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tax scout

Tax Scout | October – December, 2023

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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 December 31, 2023.

In our main story, we have dealt with the controversy involving applicability of the Most Favoured Nation clause in light of the recent judgment in ***Nestle SA*** by the Supreme Court.

In addition to the above story, we have also dealt with other important developments and judicial precedents in the field of taxation for this quarter.

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

Regards,
CYRIL SHROFF

Managing Partner
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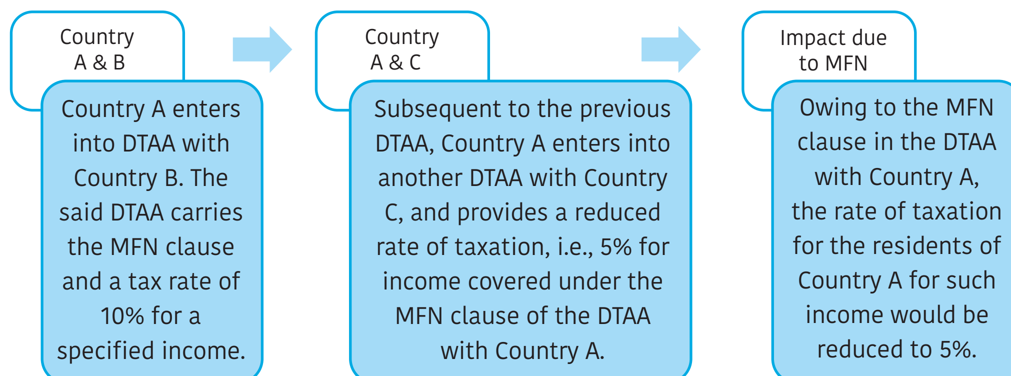
The Controversy Around the Most Favoured Nation

Introduction

The Hon'ble Supreme Court, recently, in the case of ***Nestle SA***[1] held that in any scenario there could not be automatic application of beneficial scope or rate by virtue of Most Favoured Nation ("**MFN**") clause, unless the Central Government issues a specific notification in the same regard. The MFN clause in a DTAA requires parties to ensure equally favourable treatment among investors from different countries. The MFN clause establishes an agreement among DTAA parties to confer mutual benefits. These could be in the form of lower tax rates or more limited scopes of taxation of a specific type of revenue, which are equivalent to those granted to a third party under a different DTAA. This is to ensure that residents of a state are not at a comparative competitive disadvantage. The MFN clause may be included in the DTAA, post-negotiation, in the manner agreed on between the parties. The following illustration explains the application of the MFN clause:[2]

MFN provisions in DTAAs typically emerge from bilateral negotiations; hence, their application may vary across the DTAAs. The manner of implementation for MFN can vary significantly; for example, the language might explicitly provide for triggering of the same automatically, via the publication of a notification, or through bilateral consultations and negotiations. However, in certain cases, ambiguity in the wordings of an MFN clause about the application could lead to differences of opinion between the parties regarding the applicability of such an MFN clause.

Similar issues emanating from the interpretation of the MFN clause in India's DTAAs have been a cause of constant litigation in India. The Indian Revenue Authorities ("**IRA**") has been at variance with taxpayers, various benches of the ITAT and the HCs because of conflicting decisions. Recently, in the ***Nestle SA (supra)*** case, the SC finally quelled a long controversy by holding that only post the issuance of a specific notification, a beneficial scope can be made applicable by virtue of MFN.



[1] AO v. Nestle SA [2023] INSC 928 (SC).

[2] Please note that the illustration shared herein is a simplified version of a typical MFN clause given for explanatory purposes. The actual scope and application of the MFN clause will have to be determined on a case-to-case basis depending on, *inter alia*, the terms of the clause, the nature of incomes covered, etc.

Genesis Of The Issue

DTAA with European Countries:
India enters into separate DTAAs containing MFN with the Netherlands, France, and Switzerland ("MFN Countries"), providing for same treatment as other OECD countries with respect to certain income, including dividends.

DTAA with Slovenia & Ors
Subsequently, India enters into DTAAs with Slovenia, Lithuania, and Colombia (at the time they were not OECD members) carrying a reduced tax rate of 5% in case of dividends (as opposed to 10% given under the DTAAs with the MFN countries).

OECD Membership
Post signing the DTAA, Slovenia, Lithuania, and Colombia join the OECD.

Issuance of Decree(s)
The MFN countries issued unilateral decrees claiming that the reduced tax rate of 5% would be applicable to their residents by operation of the MFN clause under their DTAAs with India.

Delhi HC agrees with the interpretation adopted by the MFN Countries, while the revenue issues a circular contrary to the ruling.

The MFN clauses in India's DTAA with the MFN Countries are worded similarly. The MFN clause as imbibed in these DTAA(s) (India–Netherlands, for example) reads as follows:

- *If after the signature of this Convention under any Convention or Agreement between India and a third State which is a member of the OECD India should limit its taxation at source . . . to a rate lower or a scope more restricted than the rate or scope provided for in this Convention . . . then, as from the date on which the relevant India Convention or Agreement enters into force the same rate or scope as provided for in that Convention or Agreement on the said items of income shall also apply under this Convention.*

After entering DTAAs with the MFN Countries, India entered into DTAAs with Slovenia, Colombia, and Lithuania. The DTAAs with these countries had a beneficial tax rate for taxation of dividends of 5% versus the 10% with the Netherlands, Switzerland, and France. This prompted the taxpayers from the MFN Countries to invoke the MFN clause contained in the DTAAs to avail the beneficial rate of taxation for the dividends received from Indian companies.

The invocation of the MFN clause requires the fulfilment of two conditions: (1) Subsequent to the DTAA entered between the MFN countries, India should enter into another DTAA with a third country that is an OECD member; (2) Such a DTAA with the third country should provide for a more beneficial taxation rate or a more restrictive scope compared to that provided to MFN Countries. However, the peculiarity with the current debate is when Lithuania, Slovenia, and Colombia entered into DTAAs with India, they were not OECD members but became so later on. The wordings of the clause under the DTAAs with the MFN Countries do not explicitly cover the scenario of a country joining OECD post the effective date of the DTAA. Nonetheless, the MFN Countries, without any negotiations or discussions with their Indian counterparts, unilaterally issued a decree declaring that the beneficial rate of 5% should stand imported by virtue of the MFN clause.[3]

It has been more than a decade since such decree was issued; however, this became relevant because India reintroduced the taxation of dividend from April 1, 2020 and abolished the dividend distribution tax (DDT). The DDT was not considered a withholding tax for DTAA purposes. This prompted several non-residents to claim the lower rate of tax available. In many cases, the claims made by these non-residents went in their favour.[4]

Subsequently, however, the Indian tax authorities issued a circular[5] dismissing the unilateral stance taken by the MFN Countries and the claims raised by non-residents owing to the same ("**Circular**"). The Circular laid down multiple clarifications, such as the following:

1. Any unilateral decrees by partner countries will not impact the tax liability in India.
2. If the third country was not a member of the OECD at the time of signing of its DTAA with India, the MFN clause under the DTAA with the MFN Countries will not come into play.
3. In India, a domestic requirement as per the Section 90(1) of the IT Act suggests that DTAA or any amendment be implemented only after its notification in the official gazette.[6] Thus, the MFN clause only becomes operational

[3] Decree No IFZ 2012/54M dated February 28, 2012; French Official Bulletin of Public Finances-Taxes by DGFIP dated November 4, 2016; and Publication by Federal Department of Finance, Swiss Confederation dated 13 August 2021.
[4] Apollo Tyres Ltd v. CIT [2018] 167 DTR 51 (Kar HC).
[5] Circular No. 3/2022 dates February 3, 2022.
[6] The circular also took selective cues from the case of Union of India v. Azadi Bachao Andolan [2004] 10 SCC 1 (SC) by referring to the part of the judgment wherein it was held that provisions of a DTAA come into picture on the date of issuance of a notification.

after the issuance of such a notification specifically importing the benefits of a subsequent DTAA into a prior DTAA.

4. Selective import of concessional rates under the MFN is not permissible in cases where the treaties contained split rate of tax for dividends.

The Circular attempted to instil clarity to the issue of importation of the benefit of the lower rate or restricted scope of source taxation rights by virtue of MFN; however, it failed at putting an end to the issue and rather ended up creating a regime marked by farrago. Interestingly, circulars issued by the IRA are binding but only on the authorities under the respective statutes not on the taxpayers.[7] In a few cases post the issuance of the Circular, its binding value over taxpayers was declined.[8] Thus, the Circular created a regime with chaos and inconsistency, while rekindling the debate around the issue of MFN.

Appeals Before The SC

Against this backdrop, marked by inconsistencies and lack of clarity, the IRA filed a batch of appeals against decisions of the Delhi HC where, *inter alia*, a lower rate of dividend taxation was allowed to certain residents of the MFN Countries by the invocation of the MFN clause. The batch of appeals also included a few earlier rulings of the Delhi HC that successfully invoked the MFN clause, even in the absence of a specific notification importing the benefits of a subsequent DTAA into a prior DTAA.

The main challenges in the appeal pertained to the rulings of Delhi HC in the cases of ***Steria,***[9] ***Concentrix Services BV,***[10] and other rulings having similar facts.

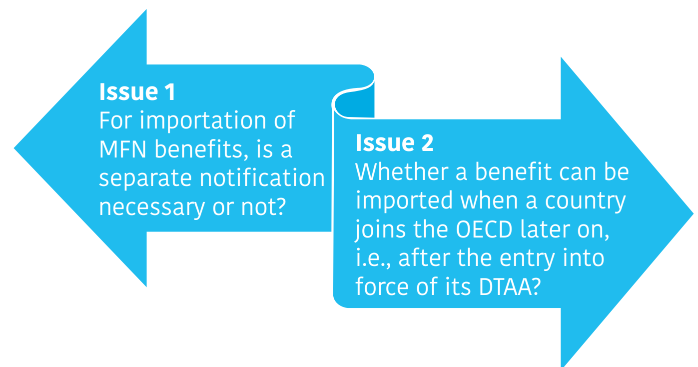
Issue in Steria

In the case of ***Steria (supra)***, it was, *inter alia*, contended that with regard to the MFN clause in the India–France DTAA, the more restrictive definition of the expression "fees for technical services" that appears in the India–UK DTAA must be read as forming part of the India–France DTAA as well. The HC agreed with the taxpayer and held that the MFN clause (being part of the Protocol to the DTAA) had been already notified as part of the DTAA and that no separate notification was required for its application in the future.

