant Clubs, it is more relevant how the income is utilised, which is why it would not matter if it is a capital receipt or revenue receipt. The Appellant Clubs also contended that mutuality would be attracted since the members of a club as a class contributed towards earning the surplus income and if same is deposited in bank, the interest earned is ultimately used for the benefit of the members.

The IRA contended the BC case had undertaken a correct analysis of the nature of the transaction involved and thus, did not require any reconsideration. The SC in the BC case had correctly laid down that as soon as the funds are invested in FDs in banks (irrespective of them being corporate members of the club or not), the principle of mutuality is ruptured as they are exposed to commercial banking operations, which would involve lending to third parties who are outside the net of mutuality, i.e., this would be a purely commercial operation.

Decision

The SC observed that the order in Cawnpore Club was not based on any reasoning or deduction made as to whether the interest

[56] Secunderabad Club Etc v. CIT, 2023 SCC OnLine SC 1004.
[57] Bangalore Club v. CIT, (2013) 5 SCC 509 (SC).
[58] Commissioner of Income Tax v. M/s Cawnpore Club Ltd., Kanpur, (2004) 140 Taxman 378 (SC).
[59] CIT v. Bankipur Club Ltd., (1997) 5 SCC 394.

earned by clubs through FDs would attract tax liability or not, the issue discussed was limited to the income earned from the rooms let out to its members, other questions such as the one surrounding the surplus investment were not discussed, and hence the case has no precedential value. The SC also laid down the essentials of every binding decision and held that there must exist material facts, principles of law applicable to the legal issues and a judgement based on the analysis and consideration of them. The SC emphasised that only the ratio decidendi of the judgement would be binding as a precedent, the legal principles underlying a decision must be ascertained and applied to further cases.

The SC elaborated on the scope of the principle of mutuality and said that it essentially stems from the fact that a person cannot earn profit from an association that he shares common identity with. They also reiterated the triple test for mutuality to be present, i.e., the presence of complete identity, the association to be an instrument obedient to the mandate of its members, and the absence of the possibility of fund contributors to derive profits from it. The SC, on consideration of the evolution of the mutuality test through judicial precedents, held that the BC case is a binding precedent and there is no requirement of reconsideration. It laid down that mutuality exists till the point that the funds are deposited in banks. However, once they are deposited as FDs, they would be used in banking operations to lend to third parties and earn higher interest and the 'privity of mutuality' would be destroyed. Each transaction of the club has to be discerned and the veil must be lifted to determine whether there is a third-party intervention and whether all the three conditions of mutuality are fulfilled. The SC also settled that the doctrine of mutuality requires complete identity between the contributors and the participants and that where facilities are extended to non-members the element of mutuality is lost. It held that the interest income earned by clubs through FDs made in banks would be treated as income within the meaning of section 2(24) of the IT Act.

Significant Takeaways

The principle of mutuality is based on the cardinal rule that persons can earn a profit from themselves. The SC, in ***Chelmsford Club***,[60] has clarified that while the definition of "income" under section 2(24) is inclusive, it envisages only one type of income arising from activities based on mutuality, i.e., those mentioned under section 2(24)(vii) (i.e., profits of a mutual insurance company or cooperative society). In all other cases, transactions covered under the principle of mutuality would be outside the purview of income-tax, not being "income" of the taxpayers.

The instant case has clarified the position on the taxability of interest income earned by clubs through FDs in banks. It reiterated that the principle of mutuality requires satisfaction of the triple test. In the context of clubs, the SC clarified that the principle of mutuality would apply if the facilities of the club are extended to members of the club who contribute towards income generated by the club, and there exists complete identity between them. However, if the facilities are offered to non-members or public for earning an additional income, it is a profit earning venture, tainted with commerciality. Similarly, previously, it has been held that where the constitutional documents of an entity permitted it to utilise the funds pooled through its members in various businesses, there was a clear commercial element involved and mutuality would not be applicable.[61]

Thus, organisations need to ensure that if the principle of mutuality is to be attracted the triple test has to be satisfied based on the facts and circumstances of each case.

"Clubs shall be liable to pay tax on interest earned from fixed deposits notwithstanding the principle of mutuality."

[60] Chelmsford Club v. CIT [2000] 243 ITR 89 / 109 Taxman 215.
[61] Devi Ahilya New Cloth Market Co. Ltd. v. CIT, [2009] 222 CTR 583 (Madhya Pradesh).

CBDT guidelines cannot prescribe a limitation period when the relevant provision does not contain such restriction

Introduction

In ***M/s Sofitel Realty LLP***[62], the Hon'ble Bombay HC held that there was no limitation period prescribed under Section 279(2) of IT Act for filing a compounding application for compounding of offence of failure to deposit TDS. It also held that there was no restriction on the number of compounding applications that may be filed by a petitioner and the only requirement under Section 279(2) of IT Act was that the prosecution proceedings instituted against such petitioner by IRA should still be pending.

Facts

The petitioners in the instant writ petition filed before Hon'ble Bombay HC were Sofitel Realty LLP ("**Assessee firm**") and Mr. Taslim Chougle and Mr. Dilshad Chougle who were the partners of the Assessee firm (collectively referred to as the "**Petitioners**"). The Assessee firm delayed the deposit of the TDS withheld by it in AY 2009-10 and eventually deposited such TDS on March 23, 2010 i.e. beyond its due date.

On account of such delay, the Petitioners got issued a SCN dated November 30, 2011 from the IRA for launch of prosecution proceedings under Section 276B read with Section 278B of IT Act. In response, the Petitioners filed a compounding application on March 26, 2012 and during the course of hearing agreed to pay compounding fees of INR 7,39,984 calculated by the IRA. However, the Petitioners failed to pay the compounding fee despite extension of time granted by the IRA and even a written reminder issued by the IRA. Therefore, the compounding application eventually got rejected by the Chief Commissioner of Income Tax *vide* order dated July 17, 2013 under Section 279(2) of IT Act.

Subsequently, on August 26, 2013 the CIT(TDS)-2 passed a sanction order for initiation of prosecution proceedings. On August 28, 2013, a complaint got filed before the Metropolitan Magistrate by the IRA under Section 276B read with Section 278B of IT Act.

Whereas on July 14, 2014, the Petitioners paid the entire compounding fees and filed a fresh compounding application on October 8, 2015 before the Chief Commissioner of Income Tax (TDS). However, the same got rejected *vide* letter dated September 17, 2018 received from ACIT on the ground that the compounding application filed in this matter on August 4, 2018 had already got rejected *vide* prior order July 17, 2013. When Petitioners requested for a copy of such rejection order, the ITO dispatched to him another letter on April 13, 2023 reiterating that his compounding application filed on August 4, 2018 had got rejected *vide* order dated July 17, 2013.

Issue

Where limitation period for filing a compounding application has not been specified under Section 279(2) of IT Act, whether the same can be laid down through guidelines issued by CBDT under the said provision?

Arguments

The Petitioners argued that they had deposited the TDS amount before the receipt of the initial SCN and their compounding application had got rejected as the compounding fees had not been paid by then. However, it had duly paid the compounding fees subsequently and even filed a fresh compounding application wherein it agreed to pay any additional compounding fees as well, if required.

The IRA argued that the compounding application dated October 8, 2015 was time barred as per compounding guidelines dated December 23, 2014 ("**Guidelines**") issued by the CBDT. The IRA relied on paragraph 8(vii) of the Guidelines laying down the offences which would generally not be compounded which stated that *"Offences committed by a person for which complaint was filed with the competent court 12 months prior to receipt of the application for compounding."* Therefore, the IRA argued that since complaint was filed by it in August 2013, the second compounding application dated October 8, 2015 was beyond such time period and, therefore, was null and void.

Decision

The Hon'ble Bombay HC observed that there was non-application of mind on the part of the IRA as far as the compounding applications filed by the Petitioners were concerned. It observed that a) the compounding application was not dated August 4, 2018, as incorrectly stated by the IRA in both its letters; b) in case application was filed on August 4, 2018 as per the IRA, the rejection order could not have been passed on July 17, 2013 and this shows that the second compounding application was never disposed off.

The Hon'ble HC further held that as per Section 279(2) of IT Act, such offence can only be compounded by the Principal Chief

[62] M/s Sofitel Realty LLP [W.P. (L) No. 14574/2023]

Commissioner or Chief Commissioner or Principal Director General or Director General of Income Tax. Therefore, an officer designated as ITO does not even have powers to hold a compounding application as null and void.

Further, Hon'ble HC drew attention to the language of Section 279(2) of IT Act and held that it provided for compounding of any offence either before or after the institution of the proceedings. There was no limitation period prescribed for filing of a compounding application.

As for the Guidelines relied upon by the IRA, the Hon'ble HC held that such Guidelines cannot lay down a limitation period nor restrict the operation of Section 279(2) of IT Act. They cannot travel beyond the scope of the powers conferred by the IT Act or the IT Rules. Guidelines cannot contain instructions or directions curtailing a statutory provision by prescribing a period of limitation where none is laid down under the relevant Act or the Rules framed thereunder.