Issue in Concentrix

In the case pertaining to ***Concentrix Services BV***, the assessees argued that the IRA was bound to extend the lower rate of withholding tax for dividends available under India's DTAAs with other OECD countries such as Slovenia, Lithuania, and Colombia to the India–Netherlands DTAA. The Delhi HC agreed with this contention, granting their request for a lower withholding tax rate owing to the concerned DTAA read with the MFN clause. The Delhi HC followed this ruling in ***Nestle SA case***[11] as well, similarly granting the benefit of the MFN clause under the India–Switzerland DTAA.

Thus, the SC considered the following primary issues:



Arguments of the IRA

The IRA's argument while appearing before the SC was that the Indian Constitution, especially by operation of Article 253 (read with Entries 13, 14, and 15 of List I of the Seventh Schedule), provides exclusive power to the Parliament for legislating in respect of any treaty or convention entered into by the Indian executive with any other nation. It was possible to enter such a treaty only in exercise of the executive power of the Union. Without Parliamentary legislation, such treaties were unenforceable with regard to the express terms of Article 253. The article gives the Parliament alone the power to make laws "notwithstanding" other provisions in that chapter, which delineate and distribute legislative power between the State and Union. India follows the "dualist" practice, meaning that international treaties and conventions are not, upon their ratification, automatically assimilated into municipal law (i.e., the national legal system). Instead, the same requires enabling

[7] Commissioner of Central Excise v. Ratan Melting & Wire Industries [2008] TIOL 194 SC CX CB (SC); Hindustan Aeronautics Ltd v. CIT AIR 2000 SC 2178 (SC).
[8] GRI Renewable Industries v. ACIT Circle-1, Pune, ITA No.202/PUN/2021, ¶12.
[9] Steria (India) Ltd v. CIT [2016] 72 taxmann.com 1 (Del HC)
[10] Concentrix Services Netherlands B.V. v. Income Tax Officer (TDS), Delhi High Court. W.P(c)9051/2020.
[11] AO v. Nestle SA [2023] INSC 928 (SC).

legislation. This is in contrast to those "monist" countries, wherein the treaty provisions are enforceable like municipal law and assigned equal weight by courts. Thus, any such treaty stands unenforceable unless the Parliament legislates upon the same. In this regard, reliance was also placed on the case of ***Azadi Bachao***.[12] As per the IRA, in the absence of any notification the structure of Section 90 of the IT Act does not give rise to any right under the laws of taxation. Furthermore, the IRA highlighted the treaty practice between India and each of the said countries where the issuance of notification conferred benefits. Mere occurrence of the triggering event did not culminate in the granting of any benefit or advantage. Lastly, regarding the manner of interpreting a treaty, the IRA highlighted the Vienna Convention on Law of Treaties, 1961 ("**VCLT**"). It argued that the Article 31 of VCLT provides for the adoption of ordinary meaning of words to be given effect to unless the context requires otherwise.

Arguments by the Assessees

Parallelly, the assessees raised the contentions that when the DTAAs and the Protocols containing the MFN clause were already notified as per Section 90 of the IT Act, it was not mandatory to notify the DTAA about amendment. They argued that such an amendment to the DTAA becomes operative automatically because of the trigger of the MFN clause to the DTAA. The assessees also contended that the unilateral notification issued in the past could not override the clear language of an MFN clause that provides for automatic application. They further raised the point that the phrase "X is a member of the OECD," implies that the third country should be a member of OECD either at the time of signing the subject DTAA or when the assessee claims for lowering the withholding tax.

Decision Of The SC

Issue 1 – Notification Requirement

The SC held that under Section 90(1) of the IT Act, it is mandatory to issue a separate notification for giving effect to any DTAA or its protocol, which effectively changes the existing provisions of the law. In this regard, the court delineated the scheme pertaining to entering into a DTAA. It expounded that only the Union has the exclusive executive power to enter into international conventions and treaties; however, the power to legislate upon such treaties and conventions lies exclusively with the Parliament. Therefore, unless the Parliament provides backing, even a validly negotiated treaty duly ratified by the Union does not *ipso facto* becomes enforceable. No legislation is

required only in situations when no citizens' rights are impacted or the law stands as it is. In the context of the IT Act, this happens through the issuance of the notification as under Section 90(1) of the IT Act.

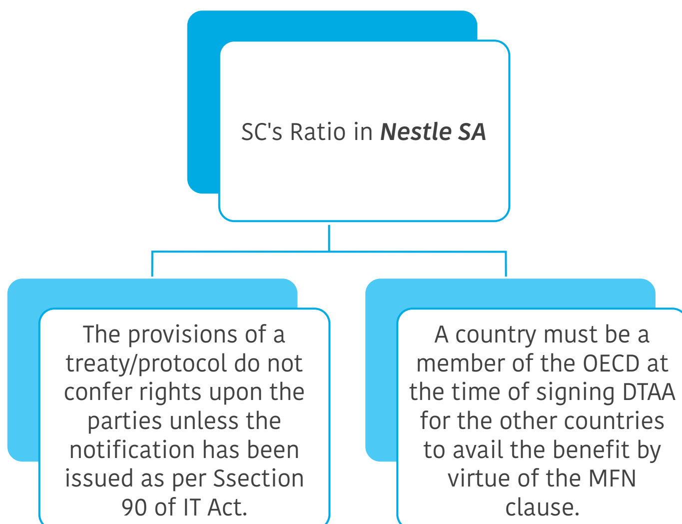
Furthermore, the SC highlighted the consistent practice on India's part. It remarked that the earlier dates of the DTAAs with countries such as Sweden and Germany did not result in India automatically extending benefits of Article IV of the India–Netherlands DTAA Protocol to the Netherlands. Similarly, when the benefits from the India–United States of America DTAA and the India–Germany DTAA were to be imported into the India–France DTAA, it was using a notification under Section 90. The SC also highlighted the fact that despite the emphatic and unambiguous phrase for automatic application in the India–Canada DTAA, a separate notification was issued then too. Dealing with the issue in ***Steria (supra)***, the SC opined that with a third country, a different trajectory of negotiations might have led to different types of benefits to the third country. The omission in the subsequent notification of certain benefits conferred to other members was an indication of India's intention to avoid granting the benefits available to certain countries to all the nations.

The Apex Court further debased the Delhi HC's ruling in the ***Concentrix Services BV (supra)*** by observing that the unilateral decrees and orders passed by other countries' governments cannot be relied upon to interpret DTAAs. The rationale behind this that the manner of assimilation of the DTAA varies from country to country. In India, the practice has been to provide MFNs benefit only post issuance of a separate notification.

[12] Union of India v. Azadi Bachao Andolan [2004] 10 SCC 1 (SC).

Issue 2—Time of membership to the OECD

On the issue of whether it was mandatory for the third country to be a member of the OECD at the time of its DTAA coming into force, the SC ruled that the word "is" was fact-dependant and carried a present signification. It further said that "is" derived its meaning from the context. As per the SC, in accordance with the language of the MFN clause contained in the subject DTAA, for any country to claim benefits by virtue of the MFN clause contained in the subject DTAA, the country from whose DTAA the said benefit was to be imported must have been a member of OECD when it entered into a DTAA with India.



Analysis

In the context of interpretation of DTAAs, the SC in ***Azadi Bachao (supra)***, while noting that the rules of treaty interpretation were not the same as rules adopted in interpreting statutory legislation, quoted with approval leading academic texts that observed *"the drafting of treaties is notoriously sloppy"* and that *"to get agreement, political uncertainty is called for."* During treaty interpretation, the VCLT is crucial. Although India is not a signatory to the VCLT, the SC has often cited it as reflecting customary international law, relevant in interpreting India's treaties. Article 31 of the VCLT advocates interpretation of treaties in good faith, considering their text, context, and purpose. Such a textual approach accords primacy to the intention of the contracting parties, which presumably appear from the ordinary meaning of the terms they use in the treaty. However, as in the present case, any ascertainment of a party's intention based on the plain meaning of the treaty's text leaves room for differing views from the contracting states' perspective. It is arguable that the MFN Countries' goal in negotiating the MFN clauses with India was to ensure equal treatment with other OECD countries, regardless of the group's composition—whether affluent or developing economies. For instance, the OECD included countries like Mexico, a less developed economy, during some MFN negotiations. Conversely, such an interpretation could lead to unforeseen consequences for India. For example, India might not have foreseen countries such as Slovenia, Lithuania, and Colombia joining the OECD when it negotiated its DTAAs with them. India's objective in agreeing to favourable tax rates under DTAAs is often to foster investment and trade. In keeping with that goal, India might have had specific intentions for countries such Slovenia, Lithuania, and Colombia. Some opinions suggest that if India were to extend this logic to the DTAAs with the MFN Countries, it could potentially undermine the country's control over its tax rights under international tax law. Both perspectives have validity, but the SC disregarded them during its decision.

The judgment also raises concerns about the unilateral modification of DTAAs by India. DTAAs are mutual-compromise agreements between two sovereign jurisdictions to facilitate cross-border trade and provide tax certainty. The SC's decision that empowered the Indian executive to modify these treaties unilaterally contradicted the principle of good faith embodied in Article 26 of the VCLT. This approach not only disrupts the balance of the DTAAs but also potentially undermines investor confidence in India by reducing tax certainty and the reliability of treaty benefits.