In context of second Explanation to Section 279 of IT Act that provided that the CBDT could issue directions, the Hon'ble HC held that an explanation merely explains the main section and is not meant to carve out a particular exception to the contents of the main section. In this regard, the Hon'ble HC relied upon a catena of judgements as follows:

a) In ***G.P. Engineering Works Kachhwa***[63], the Hon'ble Allahabad HC referred to these Guidelines issued under Section 279(2) of IT Act and held that such guidelines cannot curtail a statutory provision by prescribing a period of limitation nor take away a statutory right with which an assessee has been clothed. It observed that the object of an explanation to a statutory provision was elaborated by the Hon'ble SC in ***S. Sundaram Pillai***[64] that an explanation merely explains the main section and cannot carve out a particular exception to the contents of the main section. An explanation merely enables the CBDT to clarify any obscurity or vagueness in the main provisions to make it consistent with its dominant object. An explanation cannot take away a statutory right vested with an assessee.

b) In ***Vikram Singh***[65], the Hon'ble Delhi HC held that the CBDT cannot by relying on the Guidelines reject a compounding application on the ground that the compounding fees had not been paid in advance, as that would be irrational and contrary and ultra vires to the object of Section 279 of IT Act.

c) The Hon'ble Bombay HC further relied on its recent ruling in the case of ***Footcandles Film (P.) Ltd.***[66] wherein it was held that the Chief Commissioner of Income Tax could not have dismissed the compounding application on the ground that it was filed beyond 12 months relying on the Guidelines for compounding of offences, as guidelines are not rules of limitation and cannot take away jurisdiction of the IRA under Section 279(2) of IT Act. It also referred to ruling of the Hon'ble Delhi HC in case of ***Sports Infratech (P.) Ltd.***[67] wherein the Court had observed that while the Guidelines need to be considered at the time of considering a compounding application, they cannot bind the IRA to ignore the circumstances of each case for instance since the petitioner could not deposit the TDS due to seizure of its books which was beyond its control, the Guidelines cannot be the sole determining factor for rejecting the application.

d) Further, the Hon'ble Bombay HC relied on its own ruling in ***Durgeshwari Hi-Rise & Farms (P.) Ltd.***[68] wherein it had held that the second compounding application should not be rejected just because the first application was rejected for default.

Accordingly, the Hon'ble HC held that the compounding application of Petitioners cannot be rejected on ground of delay and, therefore, shall be taken up on merits. Further, there was no restriction under the IT Act on the number of compounding applications that may be filed by an assessee. The only requirement under Section 279(2) of IT Act for compounding was that the complaint filed by IRA should be still pending.

Significant Takeaways

The CBDT has updated its guidelines for compounding of offences from time to time. The Guidelines dated December 23, 2014 were superseded by the guidelines dated June 14, 2019, which were made applicable for compounding applications received on or after June 17, 2019. It may be noted that the period of limitation of 12 months from filing of complaint before the

[63] G.P. Engineering Works Kachhwa v. Union of India [2022] 139 taxmann.com 130/446 ITR 563 (All.)
[64] S. Sundaram Pillai v. V.R. Pattabiraman [1985] 1 SCC 591
[65] Vikram Singh v. Union of India [2017] 80 taxmann.com 371/247 Taxman 212/394 ITR 746
[66] Footcandles Film (P.) Ltd. v. ITO [2023] 146 taxmann.com 304/453 ITR 402 (Bom.)
[67] Sports Infratech (P.) Ltd. v. Dy. CIT (HQRS) [2017] 78 taxmann.com 44/246 Taxman 21/391 ITR 98 (Delhi)
[68] Durgeshwari Hi-Rise & Farms (P.) Ltd. v. Chief CIT (TDS) [2019] 103 taxmann.com 292 (Bom.). It may be noted that the Bombay HC in said ruling had observed that it should not be treated as a precedent due to the peculiar facts of the said case. The HC directed the subsequent compounding application of petitioner to be adjudicated on merits as the first application was dismissed due to non-appearance of the petitioner.

competent court in the Guidelines issued in 2014 was retained in the updated guidelines issued in 2019 and for deserving cases a timeline of 24 months[69] have also been provided.

Whereas these guidelines were further superseded by guidelines dated September 16, 2022 issued by the CBDT which were made applicable for compounding applications received on or after September 16, 2022. It may be noted that as per these guidelines, a compounding application could be filed even within 24 months (subject to increased compounding charges) or 36 months (in deserving cases subject to approval of Pr. CCIT) from the end of month of filing of complaint in court by IRA[70].

Whereas the Hon'ble Allahabad HC in its ruling dated February 8, 2022 in ***G.P. Engineering Works Kachhwa (supra)***, wherein the compounding application was filed after a delay of more than 20 years, had already held that such guidelines cannot prescribe a period of limitation or take away a statutory right vested with an assessee, which has also been relied upon in the present case. Even otherwise the Hon'ble SC has in its rulings explained the scope of an explanation to a statutory provision (as discussed above).

Further, as held by the courts in its various judgments[71], even in case an appeal is pending against the order of lower court convicting the assessee, "proceedings" shall be deemed to be pending as per Section 279(2) of IT Act and a compounding application can be filed by an assessee.

However, despite consistent unambiguous and clear position taken by the Courts including by the Apex Court, it is surprising and disappointing to see that the CBDT is regularly putting time-specific hurdles in each of its guidelines dealing with this issue. Because of the guidelines, the IRA have no option but to continuously reject the compounding applications filed by the taxpayers and thus, leaving them with no option but to approach the Courts. This is an extremely dangerous phenomenon and requires an urgent reconsideration by the CBDT since it results in unnecessary and fruitless litigation.

"The Guidelines cannot travel beyond the scope of the powers conferred by the Act or the Rules."

[69] Paragraph 9.1
[70] Paragraph 7(ii) and 9.1
[71] Chairman, CBDT v. Umayal Ramanatha [2009] 313 ITR 59 (Mad.), V.A. Haseeb & Co. (Firm) Vs. CCIT(TDS) 2016] 75 taxmann.com 57 (Madras).

Section 260A appeal not maintainable if there is no substantial question of law

Introduction

In the case of ***Bikram Singh***[72] the SC had held that its mandatory for the HCs to frame the substantial question of law before deciding the appeal on merits.

Facts

In this case, the AO had added certain amounts to the Bikram Singh's ("**Assessee**") income under section 68 of the IT Act pertaining to loans/advances the Assessee received from eight individuals. The IRA held that the Assessee couldn't prove the identity, creditworthiness, and genuineness of the lenders. The CIT(A) validated this addition. However, the ITAT overturned the said additions for four creditors and asked the Assessing Officer to verify for others. Aggrieved by the decision of the ITAT, the IRA filed an appeal before the Delhi HC under section 260A of the IT Act. In the appeal, the IRA highlighted significant inconsistencies and doubts about the credibility and financial capacity of the four creditors were highlighted. The HC admitted the appeal and held that ITAT's decision was neglectful of the inconsistencies. It said mere establishing of the identity and transfer of the amount via cheque did not mean that the transactions were genuine. Consequently, the appeal of IRA was approved. The Assessee filed an appeal against the said judgment passed by the Delhi HC stating no substantial question of law was formulated by the HC and rather, the case was heard on merits.

Issue

Whether an appeal before the HC under section 260A of the IT Act is maintainable only on a substantial question of law?

Arguments

The Assessee argued that the section 260A of the IT Act requires formulation of a substantial question of law for hearing in an appeal by the court. Further, it was argued by the Assessee that the said formulation must be done at the time of admitting the appeal. Unless the court is satisfied and formulates the substantial question of law, any appeal under section 260A cannot be entertained. It was highlighted that in the instant case there was a reversal of the procedure, wherein parties were first heard on the merits in the absence of any substantial question of law, and only afterward was the question of law formulated. The Assessee did not have any notice regarding the substantial question of law and arguments were heard on merit. Thus, it was in non-compliance of the procedure enumerated under the section 260A of IT Act.

On the contrary, the respondent defended the HC's decision, arguing that the Assessee wasn't taken by surprise. Following the HC's issuance of notice, the Assessee appeared via his counsel to respond to the notice and argued the case on its merits. The HC, after hearing the case on merits, reserved the matter for judgment and prior to passing the impugned judgment formulated the question of law.

Decision

The SC while determining the scheme of an appeal under section 260A of the IT Act, held that it is maintainable only on a substantial question of law, leave alone question of law. The Apex Court said that if in case an appeal is accepted by the HC, then substantial question(s) of law must be framed by the HC. Thereafter, the respondent is to be put on the notice. There can be issuance of the notice to the respondent only when the substantial question has been framed by the HC. The Apex Court said that if in case the HC is of the view that no substantial question of law arises, in such situation the appeal has to be dismissed. The SC further remarked that the HC also has the power to formulate a fresh question of law if it so arises on hearing the learned counsel for the respective parties. The only requirement is that the HC should be satisfied that the case involves such question.

As per the Apex Court, the HC in this instance did not adhere to the mandated procedure under Section 260A of the IT Act. It held that the HC must have formulated the substantial question upon admitting the appeal and then should have proceeded to hear arguments based on the formulated question. However, the procedure followed by the HC was not in line with this requirement. The SC highlighted the inconsistency by referring to the fact that the HC heard the appeal on its merits first and then reserved it for judgment, without initially formulating a substantial question of law. This procedural lapse was evident in the case, and as a result, the Apex Court set aside the HC's judgment. The matter was remanded back to the HC for reconsideration, ensuring strict compliance with Section 260A of the IT Act. The parties were directed to appear before the HC on a specified date, with all contentions on the merits of the matter remaining open for arguments before the HC.

[72] Bikram Singh v. PCIT [2023] 154 taxmann.com 80 (SC).

Significant Takeaway

It is lucid from section 260A that any appeal from ITAT's order shall only lie to the High Court only if the High Court is satisfied that there is a "substantial question of law" involved in the case. Under the sub-section (3), it also contemplates about the situation where the court itself is satisfied about any involvement of substantial question of law in the case, it can formulate such question. However, in the very next subsection i.e. sub-section 3 of section 260A, it is mentioned that such appeal shall only be heard on the question so formulated. A plain and literal interpretation of the said section highlights that an appeal can only be heard if there is involvement of any substantial question of law.

Further, the subsection 7 of the said section mentions that *"save as otherwise e provided in this Act, the provisions of the Code of Civil Procedure, 1908, relating to appeals to the HC shall, as far as may be, apply in the case of appeals under this section"*. As rightly remarked by the SC in the Bikram Singh case, the appeal under Section 260A is akin to the second appeal under the Code of Civil Procedure 1908. The Section 100 read with the Order XLII Rule 1 of CPC clearly mandate the formulation of a substantial question of law at the time of entertaining and admitting the matter, else the appeal is ought to be dismissed. The judgment of the court was totally in line with the precedents on the said section, where time and again courts have held that without framing substantial question of law, there can not be any hearing in the cases of second appeal.[73]

> **"Issuance of notice prior to admission without framing any substantial question(s) of law is not contemplated under Section 260A. The High Court has either to admit or not admit the appeal. If the High Court admits the appeal then substantial question(s) of law has to be framed."**

[73] Ryatar Sahakari Sakkarre Karkhane Niyamit v Assistant Commissioner of Income-tax [2019] 105 taxmann.com 3 (SC)

DRP proceedings should be completed within the overall time-limit for undertaking assessment prescribed under Section 153 of the IT Act

Introduction

The Bombay HC in the case of ***Shelf Drilling Ron Tappmeyer Ltd.***[74] held that the time limits prescribed under Section 153 of the IT Act for completing assessment proceedings would prevail over the assessment time-limit prescribed under Section 144C for undertaking proceedings before the DRP. In the absence of a final order being passed by the AO within the prescribed time limit, the assessment proceedings would be time barred.

Facts

Shelf Drilling Ron Tappmeyer Limited ("**Assessee**") is a company incorporated in the Cayman Islands and is headquartered in Dubai, UAE. The Assessee is engaged in the business of shallow water drilling for clients engaged in the oil and gas industry. It acquired a rig based on a global contract between its parent company and Transocean group in 2012. Till July 2013, the rig was in operation on a bareboat charter basis for a contract between ONGC and the Indian entity of Transocean group. From August 2013 to November 2013, the said rig was used under a nomination contract for providing drilling services to ONGC. From December 2013 to March 2014, the said rig required and underwent major repairs and refurbishment after which it was deployed for drilling for ONGC. The agreement was initially executed between ONGC and Indian entity of the Assessee, which was thereafter sub-contracted to the Assessee.

During AY 2012-13 and AY 2013-14, the Assessee had filed return of income ("**ROI**") under presumptive basis under Section 44BB of the IT Act. However, during AY 2014-15, the Assessee opted for calculation of income (other than on presumptive basis) by preparing the books of accounts and getting them audited and declared a loss. The ROI for AY 2014-15 was selected for scrutiny.

The AO passed draft assessment order invoking the provisions of Section 145 of the IT Act and rejected Assessee's books of account, calculating a profit based on presumptive taxation under Section 44BB(1) of the IT Act instead.

The Assessee filed its objections before the DRP against the draft assessment order but the DRP did not accept the same and concurred with the AO. Based on the said directions, the AO passed a final assessment order dated October 30, 2017 under Section 143(3) read with Section 144C(13) of the IT Act.

Aggrieved by the said order, Assessee filed an appeal before ITAT. By its order dated October 4, 2019, disposing the appeal, the ITAT remanded the matter to the AO for fresh adjudication. On February 5, 2020, the Assessee informed the AO about the order and requested for an early disposal of the same, and also followed up with multiple oral requests. On February 22, 2021, the Assessee was asked to produce details of the contracts and the reasons for incurring a loss. The Assessee provided all documents and details called for. The Assessee responded to the queries raised by the AO. Repeated notices by the IRA were issued under Section 142(1) of the IT Act to the Assessee which were duly responded within the prescribed timeline.

Thereafter, the AO passed a draft assessment order dated September 28, 2021. The Assessee, to safeguard against the disability of the objections being treated as delayed, filed its objections on October 27, 2021 before the DRP. In addition, the Assessee also filed this petition in the Bombay HC challenging the impugned order dated September 28, 2021. Thus, the revised final order could not be passed by the due date September 30, 2021.

Issue

Whether the limitation has expired on September 30, 2021 under Section 153(3) of the IT Act read with the provisions of the Taxation and other laws (Relaxation and Amendment of Certain Provisions) Act, 2020 and hence, final assessment order passed in the present case is time barred?

Arguments

The Assessee argued that the limitation as provided in Section 153 of the IT Act is the outermost limit provided for passing the final assessment order under the Act. The Assessee relied on Madras HC's decision in the case of ***Roca Bathroom Products (P) Ltd.***[75]. The draft assessment order, the DRP's order on the objections raised by the assessee and the final assessment order ought to have been passed within the said limitation, i.e., by September 30, 2021. As the final assessment order has not been passed before the said date, the proceedings are now barred by limitation and hence, the ROI as filed by Assessee should be accepted.

The IRA argued that the time limit given under Section 153(3) of the IT Act would be in addition to the time prescribed under Section 144C of the IT Act. No time limit has been prescribed under Section 144C(1) of the IT Act. Nine months is prescribed only for DRP to pass its order under Section 144C(12) of the IT Act

[74] Shelf Drilling Ron Tappmeyer Ltd. v. Asstt. CIT (IT) [2023] 153 taxmann.com 162 (Bom.)
[75] CIT v. Roca Bathroom Products (2022) 140 taxmann.com 304 (Madras).

and under Section 144C(13) of the IT Act, one month is provided for the AO to complete the assessment in conformity with the directions given by the DRP. Since there is no time limit prescribed to pass the draft assessment order under Section 144C(1) of the IT Act, there was no question of the assessment being barred under Section 153(3) of the IT Act.

Further, relying on an earlier decision of Madras HC in the case of ***Sanmina SCI India (P.) Ltd.***[76], the IRA argued that Section 144C of the IT Act was a self-contained code and thus, would prevail over other provisions including Section 153 of the IT Act. The IRA also contended that the non obstante clause in Section 144C of the IT Act was inserted later in Section 153 of the IT Act. The later non obstante clause ought to prevail over the previous one. Any other interpretation would make key machinery provisions unworkable and hence, should be rejected as the Assessee does not have any vested right in procedural aspects of ongoing assessments.

Decision

The Bombay HC noted that under Section 153(1) of the IT Act, the assessment must be completed with 21 months since the assessment relates to AY 2014-15. It further held that even though Section 144C of the IT Act is a self-contained code of assessment, time limits are inbuilt at each stage of the procedure contemplated. The purpose of Section 144C is to fast-track a special type of assessment with respect to transfer pricing additions. That cannot be considered to mean that overall time limits prescribed have been given a go by in the process. Thus, the HC disagreed with the IRA's view and supported the Assessee by noting that wherever the legislature intended extra time to be provided, express provisions have been introduced for the same, Section 153 of the IT Act also mentions the time taken for certain proceedings ought to be excluded, does not mention Section 144C in that list. Thus, the HC held that it does not stand to reason that proceedings on remand to the AO may be done at leisure sans the imposition of any time limit at all, and this would in fact run counter to the avowed object of provisions. Therefore, the HC held that it could not accept that the provisions of Section 153 of the IT Act excluded the operation of Section 144C of the IT Act.

The HC concluded that the object was to conclude the proceedings as expeditiously as possible and since there was a statutory time limit, it is the AO's duty to pass an order in time. After September 30, 2021, the AO had no authority to pass any final assessment order and hence, the ROI filed by Assessee had to be accepted.

Significant Takeaway

Prima facie, this judgment imposes a strict interpretation on legislative timelines and holds the income tax authorities responsible for completing assessments on time. This position is not new as similar views had also been expressed by the Madras High Court in *Roca Bathroom Products (supra) and Sanmina SCI India (supra)* wherein it was held that Section 144C is a self-contained code. However, the present case went a step further in specifically mentioning that Section 153 proceedings are also covered within this timeline. Given these decisions from the HCs, the IRA has promptly moved to the SC.

Through a recent order[77], the SC has imposed a stay on this decision since it has major impact on international tax and transfer pricing cases across India. The final decision of the SC is expected to settle the issue.

> **“ Time limit for undertaking DRP proceedings should be considered within the overall time period given for assessment proceedings. ”**

[76] CIT Chennai v. Sanmina SCI India [2017] 85 taxmann.com 29 (Madras).