In its judgment, the SC placed significant emphasis on India's long practice of issuing specific notifications to activate MFN clauses after a triggering event, as seen in the India–France and India–Canada DTAAs. The SC inferred from these practices, under the guidance of the VCLT, that such practices could influence the interpretation of treaty obligations. However, the VCLT recognizes only those practices that reflect a mutual agreement among treaty parties as meaningful for interpretation. A unilateral action by one state, like India's issuance of notifications, if read in light of Articles 26 and 31 of the VCLT, which talk about good faith, does not constitute a binding element for treaty interpretation, as it does not represent a consensus between the contracting states. Furthermore, Article 31(3) envisages a treaty practice by both the States, not a unilateral practice. The SC's reliance on India's one-sided practice is surprising, especially since it contradicted the unilateral decrees from the partner nations.

In ***Azadi Bachao (supra)***, the SC acknowledged that without Section 90 converting a DTAA into law, the same would be a slow and complicated process. Hence, Section 90 was enacted as an expedited method for integrating the DTAAs into Indian law, in line with Article 253 of the Indian Constitution. The Court held

that the executive had the power to issue notifications under Section 90 of the IT Act for implementation of DTAAs. This automatically ended up overriding the provisions of the IT Act in matters of ascertainment of chargeability to tax and scope of total income, to the extent the same are more beneficial to the corresponding provisions contained in the IT Act. Therefore, there exists an unequivocal statutory requirement to issue a notification under Section 90(1) of the IT Act to enforce a DTAA. However, this statutory requirement does not encompass issuance of a mandatory notification to bring into effect specific provisions of a pre-notified protocol to a DTAA. For the sake of completeness, a protocol is integral to a DTAA. It is unnecessary to issue a notification to give effect to an MFN clause contained in a pre-notified protocol to a DTAA. It is unclear whether any Court can read this condition into the DTAA(s) in the event the "Entry into Force" clause in such DTAA does not envisage it.

Impact Of The Decision

The SC decision will certainly act as a precedent to subsequent issues being raised in various HCs and ITATs. In fact, at present, the Delhi HC has conceded to the SC's decision in the ***Nestle SA (supra)*** in some cases by closing the writ petition concerning the lower rate of tax owing to the MFN, stating that it was already covered.[13] Similarly, the Mumbai ITAT[14] rejected a plea related to the refund of dividend distribution tax in accordance with the ***Nestle SA (supra)*** SC ruling.

Further, this ruling, by validating the stand of IRA during audits will put it in a position where it can press for enhanced tax demands in cases where the MFN was being used for lower withholding rates. This could result in the issuance of a spree of notices under Section 201 of the IT Act to income tax payers who relied on earlier rulings and withheld tax on lower rates/nil rate. This would affect every non-resident who so far has taken advantage of any MFN clause contained in any Indian DTAAs, the impact of which the Government of India has not notified, except when a non-resident taxpayer's assessment is time-barred. Thus, this would most likely impact those withholding taxes. Moreover, it is uncertain that the consequences would be limited to retroactive claims of tax. A penalty in such a scenario might not be sustainable as the issues mark substantial question of law that require the SC's adjudication, but levying of interest, if done, on the retroactive tax claims might ultimately pose a challenge to the cash flow of a business.

Furthermore, litigation has also started brewing around invocation of multilateral instrument by relying on the ***Nestle SA (supra)***. In a writ petition filed before Delhi HC, a Swiss company argued against such an invocation stating that they were not notified under Section 90(1) of the IT Act,[15] despite review petitions already having been filed with the SC for the ***Nestle SA (supra)*** case.[16] Additionally, it begs the question whether in the current scenario such a treatment would be tantamount to a unilateral denial of a benefit for a bilaterally agreed matter. It would also be relevant to see how the treaty partner country would seek to apply the MFN clause from here onwards.

[13] Et Industrielles Spafi v. ACIT TS-725-HC-2023 (DEL).
[14] DCIT v. Total Energies Marketing India Pvt. Ltd. TS-725-HC-2023(DEL).
[15] *Consequences of MLI not separately notified, argues Swiss Co. by invoking MFN Judgment before Delhi HC*, TAXSUTRA (Dec. 6, 2023) https://www.taxsutra.com/news/consequences-mli-not-separately-notified-argues-swiss-co-invoking-mfn-judgment-delhi-hc
[16] *MFN Review Petitions - 5 Key Grounds Advanced by Petitioners*, TAXSUTRA (Nov. 23, 2023) https://www.taxsutra.com/news/mfn-review-petitions-5-key-grounds-advanced-petitioners.

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Assessment order is framed qua an "assessee," revision proceedings under Section 263 not valid when an assessee is non-existent

Introduction

In the ***Cairnhill CIPEF Ltd.,***[17] the Delhi HC held that under Section 163 of the IT Act a person could not be considered an agent when the principal assessee no longer exists. As a natural corollary, it also held that a revisionary order could not be passed under Section 263 of the IT Act when the assessee company, i.e., Monet Ltd. was non-existent.

Facts

Cairnhill CIPEF Ltd. ("**Assessee**") entered into a share purchase agreement dated March 31, 2015, with Cairnhill CGPE Ltd. to jointly purchase the shares of Mankind Pharmaceutical Ltd. ("**Mankind**"), a public limited Indian company, from Monet Ltd., during FY 2015–16.. Monet Ltd. sold 21,57,534 shares of Mankind at INR 5,590.76 per share, to Cairnhill CIPEF Ltd. and Cairnhill CGPE Ltd.

Monet Ltd., a 100% subsidiary of a Mauritius-incorporated Chryscapital IV LLC, was a non-resident under the IT Act. On account of the sale of such shares, Monet Ltd. earned long-term capital gains ("**LTCG**") to the tune of INR 10,02,92,15,510, which were claimed as exempt for AY 2016–17 in its ROI under Article 13(4) of the India–Mauritius DTAA. This case, selected for scrutiny under CASS, was issued an income tax notice dated July 18, 2017, under Section 143(2) of the IT Act. Thereafter, the AO accepted the returned income by an assessment order passed on December 12, 2018.

The CIT *vide* an order dated March 27, 2021, however, treated the Assessee as an agent of Monet Ltd. under Section 163 of the IT Act. The CIT then passed an order dated March 31, 2021, under Section 263 of the IT Act ("**Revision Order**") and revised the assessment order dated December 12, 2018, treating the Assessee as an agent of Monet Ltd. and denying the benefit of India–Mauritius DTAA on the LTCG arising on the sale of shares.

The Assessee preferred an appeal before the ITAT against such a Revision Order. The ITAT held that the Revision Order was passed against the Assessee and Cairnhill CGPE Ltd. on March 31, 2021, much after Monet Ltd. had ceased to exist on December 19, 2018. The ITAT also held that the CIT did not have powers to pass an order under Section 163 of the IT Act by drawing reference to Section 246A as it observed that as per Section 246A(1)(d), an order under Section 163, treating a person as an agent, was appealable before the CIT(A). Whereas, in this instance, the CIT had treated the Assessee as an agent under Section 163 of the IT Act, even though an appeal against the order cannot be filed with the CIT(A) for being an officer of equal rank or jurisdiction. The ITAT held an officer below the rank of CIT should have passed an order under Section 163 of the IT Act.

Issue

Can revision proceedings be carried out against an assessee under Section 263 of the IT Act and could a person be held as an "agent" of such an assessee under Section 163 of the IT Act when the assessee was not in existence?

[17] Commissioner of Income Tax (International Taxation) – 2 Vs. Cairnhill CIPEF Ltd.[ITA No. 610/2023](DHC), [TS-736-HC-2023(DEL)].

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Arguments

The IRA argued the following

- A CIT has concurrent powers with those vested in the AO and could exercise powers under Section 163 of the IT Act to treat a person as an agent of an assessee.
- The assessee was liable only to the extent of the benefit that it received because of the shares acquired from Monet Ltd.
- The provisions of Section 263 of the IT Act bring into its ambit an assessment order passed by the AO and, therefore, enabling the CIT to exercise its powers *qua* an "assessment order," irrespective of the existence of the assessee concerned.

Whereas, the case of the Assessee before the ITAT and HC was that the CIT did not have powers to pass an order under Section 163 of the IT Act. Further, it was the Assessee's argument that no proceedings could be initiated against an agent by resorting to Section 163 of the IT Act when the principal had already been assessed to tax by the AO. It was also not possible to have an agent under Section 163 of the IT Act where the principal was no longer in existence.

Decision

The Delhi HC observed that Monet Ltd. ceased to exist on December 19, 2018, whereas the CIT had passed the Revision Order subsequently on March 31, 2021. The Court rejected the IRA's argument that revisionary powers under Section 263 of the IT Act were directed towards an "assessment order" and not the assessee and pointed out that an assessment order was framed *qua* "an assessee."

The Delhi HC held that before exercising powers under Section 263 of IT Act, it was mandatory to issue a notice to the concerned assessee and in its absence, to its agent by exercising powers under Section 163 of IT Act. The IRA's case here was not that Monet Ltd. was unavailable, rather it was in its knowledge that Monet Ltd. had ceased to exist. Therefore, the CIT could not have passed the Revision Order when Monet Ltd. had ceased to exist.

The Delhi HC rejected the IRA's argument that the Assessee would be liable to the extent of the benefit that it received because of the shares acquired from Monet Ltd. by stating that this rationale would apply only after it was clear that a person could be treated as an agent of a principal and that the principal was in existence, under the provisions of Section 163 of IT Act. This was not the case here.

The Delhi HC observed that in the usual and normal course, the expression "agent" suggests the existence of a principal, on whose behalf the agent acts. The Court thereby rejected the IRA's argument that Section 163 of the IT Act should apply irrespective of the principal's existence.

Significant Takeaways

Section 263(1) of the IT Act envisages that the IRA give the assessee an opportunity to be heard prior to the revision of an assessment order, thereby proposing enhancement of the assessed income. In the event an assessee no longer existed, such an opportunity could not be provided. The company, i.e., Monet Ltd. in the instant case had ceased to exist at the time the CIT carried out the revision proceedings as per Section 263 of the IT Act. In case of amalgamating companies that cease to exist because of their amalgamation, the Hon'ble Courts have held repeatedly that the amalgamating companies could not be regarded as a person under Section 2(31) of IT Act, as they have ceased to exist. Therefore, the issuance of notice to such a non-existing company was a substantive illegality, as held by the SC in the case of ***Maruti Suzuki Ltd.***[18]

In the case of ***Mahagun Realtors Pvt. Ltd.,***[19] the SC held that an assessment order passed in name of amalgamating company post-amalgamation (i.e., after it ceases to exist) should not be rejected due to the peculiar conduct of such a company as it had consistently held itself out as the assessee before the tax authorities through its various acts.