[77] Asst Commissioner of Income Tax (International Tax) v. Shelf Drilling Ron Tappmeyer Limited Order dated 22 September 2023 in IA No.188643/2023 and IA No.188644/2023.

Power to arrest a person under the GST Act is statutory in character and should not ordinarily be interfered by a writ Court.

Introduction

The SC in the case of ***Choodamani Parmeshwaran Iyer***[78] allowed the petition of the IRA, on the ground that the power to arrest granted to the IRA under section 69 of the CGST Act could be exercised where there is reason to believe. The same cannot be departed by filing a writ petition.

Facts

Choodamani Parmeshwaran Iyer & Another ("**Respondents**") had been issued a summon by the IRA for recording of statement under the provisions of erstwhile law as well as Section 70 of the CGST Act in relation to an inquiry of M/s. Iyer Enterprise Mundra Kutch. The Respondents feared arrest in consequence of the summons received, therefore filed a writ petition before the Gujarat HC. The HC, *vide* order dated December 24, 2018 ("**Impugned Order**") held that the Respondents are permitted to present themselves before the IRA and directed the IRA to completing the adjudication proceedings within a period of eight weeks. Additionally, the HC also held that arrest would not take place prior to completion of adjudication process. If they are not fulfilling obligation, they may appear before concerned police station. Aggrieved by the said decision of the HC, the IRA preferred an appeal before the SC.

However, on the date of import, the Concessional Notification was amended to exclude the category of printer to be imported by the Respondent. Due to the amended notification, the Respondent was ineligible for the concessional rate and accordingly, it filed a writ petition before the Calcutta HC to declare the amended notification as *ultra vires* section 25(1) of the Customs Act. An interim order was passed, allowing the import of the machinery at a concessional rate, subject to furnishing bank guarantee for the differential amount. The single judge bench of HC set aside the amended notification on the basis that there was no intelligible differentia in excluding a category of printer from the concessional rate.

The said decision was also upheld by the division bench when revenue appealed against it. The division bench was of the view that the imported machinery was neither manufactured in India nor any representation was made by any domestic manufacturer to amend the concessional rate. Aggrieved, the IRA filed an appeal before the SC.

Issue

Whether there can be imposition of a condition before effecting arrest under Section 69 of the CGST Act?

Arguments

The IRA contested that the Respondent had not been cooperating and out of 14 summons raised, they had appeared only once. The investigation had not completed even after five years. It was only after the completion of the investigation that they would be able to ascertain whether taxes were evaded or not. They argued that the Impugned Order passed by the HC, granting immunity to the Respondents from the arrest, does not

[78] State of Gujarat v Choodamani Parmeshwaran Iyer & Anr 2023 SCC OnLine SC 1043.

hold good in law. Power of arrest can be exercised only when commissioner has reasons to believe that person has committed offence.

The counsel of the Respondents has not submitted any arguments.

Decision

The Apex Court set aside the Impugned Order on the ground that the power to the arrest as provided under section 69 of the CGST Act was to be exercised based on objective facts of the case. The SC made reference to the case of ***Padam Narain Aggarwal***[79], which held that Courts cannot impose any condition before effecting arrest. For example, condition to provide prior information regarding arrest, would render the statutory provisions ineffective and redundant. The SC held that when a summon is issued under Section 69 of the CGST Act, the assessee does not have recourse to anticipatory bail under Section 438 of the Cr.P.C. at the summon stage since no first information report is required to be registered before arrest under Section 69 of CGST Act,

The SC also made reference to the case of Constitution bench of the SC ***Kartar Singh***[80] which held that while there is no bar on from entertaining an application pertaining to pre-arrest protection under the article 226 of the Indian Constitution but the same has to be exercised sparingly. The SC also observed that there exists a fundamental distinction between a petition for anticipatory bail and a writ of mandamus filed under Article 226 of the Indian Constitution. No writ of mandamus may be issued to direct the IRA to not effect an arrest, as it would prevent the IRA from performing their statutory function.

The SC also referred to the case of ***P.V. Ramana Reddy***[81] which highlighted that there exist a loophole under Section 69 of the CGST Act, wherein sub- section (1) empowers the authority to arrest in case where there is cognizable and non-bailable offence committed. However, Section 69(3) empowers the IRA to grant bail in cases of non-cognizable and bailable offences, even when there is no power to arrest in cases non-cognizable and bailable offences under Section 69(1) of the CGST Act. Additionally, it drew parallels between the CGST Act and CrPC. It highlighted that the safeguards during arrest engrained in the Section 41 and 41A of the CrPC, although not enumerated under CGST Act, are required to be kept in mind while making arrest under the CGST Act.

Significant Takeaways

The ruling would help the taxpayer to identify the best strategy and time for approaching court for protection where they apprehend arrest. The decision also preserves the interest of revenue by dispelling the chances of cases being protracted due to interference in the statutory procedure. In many of the instances, the common resort with respect to protection from arrest for the parties happens to be an anticipatory bail under the Section 482 of the CrPC. It also clarifies that same cannot be taken as recourse at summon stage.

The Apex Court has significantly highlighted that the power must be exercised by following provisions provided under Section 41 z and 41A(3) of the CrPC.

> **“ No writ of mandamus would lie to prevent an officer from performing his statutory duty of arrest. ”**

[79] Union of India v. Padam Narain Aggarwal (2008) 13 SCC 305.
[80] Kartar Singh v. State of Punjab, (1994) 3 SCC 569.
[81] P.V. Ramana Reddy v. Union of India Special Leave Petition (Crl.) No. 4430 of 2019 order dated 27.05.2019.

Recipient cannot claim ITC where supplier has failed to deposit GST to the Government

Introduction

The Patna HC in the case of ***Aastha Enterprises***[82] held that where the supplier fails to deposit GST with the Government, the conditions stated in the GST legislation for availing ITC are not satisfied. Therefore, the recipient cannot avail ITC; despite payment of said GST to the supplier.

Facts

Aastha Enterprises ("**Petitioner**") has procured goods and services from various vendors. It has paid the consideration along with applicable GST to such vendors. However, certain vendors have failed to deposit GST to the Government during the relevant period. As Petitioner availed ITC basis copy of invoice, payment to vendor, e-way bill etc., the IRA denied the ITC and raised a demand for wrongful availment of ITC. Being aggrieved, the Petitioner filed a writ petition before the Patna HC regarding the interpretation of the provision enabling ITC under the Bihar GST Act, 2017 ("**BGST Act**").While the Petitioner could have filed appeal before appellate authority, preferred this writ petition before the Patna HC without exhausting the said remedy. While the Patna HC, acknowledged the existence of the statutory remedy, it still proceeded to admit the petition as it involved the issue of interpreting the provision of the BGST Act.

Issue

Whether ITC can be denied to the recipient when the supplier has not paid the tax to the Government, despite collecting it from the recipient?

Arguments

The Petitioner submitted that the purchases were made after making payments through bank channels and they have relevant documents to prove that the transaction has occurred such as the invoices documents reflecting the movement of the goods purchased, etc. The Petitioner argued that the underlying object of the ITC regime was to remove the cascading effect of GST. If the IRA is allowed to recover GST from the Petitioner who has already paid it to supplier, it would amount to dual payment of GST by the Petitioner. Such allowance would frustrates the objective of GST regime. Further, the Petitioner contested that recovery would be in character of double taxation, and the IRA should proceed against the selling dealer to recover the collected amount of GST, which if not paid after collection, entails penalties under the BGST Act.

The IRA argued that availment of ITC is subject to certain conditions under the GST provision such as (a) existence of tax invoice issued by the selling dealer; (b) proof of receipt of goods or services or both and (c) tax charged in respect of the supply has been actually paid to the Government. The IRA submitted that non- fulfilment of any of the conditions would lead to denial of ITC. Further, the IRA submitted that the Petitioner did not respond to the SCN and the reminder served due to which an ex-parte order passed. The IRA argued that multiple judgments have held that ITC is in the nature of a benefit or a concession and not a right extended to the recipient and thus benefit can accrue to the taxpayer only as per the scheme as provided under the GST legislation.

Decision

The HC analysed Section 16 of the BGST Act which deals with eligibility and the conditions for availment of ITC. The HC held that the conditions have to be satisfied cumulatively and not independently. The HC also referred to SC decision in ***Ecom Gill Coffee trading Pvt. Ltd***[83]**.** which held that an assessee claiming ITC has to prove beyond doubt the transaction by furnishing the invoice, payment details, delivery related documents, etc. Additionally, the HC held that ITC is a benefit or concession and not a vested right. Thus, the benefit will be available only if all the conditions are compiled for availability.

On the issue of double taxation, the HC held that taxation is a compulsory extraction made for the purpose of public good. Where the same is not paid to the Government, the liability of tax is not satisfied. Thus, no double taxation. Further, the HC observed that even if there is a mode of recovery provided under the statute, the same could not provide a right to recipient to avail ITC when supplier has not deposited GST The HC dismissed the writ petition on the ground that mere production of all documents evidencing payment, delivery of goods would not enable the Petitioner to claim ITC unless the selling dealer has deposited the same to the Government.