Even in the instant case, the Delhi HC drew up a distinction based on facts and observed *"In this particular case, the record shows that it is not the appellant's/revenue's assertion that Monet Ltd. was available."* Rather, the tax authorities were aware that Monet Ltd. was no longer in existence. Therefore, the conduct and knowledge of the respective assessee and tax authorities would be an important factor for consideration in similar cases.

> **"An agent cannot be subjected to a revisionary assessment in the absence of the Principal."**

[18] Principal Commissioner of Income Tax Vs. Maruti Suzuki Ltd. [2019] 107 taxmann.com 375 (SC).
[19] Principal Commissioner of Income-tax v. Mahagun Realtors (P.) Ltd. [2022] 137 taxmann.com 91 (SC).

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Retrospective application of Explanations 6 and 7 to Section 9(1)(I) of the IT Act

Introduction

In the case of ***Augustus Capital,***[20] the Delhi HC affirmed the retrospective nature of Explanations 6 and 7 to section 9(1)(vi) of the IT Act, using the mischief rule to clarify that Explanation 6 and 7 have to be read along with Explanation 5; thus, Explanations 6 and 7 would be applicable retrospectively from when Explanation 5 came into force.

Facts

A Singapore-based company, Augustus Capital ("**Assessee**") invested in the shares of another Singapore-based company ("**Target**") in FY 2013–14. Target had certain investments in India. The Assessee sold its investment in Target to an Indian company ("**Buyer**") in FY 2014–15. In the return filed for the FY 2014–15, the Assessee declared the income as "nil," based on the view that the transaction involved "indirect transfer" as envisaged under Section 9(1)(i) of the IT Act read with Explanations 5, 6, and 7 to the said section. Explanation 5 to Section 9(1)(i) of the IT Act was introduced by FA 2012 with retrospective effect from FY 1961–62.

Explanation 5 provides that that any asset or capital asset, such as shares in a foreign company, would be considered situated in India if their value largely came from assets in India. Explanation 6 and 7 to the same section were added *vide* the FA 2015 to take effect from April 1, 2016. Explanation 6 sets the threshold to determine if an interest or share derives substantial value from India in accordance with Explanation 5. Additionally, Explanation 7 outlines exceptions for Explanation 5's application to small investors and defines the criteria for identifying a small investor.

The Assessee claimed that since it had acquired only 0.05% of the ordinary share capital and 2.93% of the preference share capital of Target and had no right of management and control in its affairs, the capital gains arising from such transfer would not be liable for taxation in India. The AO, however, disagreed and rejected the contention that the sale of shares of Target to the Buyer would not be taxed in India, basis the reasoning that the exemption granted to small shareholders under Explanation 7 would be applicable from April 1, 2016; therefore it would not be applicable to the year in consideration. The AO thus made an addition of the long-term capital gains under Section 9(1)(i) of the IT Act. Aggrieved, the Assessee filed objections before the DRP, wherein the AO's order was upheld. Pursuant to this, the assessee filed an appeal with the ITAT. The ITAT ruled in favor of the Assessee. The IRA then proceeded to appeal to the HC.

Issue

Can Explanations 6 and 7, appended to Section 9(1)(I) of the IT Act, which was inserted by the Finance Act 2015 with effect from April 1, 2016, operate retrospectively?

Arguments

The IRA made the following contentions:

- The cardinal principle while interpreting tax statutes is that the law applied has to be the one in force in the FY in contention, unless provided otherwise.
- Explanations 6 and 7 were not merely declaratory or clarificatory but also introduced a new set of exemptions for small taxpayers and hence were substantive amendments, which would only be applicable prospectively. This contention was based on the legal principle that if a clarificatory amendment did not bring about a change in law, it could be applied retrospectively. However, because of the IRA's contention in the present case that the amendment was substantive and introduced a new set of exemptions, it would only operate prospectively.
- Just because a legislation is framed with reference to a legal relationship or thing that occurred before the legislation came into force, it cannot automatically be said to operate retrospectively.

The Assessee contended that Explanation 5 created a legal fiction by deeming a source (in India) to the share/interest transferred outside the country by relating it to the underlying assets in India; however, the said section was both ambiguous and arbitrary and had undefined terms such as "share or interest"/"substantially," which broadened the scope of the statute. Explanations 6 and 7 were inserted to cure the unintended consequences flowing from Explanation 5. Hence, the Assessee contended that Explanations 6 and 7 be made applicable retrospectively from when Explanation 5 became operational. The Assessee contended that Explanations 6 and 7 had not brought about a substantive amendment, since it was clear from a plain perusal that they were not standalone provisions and would have no meaning if not tied with Explanation 5.

[20] CIT v. Augustus Capital PTE Ltd, TS-718-HC-2023 (DEL).

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Decision

The HC held that the argument that Explanations 6 and 7 were substantive amendments was misconceived, as these had no meaning if not read along with Explanation 5. Explanations 6 and 7 must hence be construed as clarificatory and curative. If Explanations 6 and 7 were not read with Explanation 5, there would be no legislative guidance on the meaning of the expressions "share/interest"/"substantially," as found in Explanation 5. The purpose of Explanations 6 and 7 was to remedy the mischief created by Explanation 5.

Explanations 4 and 5 of Section 9(1)(I) consisted of vague expressions such as "share and interest" and "substantially", resulting in hardships for transferors and Assessees, where the percentage of share or interest transferred was insignificant. The Government of India referred the matter to an expert committee headed by Parthasarathi Shome ("Shome Committee") due to the representations received in this regard. To decipher the intent of the legislature, the HC looked at the relevant parts of the Shome Committee records (certain recommendations of the Shome Committee regarding Explanation 6 and 7 were accepted) and the Finance Minister's speech while introducing the amendments *vide* the Finance Act 2015.

The HC thus concluded that although Explanations 6 and 7 were to take effect from April 1, 2016, they could be treated as retrospective, keeping in regard the legislative history that led to their insertion.

Significant Takeaways

The cardinal rule of interpretation while interpreting tax statutes is that of strict construction of the statute, wherein the law is applied as is, unless otherwise provided by an express or

implied implication. The HC in this case, however, used the mischief rule (also known as Heydon's rule), while interpreting the explanations to Section 9(1)(i) of the IT Act. This shift in the approach of the court provided for a holistic understanding of the law, wherein the legislative history of the provision was taken into consideration to determine whether the Explanations 6 and 7 to Section 9(1)(i) of the IT Act could be applied only prospectively or could also be applied retrospectively. The intent of the legislation was given due consideration. The provisions of Section 9(1)(i) of the IT Act read with Explanations 4, 5, 6, and 7 form the complete code, and a segmented reading of the same would have been against the intent of the legislature. The Delhi HC in 2014, in the case of ***Copal Research Ltd,***[21] had also given the benefit to small shareholders, even though Explanations 6 and 7 to Section 9(1)(i) of the IT Act were not inserted into the IT Act then. This ruling further fortifies the understanding of the HC and brings much-needed respite to taxpayers who may be facing similar additions, as in the present case.

> **"Small shareholder exemption under indirect transfer tax provisions to be available retrospectively."**

[21] DCIT v. Copal Research Ltd. [2014] 371 ITR 114.

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Assessment cannot be reopened *qua* an issue already analysed during assessment proceedings as per notices issued and replies received notwithstanding the assessment order, as its language is not in the control of the assessee

Introduction

In ***Shourya Infrastructure Pvt. Ltd.,***[22] the Delhi HC analysed the notices issued by the tax authorities during the course of assessment proceedings and replies furnished to it by the assessee to hold that assessment could be reopened on an issue already analysed earlier by the AO. The Hon'ble Delhi HC observed that it is not material whether the assessment order disclosed reasoning on such issue as the framing of the assessment order was beyond an assessee's control. It also held that the reopening was serious business and that senior officers such as PCIT were expected to apply their minds while granting their approval.

Facts

Shourya Infrastructure Pvt. Ltd. ("**Assessee**") was engaged in the real estate business including buying and selling and construction of immovable properties. During the course of its assessment proceedings for AY 2011–12, the AO issued notices to the Assessee which were dated September 2, 2013, October 14, 2013, and October 23, 2013, making various enquiries including those about the nature of its business, its financial statements, sale of land, and the consideration received including those about a sale transaction wherein it received a consideration of INR 1,51,00,000. The Assessee replied through various submissions (on November 11, 2013, November 18, 2013, December 9, 2013, and January 16, 2014) explaining that it had entered into a Memorandum of Understanding ("**MOU**")/agreement with Shourya Towers Pvt. Ltd. ("**STPL**") and purchased a piece of land for INR 1,02,33,462 from the funds it received from STPL and since no project could be executed on such land, it subsequently sold the land. After adjusting for the cost of the land, it retained its share of profits of INR 1,73,002, i.e., INR 1 lakh per acre for 1.7230 acres (which was declared by it as profit on its sale transaction) and remitted the balance profit of INR 46,93,536 to STPL. Thereafter, the AO passed an assessment order dated February 28, 2014, under Section 143(3) of the IT Act without making any addition in respect of such sale of land for INR 1,51,00,000. However, the AO changed his mind subsequently and *vide* a notice dated March 28, 2018, sought various documents from the Assessee. He then reopened the assessment in case of the Assessee for the same AY *vide* a notice dated March 31, 2018.

As per the reasons recorded by the AO for reopening of assessment, it had received information from the Income Tax Officer (Investigation), OCM (Operation Clean Money) Cell-2, New Delhi ("**ITO, OCM Cell**") that the Assessee had sold immovable property below the stamp duty value and AO estimated such value as INR 2,08,30,000. As per the reasons recorded for reopening, the AO concluded that Assessee was not in the business of trading in land and relied on the balance sheet as on March 31, 2011, which showed a stock in trade only concerning the National Highway (NH)-58 project. The AO concluded that transaction of the Assessee with STPL was on capital account and amount received by the Assessee was a loan. Therefore, the AO held that Section 50C of the IT Act would apply on the sale of the land and computed capital gains of INR 57,30,000 in the hands of the Assessee, i.e., the difference between sale consideration of INR 1,51,00,000 and circle rate value of such land, i.e., INR 2,08,30,000.

Issue

Can assessment be reopened on an issue already analysed during the course of assessment proceedings?

Arguments

The Assessee argued the following:

- The various details pertaining to the subject transaction of sale of land were disclosed before the AO during the course of assessment proceedings. Therefore, as per the first proviso to Section 147 of the IT Act (prior to the amendment by Finance Act, 2021), reopening was not possible after four years from the end of AY 2011–12 unless the Assessee failed to disclose fully and truly all material facts. Reliance was placed on the rulings in the case of ***Haryana Acrylic Manufacturing Co.,***[23] ***Wel Intertrade (P.) Ltd.***[24] and ***Suren International (P.) Ltd.***[25] which held that it was a *sine qua*

[22] *Shourya Infrastructure Pvt. Ltd. v. ITO [WP(c) No. 12709/2018].*
[23] Haryana Acrylic Manufacturing Co. v. CIT (2009) 308 ITR 38 (Delhi)
[24] Wel Intertrade (P.) Ltd. v. ITO (2009) 308 ITR 22 (Delhi)
[25] CIT v. Suren International (P.) Ltd., (2013) 357 ITR 24 CIT (Delhi)

non that there must be an allegation that escapement of income had occurred because of the Assessee's failure to disclose fully and truly all material facts.

- This was only a case of change of opinion as a specific query was raised on the subject matter and responded during the assessment proceedings and relied on the rulings in the case of ***Usha International Ltd.***[26] and ***Kelvinator of India Ltd.***[27] in this regard.
- The PCIT had granted his approval under Section 151 of the IT Act without any application of mind by only appending the word "approved" on his approval.
- The Assessee relied on the rulings in the case of ***United Electrical Company Pvt. Ltd.,***[28] ***NC. Cables Ltd.,***[29] and ***S. Goyanka Lime Chemicals Ltd.***[30] The rulings held that a reassessment was invalid where the concerned authority recorded its satisfaction in a mechanical manner and without application of mind to accord sanction for issuing a notice under Section 148 of the IT Act by merely stating *"I am satisfied."*
- A perusal of the form used to record reasons for reopening in the instant case placed before the ACIT and PCIT would show that the AO had not filled up mandatory entries regarding the following aspects: (i) the income at which the Assessee was assessed initially and (ii) whether it was a case of under-assessment at too low a rate, etc.

The IRA contended the following:

- The arrangement between the Assessee and STPL was a sham transaction considering STPL had incurred losses during this period and showed nominal profit based on the amount received from the Assessee.
- The subject arrangement had not been examined from the perspective of a sham transaction during the course of assessment proceedings and such aspect was brought to notice now by the ITO of the Operation Clean Money (OCM) Cell. The AO had not expressed any opinion on the matter and relied on the SC ruling in the case of ***Phool Chand Bajranglal***.[31]
- Since the subject transaction was a capital account transaction, , Section 50C of the IT Act would be applicable.

Decision

The Delhi HC observed that even though the IRA argued that application of Section 50C of the IT Act was not the foundation of the reasons for reopening, the records revealed otherwise. The HC observed that Section 50C would only apply in the event of a

[26] CIT v. Usha International Ltd., (2012) 348 ITR 485 (Delhi)
[27] CIT v. Kelvinator of India Ltd. (2010) 187 Taxman 312 (SC).
[28] United Electrical Company Pvt. Ltd. v. CIT 258 ITR 317 (Delhi)
[29] Principal Commissioner of Income Tax v. NC. Cables Ltd. [ITA No.335/2015](Delhi HC)
[30] CIT v. S. Goyanka Lime Chemicals Ltd. (2015) 64 taxmann.com 313 (SC)
[31] Phool Chand Bajranglal v. ITO (1993) 4 SCC 77

transfer of a capital asset and not in case of stock in trade. Both the Assessee and STPL had treated the land as stock in trade. Even the AO in the instant case in the assessment order had recorded that the Assessee was engaged in the real estate business.

The Delhi HC also observed that AO did not allege that the Assessee failed to disclose fully and truly all material facts, which was a grave folly. The HC reproduced at length the various queries put forward by the AO and the responses filed by the Assessee during the original assessment. It held that the subject transaction was adequately scrutinised by the AO. The HC also refuted the IRA's argument that the assessment order did not disclose any reasoning on the subject transaction. The Court stated that the assessee was in not control of framing an assessment order and had to rely on the SC ruling in the case of ***Cognizant Technology Solutions India Pvt Ltd.***[32] This ruling had held that the assessee was not the author of the assessment order. Hence, the contents of the assessment order were not determinative of whether it was a case of change of opinion.

Further, the Delhi HC held that the weight of the evidence, i.e., the form used for recording reasons for reopening showed that the ACIT had cleared the path without analysing it as a case of under-assessment and the PCIT had even rubberstamped the AO's request without applying his mind. As for the IRA's argument that the subject transaction was a sham transaction, the Delhi HC held that a sham transaction is something that was not what it appeared to be, whereas here it was not the AO's case that the Assessee had not executed the MOU/ agreement. The Delhi HC distinguished the ruling in the case of ***Phool Chand Bajranglal (supra)*** by stating that the AO in that case had acquired fresh information exposing the falsity of the assessee's statement at the time of original assessment.

Significant Takeaways

The said Delhi HC ruling reiterates crucial principles essential for the reopening of assessment proceedings. The AO cannot initiate reassessment merely by relying on the original assessment order instead of the record of those proceedings to show that there was no discussion on the issue at hand. A catena of judgements held that an assessee had no control over the manner in which the AO made his order of assessment, e.g., ***Hari Irion Trading Company,***[33] ***Cognizant Technology Solutions India Pvt Ltd. (supra),*** etc. Further, the sanction for reopening could not be granted in a mechanical manner without proper application of mind. It was a *sine qua non* that a statutory obligation be discharged in a proper manner and that a satisfaction for reopening recorded in a mechanical manner was not sustainable under law as also held in ***Arjun Singh,***[34] ***Astra Exim Pvt. Ltd.,***[35] etc.

> **" An issue already examined by the AO cannot be the reason for reopening an assessment subsequently. "**

[32] Joint Commissioner of Income Tax and Anr v Cognizant Technology Solutions India Pvt Ltd (2023) SCC Online SC 465
[33] Hari Irion Trading Company v. Commissioner of Income-tax: 263 ITR 437 (P&H)
[34] Arjun Singh v. Asstt. DIT [2000] 246 ITR 363 (MP)
[35] Astra Exim Pvt. Ltd. Vs. ITO [ITA No.277/Mum/2018]

Fees for the registration of domain name non-taxable as royalty

Introduction

In the case of ***GoDaddy.com LLC,***[36] the Delhi HC held that the registration of a customer's domain name is not taxable as royalty since mere registration does not create proprietorship rights in the name.

Facts

The US-based Internet domain registry, wed domain, and web-hosting company Godaddy.com LLC ("**Assessee**") was an accredited registrar for Internet Corporation for Assigned Names and Numbers ("**ICANN**"). The Assessee was engaged in the business of providing domain name registration services, web designing, and web hosting. The Assessee did not have a PE or fixed place of business in India. The Assessee offered to tax the income from web-hosting and web-designing services as royalties; however, the AO recharacterised the same as Fees for Technical Services ("**FTS**") (which was not challenged by the Assessee, presumably on the ground that it would have not impacted the rate at which the tax was imposed). The dispute was in relation that consideration received for providing domain name registration was taxed as royalty under Section 9(1)(vi) of the IT Act read with Article 12(3)(a) of the India-US DTAA. The DRP upheld the AO's draft order and the AO passed a final assessment order. On appeal, the ITAT provided the rationale that domain name was equivalent to trademark and hence, ruled that the consideration received by the Assessee for the domain name registration services was in the nature of royalty.

Issue

Could the income received by the Assessee as a consideration for providing the domain name registration services amount to "royalty" under Section 9(1)(vi) of the IT Act?

Arguments

The Assessee submitted that the ITAT had erred in concluding that the domain name is like a trademark. The domain name is the creation of a registration process with limited use and for a defined timeline, while a trademark is created out of goodwill and is independent of registration. A trademark, unlike a domain name, will be protected even if it is not registered as long as it depicts distinctiveness. The Assessee was only an intermediary who rendered registration services, and the domain name's owner was the customer who sought the registration. The Assessee did not transfer the right to use the domain name to the customer, i.e., the registrant. The Assessee contended that for the consideration received to fall within the scope of "royalty," a domain name must exist in the form of a trademark and the taxpayer must transfer the rights in the said trademark (including the right to use) to a third party. The Assessee submitted that none of these attributes existed in the services it offered.

The IRA's submission majorly relied on the ITAT ruling and equated the domain name to a trademark. It contended that the consideration the Assessee received was in the nature of royalty. The ITAT had placed reliance on the ratio laid down in ***Satyam Infoway.***[37]

[36] Godaddy.Com LLC v. Assistant Commissioner of Income-tax, [2023] 157 taxmann.com 256 (Delhi)
[37] Satyam Infoway Ltd., People Interactive (India) Pvt. Ltd. vs. Vivek Pahwa, 2016 SCC OnLine Bom 7351

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Decision

The HC analysed the nature of the domain name registration services provided by the Assessee and the accreditation agreement entered into between the ICANN and the Assessee. It held that the Assessee did not have any ownership rights in the registered domain names but merely acted as a registrar, who cannot have any proprietorship rights in the domain name. Accordingly, the Court accepted the Assessee's contention that it could not have conferred the right to use the domain name to another entity since it was not the owner of the domain name.