Significant Takeaways

Though this decision employs strict interpretation of tax statutes, it also questions the objective of GST legislation, i.e. good and simple tax. Such denial of ITC even after making

[82] Aastha Enterprises v. The State of Bihar [2023] 153 taxmann.com 491 (Patna).
[83] The State of Karnataka v. M/s Ecom Gill Coffee Trading Private Limited; Civil Appeal No. 230 of 2023.

payment to supplier, on account of supplier non-compliances, penalises the honest recipient. It also raises concern as plethora of rulings under the erstwhile VAT regime, categorically allowed ITC to a bona-fide buyer for non- compliance by the supplier.

It must also be noted that several different State HCs have rendered conflicting decision. The Calcutta Hc[84] has held that purchaser cannot be directed to reverse ITC benefits unless appropriate action is taken to recover the unpaid tax from the supplier Therefore, it is a state of chaos and ambiguity, leading to increase in frivolous claims. It is expected that some mechanism is devised to preserve the interest of honest recipient, such as not to proceed against recipient without conducting an investigation or enquiry against the non-compliant supplier.

“ ITC is benefit conferred under statute which is subject to underlying conditions. ”

[84] Suncraft Energy Private Limited and Ors. v. The Assistant Commissioner, State Tax, Ballygunge Charge and Ors. 12023 (8) TMI 174 - CALCUTTA HIGH COURT.

There is no power to seal the premises under Section 105 of the Customs Act

Introduction

The Bombay HC in the case of ***M/s Narayan Power Solutions***[85] held that sealing of premises is a draconian actions affecting the right to conduct business. Hence, for undertaking search, the premises cannot be sealed under Customs Act without such explicit power.

Facts

An investigation was initiated against ST Electrical. The goods supplied by ST Electrical were indirectly purchased by M/s Narayan Power Solutions ("**Petitioner**") through other vendors in the supply chain. However, without issuing any notice to Petitioner, the IRA sealed the business premises of the Petitioner. Aggrieved by the same, the Petitioner has filed the present writ petition before the Bombay HC.

Issue

Whether the power to search goods and documents under Section 105 of the Customs Act also entail power to seal the premises.

Arguments

The Petitioner submitted that the IRA does not have the power or jurisdiction under the Section 105 of the Customs Act to seal the business premises of the Petitioner.. The Petitioner also submitted that the goods in relation to which the investigation was ongoing, were not purchased by the Petitioner directly from S.T. Electricals. They contended that under section 105 of the Customs Act the authorities have the power to search the documents and goods which should be confined to transactions which are in question under the investigation and the IRA should not investigate in regards to other transactions undertaken by the Petitioner with other third party suppliers. The IRA cannot undertake a fishing exercise in absence of reasons to believe. It further contented that they have been cooperative and ready to cooperate further for the entire investigation.

The IRA via their counsels submitted that they have the power to search the premises of the Appellant under section 105 of the Customs Act. In case, where the taxpayer is not being cooperative during the investigation proceedings, IRA may take such action. Therefore, the IRA sealed Petitioner's premises.

Decision

The Bombay HC passed the judgment in favour of the Appellant by ruling that power to search cannot mean power to seal. It is provided under Section 105 of the Customs Act that search can be undertaken under two circumstances, i.e. goods are liable for confiscation or documents relevant to proceeding are secreted. There was no power to seal under the said provision. The IRA has undertaken draconian step by sealing the premises of Petitioner. It held that sealing of the premises has direct effect on the legal rights of the Appellant and is violative of Article 300A of the Constitution which provides for free use and occupancy of the land by a person. Sealing of business premises would affect the right to carry on business and trade which is enshrined in article 19(1)(g) of the Indian Constitution. Thus, the HC ordered the IRA to unseal the premises and conduct search in the presence of Petitioner.

Significant Takeaways

The aforementioned decision is a favorable decision for the tax payers as it holds that a premises cannot be sealed in absence of power under the statute. Hence, the decision would even apply under the GST legislation. It is essential to understand that the power under statute is limited to seizure of documents or things relevant to investigation. It is expected that the IRA would avoid undertaking such drastic steps such as sealing of the entire business premises or units of a tax-payer in future as itis violative of fundamental and legal rights granted under the Indian Constitution.

> **"Power is limited to search for the goods liable to be confiscated or the documents secreted in any place which are relevant to any proceeding."**

[85] M/s Narayan Power Solution v. UOI & Another 2023 (7) TMI 1134 - BOMBAY HIGH COURT.

Customs Act does not contain substantive provision required to impose interest and penalties in relation to CVD, SAD and surcharge.

Introduction

The Supreme Court in the case of ***Union of India and Ors. v. Mahindra and Mahindra Ltd.***[86] upheld the decision of the Bombay Hc[87] stating that interest and penalties cannot be imposed on demand of CVD, SAD and surcharge in the absence of a specific provision in the respective tax statutes containing the charging provisions.

Facts

Mahindra & Mahindra ("**Respondent**"), are engaged in the business of vehicle manufacturing. Respondent received four show cause notices ("**SCNs**") from the IRA alleging that Respondent did not declare correct value at time of import in respect of certain products and it amounted to misdeclaration. The demand was confirmed and in order to settle the same, Respondent approached the settlement commission. The settlement commission held that the customs duty was payable along with interest at the rate of 10% p.a and penalty. Aggrieved by the same, the Respondent filed writ petitions in the Bombay HC. The Bombay HC decided in favour of the Respondent, on the grounds that imposing interest and penalty on the portion of demand relating to CVD, SAD and surcharge ("**Additional Customs Duty**") i.e. except basic customs duty, was incorrect and remanded it to the settlement commission for fresh order. However, settlement reiterated its past order. Respondent again approached the Bombay HC and quashed the demand. Subsequently, the IRA has filed the present appeal before the Supreme Court.

Issue

Whether interest and penalty can be levied in relation to amounts payable as Additional Customs Duty?

Arguments

The IRA submitted that the Additional Customs Duty charged under different provision of the CT Act and Finance Act, 2000 were duties of customs. The interest was applicable under Section 28AB of the Customs Act, (as then prevailing) which dealt with interest on delayed payment under special circumstances. As the Respondent has misdeclared the value, there was underpayment of Additional Customs Duty. Therefore, IRA was justified in imposing interest and penalty. Further, the IRA contended that under Section 127C of the Customs Act, the settlement commission had the inherent power to determine the terms of settlement covering not only the duty payable but also interest and penalty. The IRA also argued that Section 127H of the Customs Act provided the power to grant immunity from prosecution and penalty subject to conditions imposed by it. Considering, the said power was exercised, it had the right to impose interest and penalty. The procedure followed by settlement commission was not challenged, hence, the HC had incorrectly interfered with validity of order.

On the other hand, Respondent urged that under Article 226 of the Constitution of India, the HC has power to verify the legality of procedure followed and whether the order of the settlement commission is in conformity with the provisions of law or contrary to the provisions. On merits, the Respondents contended that provision dealing with levy of Additional Custom Duty did not contained provision for imposition of interest or penalty. Hence, there was no power under the provisions of law to impose such interest and penalty.

Additionally, the Respondents submitted that section 28AB of the Customs Act, which provide for interest on delayed payment of duty does not provide for applicability of interest for delayed payment of Additional Customs Duty. It also placed reliance on the case of ***M/s. Khemka and Co. (Agencies) Pvt. Ltd.***[88] which held that penalty is a statutory liability which is in addition to the tax and there must be a clear charging section to create such statutory liability.

Decision

The SC dismissed the SLP filed by the IRA as without merits and upheld the decision of the Bombay HC. The HC had correctly differentiated between a charging section which creates a tax liability and the 'machinery' around it in the form of mode of recovery, penal provisions, delayed payments, etc., to make it effective. The Bomaby HC had held that the charging section is strictly construed, whereas the machinery provisions do not need to specifically strictly construed. As per the HC, a penalty was not a continuation of assessment proceedings as it partakes the character of additional tax. Where there is no substantive provision requiring the payment of interest, IRA cannot, for the purpose of collecting and enforcing payment of

[86] Union of India and Ors. v. Mahindra and Mahindra Ltd. 2023 (8) TMI 135 - SC ORDER.
[87] Mahindra and Mahindra Ltd. v. Union of India and Ors. 2022 (10) TMI 212 - BOMBAY HIGH COURT.
[88] M/s. Khemka and Co. (Agencies) Pvt. Ltd. Vs. State of Maharashtra (1975) 2 SCC 22.

tax, charge interest thereon. In absence of borrowing provision, no interest or penalty can be imposed. It also relied upon decision in context of antidumping duty, where no interest or penalty was payable due to absence of provision. In order to remove such defects, specific amendment in CT Act were incorporated.

Additionally, it held that IRA was incorrect in relying on Section 127C of the Customs Act to impose interest as the provision itself provides that the order of the settlement commission has to be in accordance with the provisions of the Customs Act.