The HC also laid down that ITAT's reliance on Satyam Infoway (supra) was misconceived since the said case was only concerned with the right of the domain name owner and not the registrar. The SC, in that case, had held that the registrant owning the domain name could protect its goodwill by initiating a passing-off action against a subsequent registrant of the same or deceptively similar domain name.

Significant Takeaways

This Delhi HC judgement recognizes the role of registrars as intermediaries in the process of domain name registration and provides an important clarification on the aspect of taxation of income derived from such registration services. It analysed and accounted for the unique nature of domain names. This case is an important precedent and would have positive implications on similar cases wherein the distinction between trademark and domain name would be of eminence. By virtue of the SC's decision the case of ***Kotak Securities***,[38] it can be stated that since no human element is involved in the registration of domain names, it would neither be considered royalty nor FTS.

“Consideration received for the registration of domain name would not be taxable as royalty.”

[38] Civil Appeal No. 3141 of 2016

Software development services, etc., non-taxable as royalty or FTS in India in the absence of the FTS clause in the relevant DTAA

Introduction

The ITAT Delhi in ***Campus Eai India Pvt. Ltd.***[39] recently held that the amount received by a foreign company for providing Application Development Services ("**ADS**") and Web Hosting Services ("**WHS**") was not taxable as royalty or Fees for Technical Services ("**FTS**") in India. Further, the payment for Marketing and Sales Support Services ("**MSSS**") rendered for overseas clients cannot be taxed in India in the absence of a PE as it did not accrue or arise in India. Thus, there was no need to deduct taxes while making payments for any of the aforementioned services.

Facts

Campus Eai India Pvt. Ltd. ("**Assessee**") is engaged in the business of development of computer software and providing related services. The Assessee filed its return of income ("**ROI**") in 2017, declaring an income of INR 6,99,57,250. The case of the Assessee was selected for scrutiny, and a statutory notice under Section 143(2) along with the questionnaire under Section 142(1) of the IT Act was issued to the Assessee. The Assessee duly responded to these.

During the assessment proceedings, the AO observed that the Assessee had made various foreign remittances to multiple entities without deducting TDS. These entities were:

i) Brain Point Consultants, UAE - MSSS

ii) Dubai Leading Technologies, UAE - ADS

iii) OIT Managed Services, Mauritius - WHS

The AO passed his assessment order under Section 143(3) of the IT Act treating the aforementioned remittances in the nature of payments for royalty and FTS and disallowed the said payments as per Section 40(a)(i) of the IT Act for non-deduction of TDS. The Assessee appealed before the CIT(A), who held that the aforementioned payments were not chargeable to tax in India and that the AO had erred in disallowing the amount under Section 40(a)(i) of the IT Act on account of non-deduction of TDS on such payments.

Aggrieved by the order of the CIT(A), the IRA filed the appeal before the ITAT.

Issue

Should payments made by the Assessee for ADS, MSSS, and WHS be disallowed under Section 40(a)(ia) of the IT Act?

Arguments

On ADS (Issue 1) and MSSS (Issue 2), the IRA argued the following:

- Payments made by the Assessee for the purposes of ADS and MSSS were in the nature of FTS because the software for application development was custom-made for the Assessee with specific features
- Payment for the same was linked to milestones in development
- The Assessee owned the developed application instead of licensing it.

Since the India–UAE DTAA did not have a clause on FTS, the IRA relied on ***TVS Electronics Limited***[40] to argue that the taxability of the said payments would not be determined as per the residuary Article 22 of the DTAA but by the IT Act.

On the other hand, the Assessee argued that it had submitted the relevant forms and documents such as the tax residency certificate ("**TRC**") and Forms 15CA and 15CB before the IRA. It also argued that the payee did not have a PE in India and the activities were utilised for the purpose of making or earning income from a source outside India. The same should be applied considering the provisions under the India–UAE DTAA are more beneficial to the Assessee. Even under the IT Act, the same is not taxable as provisions of Section 5 are restricted only for business operations in India. The Assessee also argued that the IRA's reliance on the decision in ***TVS Electronics (supra)*** was overruled in ***Bangkok Glass Industry Ltd***[41] and ***Kingfisher Airlines Ltd.***[42] ***Kingfisher Airlines (supra)*** had held that in the absence of a clause in a treaty not dealing with a particular item of income, the same should not be regarded as residuary income but as income from business. Moreover, in the absence of a PE of the non-resident in India, the same could not be taxed. Similarly, ***Bangkok Glass Industry Ltd (supra)*** had overturned ***TVS Electronics (supra)*** and held that consideration under royalty and towards technical services did not fall under miscellaneous income, and thus could not be brought to tax under Article 22 of the DTAA.

With regard to the payments made by the Assessee for WHS (Issue 3), the IRA argued that the services being provided were

[39] DCIT, Circle-4(2), New Delhi Vs. Campus Eai India Pvt. Ltd. [ITA No. 355/Del/2021]
[40] DCIT v. TVS Electronics Limited (TS-421-ITAT-2012)
[41] Bangkok Glass Industry Ltd. v. ACIT (2013) 34 taxmann.com 77
[42] Kingfisher Airlines Ltd. v. DDIT (2019) 179 ITD 364.

not standalone hosting services of merely installation and operation of sophisticated equipment but comprehensive IT solution services along with transfer of certain copyrights. Thus, the payment was of the nature of royalty as consideration had been paid for the transfer of copyright in the "Work Product" and that the associated services were chargeable to tax as FTS. The IRA reiterated that since the India–Mauritius DTAA did not have a clause on FTS, ***TVS Electronics (supra)*** would apply so that the taxability would not be determined as per the residuary Article 22 of the DTAA but by the IT Act.

In response, the Assessee relied on the decisions in the case of ***Bharti Axa General Insurance***[43] and ***Rackspace US Inc.,***[44] which held that the payment towards WHS could not be held as royalty or FTS in cases where the customers only availed the services but did not use, possess, or control the equipment used for providing such services.

Decision

The Delhi ITAT approved the decision of the CIT(A) and deleted the addition made by the IRA under Section 40(a)(i) of the IT Act for non-deduction of tax at source on foreign remittances made by the Assessee to avail services such as ADS, WHS, and MSSS. On Issue 1, the ITAT held that the payment made for ADS could not be brought within the ambit of FTS in the absence of a specific clause in the India–UAE DTAA, which permitted taxation as FTS. Further, it observed that in the absence of a specific clause in the DTAA dealing with a particular item of income, the payment for such income should be regarded as business income, not residuary income. However, in the absence of a PE of the foreign company in India, the said income could not be chargeable to tax in India. Thus, the ITAT held that the Assessee was not under an obligation to deduct TDS under Section 195 of the IT Act.

On Issue 2 regarding the payment for MSSS, the ITAT relied on the Delhi HC ruling in ***Eon Technology***[45] to hold that the income of a non-resident agent from MSSS rendered for overseas client could not be taxed under the residuary clause in the absence of a specific provision related to FTS in the DTAA. Further, such income did not accrue or arise in India under Section 5(2) of the IT Act.

Regarding the payment for Issue 3, the ITAT held that the WHS availed by the Assessee did not constitute royalty or FTS. The ITAT relied on two cases. (1) The ***MOL Corporation***,[46] which held that the subscription fee for a cloud-based service did not fall under the ambit of royalty, as the cloud-based services did not involve any transfer of rights to the customers in any process. (2) ***Millennium Infocom Technologies***,[47] which held that provision of space on the servers by non-residents for website hosting would not amount to provision of technical service. Thus, the ITAT dismissed the IRA's appeal and held that these payments were not chargeable to tax in India because of which the

[43] Bharti Axa General Insurance Co. Ltd. (2010) 326 ITR 477 (AAR)
[44] Rackspace US Inc. v. DCIT (2020) 113 taxman.com 382 (Mumbai Trib)
[45] CIT v. Eon Technology P. Limited, (ITA No. 1167/2011)
[46] MOL Corporation v. DCIT ITA No.1554/Del/2016.
[47] Millennium Infocom Technologies Ltd. v. ACIT (2008) 117 ITD 114 (Delhi Trib.)

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Assessee was not required to withhold any tax on the impugned payments.

Significant Takeaways

The Delhi ITAT judgment provides much-needed clarity and reiterates the position regarding taxability regarding the provision of services by a non-resident entity to a resident. Conflicting decisions were made in the past regarding the treatment of payments made in the absence of a specific clause in the DTAA dealing with as particular item of income. In some instances such as ***TVS Electronics (supra)***, the payments were classified under the residuary clause of the DTAA. In line with other similar HC and ITAT decisions, the ITAT in this case rightly held that in the absence of a specific clause in the DTAA, the payment would be treated as business income under the DTAA and not under the residuary clause, and thus the same cannot be taxed in India in the absence of a PE of a foreign company in India.

The decision also provides clarity regarding the constituting elements of FTS and royalty. Every service related to technology cannot be regarded as providing a technical service. Hence, relying on precedents such as ***MOL Corporation (supra)*** and ***Millennium Infocom Technologies (supra)***, the ITAT has clarified that mere installation and operation of equipment did not result in the provision of technical services and hence could not be taxed as FTS. Furthermore, it reiterated that the provision of WHS in the absence of hiring or leasing could not be said to be royalty since for constituting royalty, a privilege, or right needs to be granted.

This decision also follows an emerging trend of allowing justified relief to the taxpayer assessee—much like the recent Jaipur ITAT decision in ***Isys Softech Pvt. Ltd v ITO***,[48] which held that since the assessee had failed to deduct tax under a *bona fide* belief that foreign remittances were not subject to TDS as there was no PE, branch office, liaison, or PAN of the non-resident payee in India, the penalty imposed on it could not be sustained. More judgments will likely be issued to provide greater clarity on the taxability of new-age technological means and tools.

> **“ Software development, marketing and sales support services, and web hosting services availed by the assessee do not constitute royalty or FTS. ”**

[48] Isys Softech Pvt. Ltd v ITO [TS-737-ITAT-2023(JPR)]

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Licence fee is a capital expenditure and shall have to be amortised over the licence period

Introduction

The SC in the ***Bharti Hexacom Ltd.***[49] case held that payment of entry fee as well as variable annual licence fee paid by companies engaged in the business of telecommunication services to Department of Telecommunications ("**DoT**") under the New Telecom Policy, 1999 ("**1999 Policy**"), are capital in nature and may be amortised in accordance with Section 35ABB of the IT Act.

Facts

The National Telecom Policy of 1994 ("**1994 Policy**") was substituted by the 1999 Policy. Under the 1999 Policy, a licensee needs to pay to DoT, a one-time entry fee and additionally, annual variable licence fees calculated at a certain percentage of annual gross revenue earned by the licensee. Bharti Hexacom ("**Assessee**") was an existing telecom operator under the 1994 Policy and was engaged in the business of telecommunication services. Since 1994, it was granted a non-transferable and non-assignable licence to establish, maintain, and operate cellular mobile services. The Assessee migrated to the 1999 Policy. Hence the fees the Assessee paid up to July 31, 1999, was treated as one-time entry fee under the 1999 Policy. The Assessee considered such an entry fee as capital expenditure for the purposes of the IT Act. With effect from August 1, 1999, the Assessee was required to pay annual variable licence fees calculated at 15% of annual gross revenue earned by the Assessee on revenue-sharing basis.

Scrutiny by the IRA for AY 2003–04 noted that the Assessee claimed the annual variable licence fees paid as revenue expenditure. Since the IRA treated such annual licence fees as capital expenditure, it had to be amortised in accordance with Section 35ABB of the IT Act over the remainder licence period of 12 (twelve) years. Therefore, in the assessment order, only the proportionate amount, i.e., one-twelfth of such annual variable licence fees was allowed as a deduction under Section 35ABB of the IT Act. The remaining amount was disallowed and added back to the income of the Assessee.

The Assessee appealed to the Commissioner of Income Tax (Appeal), who held that such annual variable licence fee was revenue expenditure deductible under Section 37 of the IT Act. The IRA appealed before the ITAT, but the appeal was dismissed. The IRA further appealed to the Delhi HC, which held that while the licence fee payable up to July 31, 1999, should be treated as capital expenditure that will qualify for deduction as per Section 35ABB, the variable licence fees paid after August 1, 1999, on revenue-sharing basis should be treated as revenue expenditure and accordingly deductible under Section 37 of the IT Act. This led to the present appeal by the IRA before the Supreme Court.

Issue

The Supreme Court defined the issue as follows:

> *"The controversy in these cases revolves around the question, as to, whether, the variable licence fee paid by the respondent-assessees to DoT under the New Telecom Policy of 1999 is revenue expenditure in nature and is to be allowed deduction under Section 37 of the Act, or, whether the same is capital in nature, Section 35ABB of the Act."*

[49] CIT v. Bharti Hexacom Ltd. [2023] 155 taxmann.com 322 (SC).

Arguments

The IRA contended as follows:

- The payment of licence fee for acquisition of a licence cannot be characterised partly as capital expenditure to the extent of entry fee and partly as revenue in nature to the extent payable annually, when both types of payments were towards acquisition of a licence.
- Since the Assessee had duly amortised the licence fee paid annually as capital expenditure under the 1994 Policy as well as the entry fee under the 1999 Policy, there was no basis to reclassify the same as revenue expenditure under the 1999 Policy in so far as variable licence fee was concerned for the subsequent years.
- The payments made, either of entry fee or of annual licence fee, were in essence only towards securing a licence to establish, maintain, and operate a telegraph system. Hence, both the entry fee and annual variable payments were covered within the ambit of "consideration" chargeable under Section 4 of the Telegraph Act. Hence, the division between entry fee for acquiring the licence and variable licence fee for operating the licence had no legal basis.
- The mode and manner of payment of the license fee was irrelevant, considering as long as the payment was towards licence fee, the expenditure so incurred would be "in the nature of capital expenditure" as envisaged under Section 35ABB of the IT Act.

The IRA also relied on ***Aditya Minerals***[50] to assert that the mode of payment would not be determinative in identifying the nature of the expenditure, i.e., whether or not it was capital expenditure. The IRA also relied on ***Jalan Trading Co.***[51] to aver that the payment could not be construed as a revenue expenditure since the annual payment based on AGR was only towards licence fees and merely because it was paid on the annual gross revenue..

On the other hand, the Assessee argued that for attracting provisions of Section 35ABB, it was necessary that the expenditure be capital in nature and was incurred for acquiring or obtaining a licence, which gave the Assessee the right to operate telecom services. It also submitted that the payment of the licence fee under the 1994 Policy, i.e., prior to migration to the 1999 Policy, was for obtaining the licence. However, the variable licence fee payable with effect from August 1, 1999, as a percentage of annual gross revenue was not in the nature of capital expenditure as it was not incurred with a view to acquire the right to operate telecommunication services but to continue the right to operate telecommunication services, given that the said services were already being operated by the Assessee by virtue of a licence obtained in 1994. Since the restriction on the number of players or operators in each region was completely lifted under the 1999 Policy, no enduring benefit was accruing to the Assessee, which was a prerequisite for a capital expenditure. The Assessee further contended that when the provisions of Section 35ABB were introduced in the IT Act in 1996, the concept of variable licence fee did not exist, and that the application of the said provision to variable licence fee would give rise to absurd results not intended by the Legislature. The Assessee also contended that the annual licence fee, even though termed as a "licence fee," was in essence expenditure incurred to operate the telecommunication services from year to year. Such expenditure was incurred annually to earn revenue, was also paid as percentage of revenue, and, hence, was an annual revenue expenditure. Merely because the DoT can rescind the licence owing to non-payment of the variable licence fee, it did not mean that the payment was towards acquisition of the licence. The benefit of the variable licence fee was only restricted to one year to which the payment pertains. Hence, the same could not be held to be capital expenditure or expenditure for acquisition of a capital asset.

The Assessee also relied on various judgments to further these contentions. Referring to the SC's decision in ***Mewar Sugar Mills***,[52] the Assessee submitted that in the said case, the expenditure incurred by the assessee was apportioned. It was held that the sums paid for acquisition of monopoly rights for the manufacture of sugar were in the nature of capital expenditure, whereas the royalty paid on a yearly basis was revenue expenditure. In that context, the principle laid down in the said case would directly apply to the case at hand, wherein the one-time entry fee paid for acquiring the licence was, therefore, in the nature of capital expenditure, whereas the annual licence fee to operate the licence and earn profits was, therefore, in the nature of revenue expenditure. The Assessee also distinguished the facts at hand from ***Jalan Trading Co (supra)***, wherein no lump-sum payment was made, as opposed to the present case where a one-time payment was made to acquire the license and yearly payments were made to retain the license. Thus, the Assessee argued that the impugned decision of the Delhi HC was detailed and well reasoned. It prayed that the appeals filed by the IRA be dismissed on the ground that there was no infirmity in the impugned judgment of the Delhi HC.

[50] Aditya Minerals Pvt. Ltd. vs. Commissioner of Income Tax, (1999) 8 SCC 97
[51] CIT vs. Jalan Trading Co. Pvt. Ltd., (1985) 4 SCC 59
[52] Mewar Sugar Mills Ltd.v. CIT, (1973) 3 SCC 143

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Decision

The SC considered many judicial precedents and attempted to list down the broad principles and tests used to determine if a given expenditure was capital or revenue in nature. The SC also attempted to distinguish payment made to acquire a right from the payment of royalty for right to use. The Court explained that where a payment is not referable to the acquisition of a capital asset but only secures a right to use the asset, the same would be a royalty and hence classified as a revenue expenditure. The SC highlighted that what is material is the nature of right sought to be secured through the payment, and the structure or form of the transaction or the payment schedule is hardly suggestive of the nature of the transaction.

In the present case, the SC concluded that since the annual payment of variable licence fee was only towards licence fees and merely because it was paid in annual instalments based on the annual gross revenue, the payment could not be construed as revenue in nature. The SC further explained that the annual payments of licence fee as also the entry fee relate to the single purpose, i.e., the acquisition of the right to carry on the business of rendering telecommunication services. Since this right is a capital asset, the payments made towards the acquisition of the right, whether in lump sum or in annual instalments based on annual gross revenue, would be capital expenditure. The Court also held that the HC had erred in apportioning the licence fee as partly revenue and partly capital since the licence issued under Section 4 of the Telegraph Act was a single licence to establish, maintain, and operate telecommunication services and did not conceive of divisible payments. Further, the fact that failure to pay the annual variable licence fee leads to revocation or cancellation of the licence vindicates the legal position that the annual variable licence fee was paid towards the right to operate telecom services. In addition, the SC also pointed out that a composite right by way of licence cannot be split up in an artificial manner, and such bifurcation was contrary to the terms of the licensing agreement and the 1999 Policy.

The SC also held that an annual payment based on profit sharing towards right to carry on business would be capital in nature. If the expenditure in its core was capital in nature, neither the fact that the same was paid in instalments nor that it was dependent on revenue or profit of the assessee would warrant a change in classification of the transaction. Further, since the entry fee and the variable licence fees are traceable to the same source, i.e., acquisition of a licence, they both would have to be held to be capital in nature regardless of the fact that the variable licence fee was paid in a staggered manner. Thus, the SC also observed that as the Assessee accepted that both components, fixed and variable, of the licence fee under the 1994 Policy must be duly amortised, there was no basis to reclassify the same under the 1999 Policy as revenue expenditure, in so far as variable licence fee was concerned.

Significant Takeaways

The IT Act does not define the term "capital expenditure." As a result, the controversy over what is capital and revenue expenditure has persisted over several years. Whether a particular expenditure is revenue or capital in nature must be determined on a consideration of the facts and circumstances of the case and by applying the principles upheld in various judicial precedents. Section 37(1) of the IT Act is the residuary section that allows deduction of expenses to determine the taxable business profits. For a taxable deduction, expenditure must be incurred wholly and exclusively for the purposes of the business and it should not be in the nature of capital expenditure. Thus, capital expenditure is not an allowable expenditure.