Significant Takeaways

The above discussed decision seems to have a tax-friendly nature as it draws an important distinction between charging section creating the liability and the machinery provisions for recovery thereof, in tax statutes. Charging sections which impose the liability of tax require a clear authority of law for imposition and have to be strictly interpreted, as opposed to the machinery provisions which are interpreted like any other statutes. By treating penalty provisions as charging sections to create the penal liability, the court has restricted the rampant and oftentimes arbitrary imposition of penalties that is undertaken by the IRA without any particular section imposing such liability. As per our opinion, the same rationale is applicable wherein IGST and compensation cess are levied under Section 3 of the CT Act. Penal provisions have not been borrowed in the current context, where Section 3 imposes an IGST and compensatory cess on products imported into India.. Therefore, it will be intriguing to see if the disputes involving IGST, the same view is taken by the courts, or whether the authorities come out with relevant clarification.

“ Interest and penalty cannot be imposed over CVD and SAD. ”

ITC cannot be availed post the expiry of last date

Introduction

The Patna HC in the case of ***Gobinda Construction***[89] has upheld the constitutional validity of section 16(4) of CGST Act, which provides restriction on availment of ITC after due date of furnishing of monthly return for the month of September following the FY in which invoice/ debit note was raised.

Facts

Multiple writ petitions challenging the constitutionality of section 16(4) of the CGST Act read with BGST Act were filed before the Patna HC. Since all the writ petitions filed involved the similar issue, the same were clubbed and Gobinda Construction was chosen as the representative case.

Gobinda Construction ("**Petitioner**") had filed it's GSTR-3B return for the month of February 2019 and March 2019 ("**Disputed Tax Period**") much after the due date, i.e. on October 23, 2019 and November 7, 2019 respectively. Subsequently the Petitioner received SCN from the IRA proposing to disallow the ITC for the Disputed Tax Period on the ground of claiming post expiry of prescribed period. The Petitioner responded to the SCN, however, IRA did not accept and confirmed the liability along with interest and penalty. Aggrieved by the order the Petitioner appealed before the Appellate Authority, who also dismissed the appeal on the same ground.

Thus, the Petition have approached the Patna HC *vide* writ petition challenging the vires of section 16(4) of the CGST Act.

Issue

Whether Section 16(4) of the CGST Act is violative of Article 14 and 300A of the Indian Constitution.

Arguments

The Petitioners submitted that refusal to permit ITC post the date contemplated was confiscatory in nature as ITC which is a financial benefit is deprived. The ITC was a protected and vested right under Article 300A which cannot be taken away on the ground of belated filing. The Petitioner further contested that the time limit prescribed in provisions is merely procedural in nature and cannot override the substantive provisions.

Additionally, the Petitioners argued that Section 16(4) of the CGST Act was violative of Article 14 of the Constitution as it creates differentiation between taxpayers. It also imposes unreasonable restriction on the fundamental right guaranteed under 19(1) (g) of the Indian Constitution to carry out free trade and profession. It also submitted that there is no rationale behind fixation of such date. It also argued that denial of ITC leads to double taxation as the recipient has to pay GST to supplier and then again as part of outward supply without any benefit of adjustment. It violated Article 265 of the Constitution which provides that tax cannot be levied without authority of law.

The Petitioners also contested that that conditions prescribed under Section 16(4) must be restricted to claims of ITC in relation of such invoices or debit notes that were received after September of following FY and it does not put restraints on claim of ITC which were claimed via a belated return.

On the other hand, the IRA contested that ITC was a concession or benefit which could only be availed as per the scheme envisaged in the CGST Act. The provision had uniform applicability and cannot be said to be arbitrary or violative. The time-period prescribed under Section 16(4) of CGST Act was a condition precedent of mandatory nature for availment of ITC.

Decision

The Patna HC dismissed the writ petition and upheld the constitutional validity of Section 16(4) of the CGST Act. The Patna HC held that on applying the fundamental rules of statutory interpretation, the language as provided under Section 16(4) of the CGST Act does not suffer from any ambiguity. There is no scope of amending, adding words or alter the provisions. It is clear that it is one of the pre-conditions required to be met by the registered taxpayer for grant of the said ITC. The HC also held that grant of ITC is not a vested right and the pre-requisite conditions have to be met, and once these conditions are fulfilled then ITC becomes a vested right.

Additionally, the Patna HC held that the presumption of constitutional validity of a legal provision exists since inception, and the burden to prove the contrary lies on the person challenging the same. Thus, the HC held that Section 16(4) of the CGST Act is not violative of Article 300A of the Indian Constitution. While referring to the case of the Apex Court ***Godrej & Boyce Mfg. Co. Pvt. Ltd.***[90]**,** the Patna HC observed that

89 Gobinda Construction v. UOI 2023(9) TMI 902
90 Godrej & Boyce Mfg. Co. Pvt. Ltd. & Ors. vs. Commissioner of Sales Tax & Ors. reported in (1992) 3 SCC 624

as ITC is in a nature of concession, it can be granted to the taxpayer under a statutory scheme.

Thus, the HC upheld the validity of Section 16(4) of the CGST on the ground that the same is not inconsistent of violative of Article 14, 19(1) (g) and Article 300A of the Indian Constitution.

Significant Takeaway

The aforementioned decision by upholding the conditional requirement of availing ITC within prescribed time-limit provides clarity that the conditions are mandatory and not mere procedural requirement. The aforementioned ruling has re-affirmed that the ITC is not a vested right but a concession which can be availed subject to fulfilment of prescribed conditions. The taxpayer cannot adopt position favourable to them without undertaking requisite compliances.

> **“ITC is in the nature of benefit/ concession extended to a dealer under the statutory scheme and the concession can be received by the beneficiary only as per the scheme of the statute.”**

CBDT issues clarifications on various provisions relating to Charitable and Religious Trusts

The CBDT has issued a few clarifications with respect to various provisions related to charitable and religious trusts following amendments made by the FA, 2023.[91] These clarifications have been summarised below:

i) The FA, 2023 amended section 115TD of the IT Act to tax the accreted income of the trusts who have not applied for registration/ approval within the prescribed time limit. This amendment was made effective from April 1, 2023. The CBDT has extended the due date to file an application in Form No. 10A or Form No. 10AB till September 30, 2023, where the due date for making such application has expired prior to such date. Earlier, trusts were subject to tax under section 115TD if the application was not made by November 25, 2022 (in case of existing trusts seeking registration/ approval) or September 30, 2022 (in case of provisionally registered/approved trusts).

ii) The due date for furnishing of statement of donation in Form No. 10BD and the certificate of donation in Form No. 10BE in respect of the donations received during the FY 2022-23 has been extended to June 30, 2023.

iii) It has been clarified that the provisional approval or provisional registration for section 10(23C), section 11 or section 80G of the IT Act, shall be effective from the FY in which the application is made and shall be valid for three subsequent AYs subject to the provisions of the aforementioned sections.

iv) FA, 2023 amended section 11 of the IT Act to provide that statement of accumulation must be furnished at least two months before the due date of furnishing the return of income under section 139(1) of the IT Act. A similar amendment was made in section 10(23C). The CBDT has not clarified that the statement of accumulation in Form No. 10 and Form No. 9A must be furnished at least two months before the due date of furnishing the return of income so that it may be taken into account while auditing the books of account. However, the accumulation/deemed application shall not be denied to a trust as long as the statement of accumulation/deemed application is furnished on or before the due date of furnishing the return as per section 139(1) of the IT Act.

v) Auditor's Report furnished in Form No. 10B and Form No. 10BB requires the auditor to bifurcate certain payments or applications in electronic modes and non-electronic modes. Notes to the said Forms provide for all other electronic modes, including Credit Card, Debit Card, Net Banking, IMPS, UPI, RTGS (Real Time Gross Settlement), NEFT (National Electronic Funds Transfer), and BHIM (Bharat Interface for Money) Aadhar Pay but does not include account payee cheque drawn on a bank or an account payee bank draft or use of electronic clearing system through a bank account. Therefore, it has been clarified that for the purposes of Form No. 10B and Form No. 10BB, electronic modes referred are in addition to the account payee cheque drawn on a bank or an account payee bank draft or use of electronic clearing system through a bank account.

[91] Circular No. 6 of 2023 [F. No.370 I 33/06/2023-TPL] dated May 24, 2023.

CBDT notifies Rules and issues guidelines on winnings from Online Games

The FA, 2023 introduced section 115BBJ to the IT Act to tax net winnings from online games at the rate of 30% from FY 2023-24. It further inserted section 194BA to the IT Act to also require tax to be withheld on winnings from online gaming. However, the manner of computing net winnings was not prescribed under the FA, 2023. Exercising its powers under the removal of difficulty clause given under section 194BA(3), the CBDT has issued guidelines to clarify the scope of the said provision.[92] Further, the CBDT also inserted Rule 133 to the IT Rules in order to provide the manner of calculating net winnings.[93] Some of the key features of these guidelines and the newly inserted Rule have been summarized below:

i) For the purpose of computing 'net winnings' the aggregate balance of all user accounts held by a taxpayer, across multiple gaming platforms shall be considered. In case, it is not feasible for a taxpayer to integrate multiple user accounts, such taxpayer may compute his TDS liability separately for each account. However, in such case, transfer from one account to another shall be considered as withdrawal or deposit for calculating net winnings.

ii) In a case where user borrows the money and deposit in his user account, it shall be considered as non-taxable deposit.

iii) Bonus, referral bonus, incentives etc. given by online game intermediary to the user are to be considered as taxable deposit which will increase the balance in user account and thus, form part of net winnings. However, in case where some incentives/bonus is credited in user account only for the purposes of playing and they cannot be withdrawn or used for any other purposes, such deposit shall be ignored for calculating net winnings.

iv) An amount will be considered to have been withdrawn when it is moved from the user account to any other account (any account of the user not registered with the online game intermediary). Similarly, when in consideration of amount in user account, some coupons etc. are issued for purchase of goods or services, or some item in kind is issued, it shall also be considered as withdrawal.

v) Certain relaxations have also been provided as per which no liability to deduct TDS arises if:

   a. Net winnings comprised in the amount withdrawn does not exceed INR 100 in a month;

   b. TDS no deducted on account of aforementioned concession is deducted at a time when the net winnings comprised in withdrawal exceeds INR 100 in the same month or subsequent month or if there is no such withdrawal, at the end of the FY; and

   c. The deductor undertakes responsibility of paying the difference if the balance in the user account at the time of TDS under section 194BA of the IT Act is not sufficient to discharge TDS liability in accordance with Rule 133 of the IT Rules.

vi) Net winnings in kind are included within the purview of section 194BA.

vii) It has also been clarified that due to time lag in issuance of Rule 133 and the guidelines, any shortfall in TDS from April 1, 2023 till such issuance may be deposited along with the TDS for the month of May 2023, i.e., by June 7, 2023.

CBDT notifies e-appeals scheme for Joint Commissioner (Appeals)

By way of Finance Act, 2023, a new designated income tax authority of Joint Commissioner (Appeals) ("**JCIT(A)**") had been introduced *vide* amendment in section 246 of the IT Act to handle a certain class of cases involving small appeal disputes.

To implement the functioning of the JCIT(A), *vide* a Notification[94], CBDT has rolled out e-Appeals Scheme, 2023 ("**Scheme**"), effective from May 29, 2023. The Scheme enlists the scope, procedure to be adopted, penalty proceedings, rectification proceedings, and other provisions to ease the implementation.

Similar to the appeal filed before the CIT(A), the same electronic faceless system has been provided wherein the cases shall be randomly allocated to the JCIT(A). Further, the scheme leverages the technology and provides the option of video conferencing to ensure fair hearing of the appeals.

The Scheme concentrates on resolving appeals related to TDS default, orders on TDS default and orders on the processing of return of income. By targeting these specific areas, the scheme aims to address key issues and reduce the pendency of appeals in these categories.

[92] Circular No. 5 of 2023 [F. No. 370142/12/2023-TPL] dated May 22, 2023.
[93] Notification no. 28/2023 dated May 22, 2023
[94] CBDT Notification No. 33/2023/F.No. 370142/10/2023-TPL, S.O. 2352(E) dated May 29, 2023.

CBDT notifies investors exempt from applicability of Section 56(2)(viib) of the IT Act

Finance Act, 2023 had extended the applicability of section 56(2)(viib) of the IT Act to non-resident investments as per which amount received by an Indian company (in which public are not substantially interested) for issuance of shares at a premium shall be taxable as 'Other Income' in the hands of the Indian company.

By issuance of Notification[95], the CBDT has notified the class of investors who shall be exempt from the applicability of provisions under Section 56(2)(viib) of the IT Act. The said list includes (i) government and government related investors such as central banks, sovereign wealth funds, international or multilateral organisations, (ii) banks/ entities involved in insurance business; and (iii) certain specified entities like specified foreign portfolio investors, endowment and pension funds, which are resident of any of 21 listed countries.

Further, by issuance of another Notification[96], the CBDT has notified that the provisions of Section 56(2)(viib) of the IT Act shall not apply, if the said consideration has been received from any person which fulfils the conditions specified in earlier notification[97] and files the requisite declaration as specified therein with the Department for Promotion of Industry and Internal Trade.

CBDT clarifies regarding taxability of income earned by a non-resident investor from off-shore investments in investment fund routed through an AIF

Finance Act, 2023 had amended the definition of 'investment fund' under the IT Act to include the reference to International Financial Services Centres Authority (Fund Management) Regulations, 2022 made under the International Financial Services Centres Authority Act, 2019. CBDT *vide* its circular no. 12/2023 dated 12.07.2023 provided clarifications regarding the change in definition of 'investment fund' under the para 3 of circular no. 14/2019 dated 03.17.2019 due to the changes effected by Finance Act, 2023.

The circular no. 14/2019 was issued to clarify the taxability of income earned by non-resident investor from offshore investment routed via investment fund, and the same was applicable to Category I or Category II AIFs regulated under SEBI regulations. In view of the amendment by Finance Act 2023, the definition of 'investment fund', para 3 of the circular no. 14/2019 will now stand changed to include reference to International Financial Services Centres Authority (Fund Management) Regulations, 2022 made under the International Financial Services Centres Authority Act, 2019.

CBDT relaxes TDS withholding obligations where the payee is a unit in India's IFSC in Gift City earning exempt income

CBDT has provided relaxation from withholding of TDS on payments made to a unit of India's IFSC in Gift City, where such income is already exempt in the hands of payee as follows:

i) CBDT *vide* Notification[98] dated July 20, 2023 provided relaxation from withholding of TDS on payment of dividend under Section 194 of IT Act, where dividend payment is made by a unit in IFSC engaged in aircraft leasing to another unit in IFSC also engaged in aircraft leasing activity.

   It may be noted that recently *vide* the FA 2023, dividend income earned by an aircraft leasing unit in IFSC from a company, also being a unit in India's IFSC engaged in aircraft leasing business, was made exempt by insertion of Section 10(34B) in IT Act. Hence, the said notification would help to avoid unnecessary blockage of funds of the payee in the form of TDS in case of such exempt income.

   In order to avail such relaxation from withholding of TDS, the payee shall need to provide a statement-cum-declaration in Form No. 1 (as given in the said notification) to the payer giving details of the relevant year in which such dividend income, that is exempt, is payable. Therefore, on receipt of such declaration the payer shall not withhold taxes from the dividend payment and shall also disclose details of such payment in its TDS return for the relevant period.

ii) Further CBDT *vide* Notification[99] dated August 1, 2023 provided relaxation from withholding of TDS on payment of rent under Section 194I of IT Act, where payment is made by a lessee to a lessor which is a unit in IFSC for lease of a ship. The exemption from withholding of TDS has been provided only for those years which form part of the 10-year period in which the lessor shall avail 100% deduction from its income under Section 80LA of IT Act.

[95] CBDT Notification No. 29/2023/F. No. 370142/9/2023-TPL (Part-I) S.O. 2274(E), dated May 24, 2023
[96] CBDT Notification No. 30/2023/F. No. 370142/9/2023-TPL (Part-I)] S.O. 2275(E), dated May 24, 2023
[97] Para 4 of the Notification No. G.S.R. 127(E), dated February 19, 2019 issued by the Ministry of Commerce and Industry in the Department for Promotion of Industry and Internal Trade and published in the Gazette of India, Extraordinary, Part-II, section 3, Sub-Section (i) on February 19, 2019
[98] Notification No. 52/2023/F.No. 275/17/2023-IT(B) dated July 20, 2023.
[99] Notification No. 57 /2023/F. No. 275/19/2023-IT(B) dated August 1, 2023.

It may be noted that as per Section 80LA of IT Act, a unit of IFSC engaged in ship leasing activity can claim 100% deduction from its income for a period of 10 consecutive AYs out of 15 AYs beginning with the year in which it obtained registration from the International Financial Services Centres Authority ("**IFSCA**").

In order to avail such relaxation from withholding of TDS, the lessor shall need to provide a statement-cum-declaration in Form No. 1 (as given in the said notification) to the lessee each year thereby giving details of the relevant 10 AYs in which it shall opt for deduction under Section 80LA of IT Act. Therefore, on receipt of such declaration the lessees shall not withhold taxes from the rent payment and shall also disclose details of such payment in its TDS return for the relevant period.

CBDT exempts relocation of funds to India's IFSC from tax implications under Section 56(2)(x) of IT Act in hands of the fund management entity

It may be noted that capital gains on relocation of offshore funds to India's IFSC in Gift City i.e. transfer of assets from the original fund i.e. a fund registered outside India to a resulting fund i.e. a fund registered in India and located in India's IFSC, was made exempt under Section 47(viiac) of IT Act. Further, transfer of shares or units held in the original fund by its shareholder or unit holder, in lieu of shares or units in the resultant fund, in the same proportion in which it was held by it earlier in the original fund, was also made exempt in the hands of the shareholder or unitholder under Section 47(viiad) of IT Act.

In addition to the above, to ensure that tax implications do not arise in hands of the fund management entity ("**FME**") on account of relocation of offshore funds to India's IFSC and to incentivise such relocation, CBDT *vide* Notification[100] dated July 18, 2023 has exempted the FME of the resultant fund from tax implications under Section 56(2)(x) of IT Act. CBDT *vide* said notification has inserted sub-rule 5 in Rule 11UAC of IT Rules. As per said rule, any shares or units or interest in the resultant fund received by the FME of the resultant fund, in lieu of shares or units or interest held by the investment manager entity in the original fund, pursuant to such relocation, shall be exempt from any tax consequences under Section 56(2)(x) of IT Act, subject to the following conditions:

i) Atleast 90% of shares or units or interest in the FME of the resultant fund are held by the same person(s) in the same proportion as held in the investment manager entity of the original fund, and

ii) Atleast 90% of the shares or units or interest in the investment manager entity of the original fund were held by the same person(s).

[100] Notification No. 51/2023/ F. No. 370142/22/2023-TPL dated July 18, 2023.

REGULATORY INDIRECT TAX UPDATES

Amendments pertaining to Online Gaming

The CBIC had implemented the following changes:

a) Amendment introduced *vide* Amendment Act, 2023 such as definition of online game, online money game, supplier, specified actionable claim, requirement of mandatory registration by supplier in non-taxable territory supplying online money game, treating actionable claim pertaining to online money game, lottery, gambling, casino, horse racing ("**specified actionable claim**") as taxable supply, w.e.f. October 01, 2023 notified *vide* Notification No. 48/2023 – Central Tax and Notification No. 02/2023 – Integrated Tax dated September 29, 2023.

b) Specified actionable claim notified under the Customs Tariff Act, 1975 *vide* Notification No. 72/2023-Customs (N.T.) dated September 29, 2023. It is further notified that *vide* Notification No. 03/2023 – Integrated Tax dated September 29, 2023 that import of online money game is not to be governed by Customs Act.

c) Valuation of the following supplies shall be governed by special valuation rule prescribed in this regard :

   i. supply of online money gaming;

   ii. supply of online gaming, other than online money gaming; and

   iii. supply of actionable claims in casinos as per Notification No 49/2023 – Central Tax dated September 29, 2023

d) The value of online game would be the total amount paid or payable to or deposited with the supplier by way of money or money's worth, including virtual digital assets, by or on behalf of the player. However, any amount returned or refunded by the supplier to the player is not allowed to be deductible from the value of supply of online money gaming notified *vide* Notification No. 51/2023 – Central Tax dated September, 2023.

e) GST shall be payable for advance received for supply of specified actionable claim.

f) GST registration in case of in case of supply of online money gaming provided by a person located in non-taxable territory may be obtained from Principal Commissioner of Central Tax Bengaluru west as per Notification No. 4/2023- Integrated Tax dated September 29, 2023.

Clarifications issued post GST Council meeting

a) Taxation of services offered by one office of a company to another office: The CBIC *vide* Circular No. 199/11/2023-GST dated July 17, 2023 clarified the following issues, in a scenario wherein the head office ("**HO**") is located in one sates and the branch offices ("**BO**") are located in other states and the BO provides internally generated services and procured services to the BO.

   i. Wherein the HO buys common input services from a third party that are relevant to both the HO and BOs, or exclusively to certain BOs, the HO has a choice to (i) either use the ISD mechanism for ITC distribution, or (ii) issue tax invoices directly to the BOs. There is no mandatory requirement to use the ISD mechanism. The distribution of ITC should only be done for input services directly connected to the respective BOs, and services must have genuinely been provided to those Bos.

   ii. Where the recipient is eligible for full ITC, the value stated on the invoice is considered as the open market value. Similar principal applies in case of internally generated services provided from the HO to BO, on the condition that the BO is eligible for claim of full ITC. If the HO doesn't issue an invoice for certain services, and full

ITC is available to the BO, the value may be considered Nil, and this is deemed the open market value.

iii. In the case of internally generated services provided by the HO to BOs, it's not obligatory to include the cost of salaries of HO employees involved in providing these services when calculating the taxable value of the supply including in cases wherein full ITC is not available to the respective BOs.

b) Services provided by a director of a company: The CBIC *vide* Circular No. 201/13/2023-GST dated August 1, 2023 clarified that services provided by a director of a company in their personal capacity, such as renting out immovable property, are not subject to GST payable by the company under RCM.

c) Holding of shares by holding company: The CBIC *vide* Circular No. 196/08/2023-GST dated July 17, 2023, clarified that the activity of holding of shares of subsidiary company by the holding company per se cannot be treated as a supply of services by a holding company to the said subsidiary company. Therefore, GST is not applicable.

Interest under Section 50(3) in case of wrong availment of IGST

The CBIC *vide* Circular No. 192/04/2023-GST dated July 17,2023 has clarified that in case where a registered person incorrectly claims IGST credit and subsequently reverses it, interest would be calculated on the amount that shortfalls after the total balance of ITC in the electronic credit ledger under the heads of IGST, CGST, and SGST combined. Compensation Cess cannot be considered to determine interest payable in case of wrongly availed and utilized ITC pertaining to IGST, CGST or SGST.

Procedure for E-commerce operator to collect TCS

CBIC *vide* Notification No. 37/2023- Central Tax dated August 4, 2023 notified the procedure for electronic commerce operators ("**ECO**") who are required to collect tax at source ("**TCS**"), especially in situations where the supply of goods is made through an ECO by individuals or entities exempted from registration. The notified procedure is as follows:

1. The ECO must only allow the supply of goods by the exempted person if an enrolment number has been allotted to that person on the common portal.
2. The ECO is not permitted to facilitate inter-State supply of goods by the exempted person.
3. The ECO is not required to collect TCS for the supply of goods made by the exempted person through their platform.
4. The ECO must electronically furnish the details of supplies of goods made by the exempted person in the GSTR-8 statement on the common portal.

Additionally, it also notified that in cases where multiple ECOs are involved in a single supply of goods through an electronic commerce platform, the ECO who ultimately releases payment to the exempted person for the supply made through their platform would be responsible.

Procedure to be followed when effect of provisional attachment of property ceases.

Section 83 of the CGST Act read with Rule 159 of the CGST Rules provides that effect of provisional attachment expires after one year of the attachment order. CBIC *vide* Instruction No. GST/INV/Provisional Attachment/Advisory/2023-24 dated September 2, 2023 issued advisory providing procedure to be followed in case of cease of effect of provisional attachment of property, including bank accounts. The Commissioner is required to send a communication or intimation to the relevant authority or bank, indicating the release or restoration of the pertinent property or account, in accordance with these provisions. A copy of this intimation will also be provided to the concerned taxpayer.

Exemption to the deposits made under Electronic Cash Ledger under the Customs Act

The CBIC *vide* Notification No. 18/2023- Customs dated March 30, 2023 has provided that there would not be requirement to deposit tax, interest and penalty for period April 1, 2023 till November 30, 2023 through electronic cash ledger in following circumstances:

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

b) goods imported or exported in International Courier Terminals.

c) Accompanied baggage;

d) Other than payment apart from customs duty, GST, cess or amount payable under Customs Act.

Further, except for (b) above, all other would continue to be exempted per Notification No. 70/2023-Customs (N.T.) dated September 09, 2023 w.e.f. December 01, 2023.

Extension of RoDTEP scheme for exports

DGFT *vide* Notification No. 33/2023 dated September 26, 2023, RoDTEP scheme is extended for exports made from October 01, 2023 till June 30, 2024.

The existing rates for all the items would remain same. However, it would be subject to the budgetary framework as provided for current FY.

GLOSSARY

ABBREVIATION	MEANING
AAR	Hon'ble Authority for Advance Rulings
AAAR	Hon'ble Appellate Authority for Advance Rulings
AO	Learned Assessing Officer
AY	Assessment Year
Customs Act	Customs Act, 1962
CBDT	Central Board of Direct Taxes
CENVAT	Central Value Added Tax
CESTAT	Hon'ble Customs, Excise and Services Tax Appellate Tribunal
CGST	Central Goods and Services Tax
CGST Act	Central Goods and Services Tax Act, 2017
CGST Rules	Central Goods and Services Tax Rules, 2017
CIT	Learned Commissioner of Income Tax
CIT(A)	Learned Commissioner of Income Tax (Appeals)
CVD	Countervailing Duty
DGFT	Directorate General of Foreign Trade
DRP	Dispute Resolution Panel
DTAA	Double Taxation Avoidance Agreement
ECB	External Commercial Borrowing
EPCG	Export Promotion Capital Goods
FA	Finance Act
FMV	Fair Market Value
FTP	Foreign Trade Policy
FY	Financial Year
GST	Goods and Services Tax
HC	Hon'ble High Court
HUF	Hindu Undivided Family
IBC	Insolvency and Bankruptcy Code, 2016
IFSC	International Financial Services Centre
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
NCLT	National Company Law Tribunal
NCLAT	National Company Law Appellate Tribunal
OECD	Organisation for Economic Co-operation and Development
PAN	Permanent Account Number
PCIT	Learned Principal Commissioner of Income Tax
PE	Permanent Establishment
Pvt.	Private
RBI	Reserve Bank of India
SAD	Special Additional Duty
SC	Hon'ble Supreme Court
SCN	Show-cause Notice
SEBI	Securities and Exchange Board of India
SEZ	Special Economic Zone
SGST	State Goods and Services Tax
SGST Act	State Goods and Services Tax Act, 2017
SLP	Special Leave Petition
TDS	Tax Deducted at Source
USA	United States of America
UTGST	Union Territory Goods and Services Tax
UTGST Act	Union Territory Goods and Services Tax Act, 2017
VAT	Value Added Tax
VAT Tribunal	Hon'ble VAT Tribunal

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