This decision may create significant tax litigation as many completed tax assessments are likely to be reopened. It will impact the telecommunication sector and many other sectors, where entities have claimed a business expense on payouts to the government for licenses, mining rights, port and airport concessions under regulated sectors or those relating to franchise arrangements, collaboration and technical knowhow agreements, sports team contracts, marketing, media and broadcasting contracts, or other similar business or commercial arrangements, in consideration of an upfront fee together with variable fees charged on revenue-sharing basis or on the basis of output that should have been amortised. All such cases need a thorough analysis of the facts and relevant contracts/ documents to ascertain whether the licence fees payable on a revenue-sharing basis can be linked to the acquisition of a right being a capital asset.

"As the entry fee and the variable licence fees are both traceable to the same source, they both would be regarded as capital in nature."

Delhi HC rules on the extended period of limitation and discards the "travel back in time" theory

Introduction

In the case of ***Ganesh Dass Khanna***,[53] the Delhi HC held that where the undisclosed income did not exceed INR 50 lakhs in the relevant AYs, the period of limitation of 3 (three) years would commence from the end of the relevant AY on notices issued under amended Section 148 of the IT Act. The Delhi HC also referred to the Memorandum to the Finance Bill, 2021, and the Finance Minister's speech in support of its ruling. It further held that the SC ruling in the case of ***Ashish Agrawal***[54] held that notices issued between April 1, 2021, and June 30, 2021, would be deemed as issued under Section 148A(b) instead of 148 of the IT Act to save the reassessment proceedings valid under FA 2021. The court did not suggest that notices issued post March 31, 2021, would be deemed as notices issued prior to March 31, 2021.

Facts

Various petitioners ("**Assessees**") filed a batch of writ petitions raising a common issue—the validity of notices issued under Section 148 of the IT Act for AY 2016–17 and 2017–18 as per Section 149 of the IT Act. This legal quagmire, intensified by the COVID-19 pandemic's aftermath and subsequent legislative amendments, has prompted a closer examination of this common issue by various courts.

The pandemic prompted the passing of the Taxation and Other Laws (Relaxation and Amendment of Certain Provisions) Ordinance, 2020 ("**2020 Ordinance**"). The ordinance extended timelines for various compliances under the IT Act, such as filing of any return, appeal, etc., by the taxpayers or completion of any proceeding, passing of any order, issuance of any notice under the IT Act etc. by the IRA until June 30, 2020. These were subsequently extended until March 31, 2021, with the enactment of the Taxation and Other Laws (Relaxation and Amendment of Certain Provisions) Act, 2020 ("**TOLA**"). However, the provisions underwent significant transformation with the passing of the FA 2021, which brought substantial changes to reassessment proceedings related provisions.

This led to substantial litigation on notices issued under the unamended Section 148 of the IT Act with various HCs taking varying opinions. The matter reached the SC and was decided in the case of ***Ashish Agrawal (supra),*** which upheld the notices issued under the unamended Section 148 of the IT Act and held that they would be deemed to have been issued under the amended Section 148A of IT Act. Subsequently, pursuant to such ruling of the SC, the CBDT issued an instruction dated May 11, 2022 ("**CBDT Instruction**"), stating that the reassessment notices issued under the unamended Section 148 would be deemed to have been issued under the amended Section 148A of the IT Act and fresh reassessment notices issued under the amended Section 148 of the IT Act would be treated to be travelling back in time to the original date when they were to be issued.

Issue

Are the orders passed under Section 148A(d) of the IT Act and subsequent notices issued under Section 148 of the IT Act valid as per the limitation period prescribed under Section 149(1)(a) of the IT Act for the AY 2016–17 and 2017–18?

Arguments

The Assessees argued the following:

- The orders under Section 148A(d) of the IT Act and subsequent notices under Section 148 of the IT Act were issued outside the three-year limitation period as per Section 149(1)(a) of the IT Act as it expired on March 31, 2020, and March 31, 2021, for AY 2016–17 and 2017–18.
- The extended limitation period of 10 years under Section 149(1)(b) of the IT Act was inapplicable as the alleged escaped income was below INR 50 lakhs.
- The "travel back in time" theory endorsed by the CBDT instruction has no legal basis nor is borne out of the SC's decision in the case of ***Ashish Agrawal (supra)*** or from the provisions of TOLA.
- The CBDT's circulars and instructions cannot override the SC's directive in case of ***Ashish Agrawal (supra)***, which clearly mandated that post March 31, 2021, the new regime brought by FA 2021 would apply and notices issued between April 1, 2021, and June 30, 2021, would be deemed as issued under Section 148A(b) instead of Section 148 of the IT Act to save the reassessment proceedings valid under FA 2021. The said judgement did not suggest that notices issued post March 31, 2021, would be deemed as issued prior to March 31, 2021.

[53] Ganesh Dass Khanna v. ITO, (2023) 156 taxmann.com 417 (Delhi).
[54] Union of India v Ashish Agarwal, (2023) 1 SCC 617.

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- The CBDT's Notification No. 20 of 2021 dated March 31, 2021, and Notification No. 38 of 2021 dated April 27, 2021, which propounded the travel-back-in-time theory did not mention the original date the notices would travel back.
- The rule of strict interpretation for taxing statutes and emphasised that any ambiguity should favour the Assessees.
- Any reliance on notifications issued under TOLA was unwarranted, as they pertain to the repealed provisions replaced by FA 2021.

The IRA, meanwhile, argued that notices issued between April 1, 2021, and June 30, 2021 stood revived as per the SC's directions in ***Ashish Agrawal (supra)*** read with CBDT Instruction and the TOLA, as already held in ***Touchstone Holdings***[55] and ***Salil Gulati***[56]. The IRA further contended that the powers to extend the time limit under Section 3(1) of TOLA and the notifications issued thereunder were not challenged in earlier cases, emphasising that the challenge in the present cases on piece-meal basis is misplaced. The IRA argued that the travel-back–in-time theory in the CBDT instruction was aligned with the directions in ***Ashish Agrawal (supra)*** and provisions of the TOLA.

Decision

The Delhi HC held that the SC in the case of ***Ashish Agrawal (supra)*** did not explicitly discuss TOLA or the subsequent notifications issued in this regard. The powers conferred on the Central Government under Section 3(1) of TOLA for the extension of the end date for the completion of proceedings and compliances cannot be construed as one that could amend the IT Act or extend the period of limitation provided under Section 149(1)(a) of the IT Act. The Delhi HC also observed that the SC in ***Ashish Agrawal (supra)*** had held that any defence under Section 149 of the IT Act would be available to the Assessees and that all defences and rights under the law would remain open. The Delhi HC also held that Notification No. 20 of 2021 dated March 31, 2021, and Notification No. 38 of 2021 dated April 27, 2021, which extended the limitation period for Section 149 of the IT Act to April 30, 2021, and June 30, 2021, respectively, sought to bypass substituted provisions of Sections 148 and 149 of the IT Act incorporated *vide* FA 2021. Even the reassessment notices issued by the IRA pivoted on these notifications. The Delhi HC also observed that rulings in ***Touchstone (supra)*** and ***Salil Gulati (supra)*** would not be helpful to the IRA as the facts were different in those cases since the escaped income exceeded INR 50 lakhs and extended limitation period as per Section 149(1)(b) was applicable.

The HC stated that the SC's judgment in the case of ***Ashish Agrawal (supra)*** and the provisions of TOLA would show that neither of them allowed that the notices would "travel back in time" and, therefore, the provisions of the amended Section 149(1)(a) of the IT Act would apply. The HC highlighted that the legislative intent of the amended provisions for reassessment could be gathered from the Finance Minister's speech and the Memorandum that provided that the aim was to expedite assessments, reduce litigation, ensure ease of doing business for taxpayers. Therefore, the HC quashed the notices issued under the old regime for the AY 2016–17 and 2017–18

Significant Takeaways

The issues involved in the present appeal have been raised repeatedly before various Courts. The litigation on this issue, however, persists and the controversy has still not died down. The SC in the case of ***Ashish Agarwal (supra)*** held that notices issued between April 01, 2021, and June 30, 2021, under the unamended Section 148 of the IT Act would be deemed to be considered as notices issued under the amended Section 148A of the IT Act, whereas the defences of an assessee under Section 149 of the IT Act would still be available.

Interestingly, the SC in the previously mentioned case was dealing with a situation where around 90,000 reassessment notices would have been invalidated and, therefore, the SC took a sympathetic view and revived those notices. The said case covered taxpayers pertaining to various AYs spanning across several years including AYs 2016–17 and 2017–18. On the one hand, the instant decision of the Delhi HC has intrinsically laid to waste the effect of the directions of the SC as a multitude of reassessment notices would still be invalidated. However, at the same time, it has to be appreciated that the SC was merely trying to save the notices that were issued under the wrong provision viz. the unamended Section 148 instead of Section 148A introduced by FA 2021., Its intention was to keep alive other defences available to an assessee as per Section 149 of IT Act. The reasoning of the Delhi HC in the instant case is, therefore, case specific where the notice is freshly tested on the threshold of Section 149 of IT Act. More cases may be raised in the future, where proceedings revived by the IRA on the back of SC's

[55] Touchstone Holdings Pvt. Ltd. v. ITO and Ors., (2023) 451 ITR 196 (Del).
[56] Salil Gulati v. ACIT, 2022: DHC: 3709-DB.

decision might be struck down on account of other legal defences of an assessee, as per the merits, on case to case basis.

For instance, the Bombay HC recently in ***Siemens Financial Services Pvt Ltd.***[57] took a similar stand that CBDT instructions could not be relied upon, as it is not open to the IRA to clarify that the law laid down by ***Ashish Agarwal (supra)*** means that the extended reassessment notices will travel back in time. Even the Allahabad HC has recently held in the case of ***Rajeev Bansal***[58] that TOLA cannot infuse life in the earlier provisions, which was replaced by the FA 2021. In the absence of any express-saving clause and that CBDT's instruction propounding the travel-back-in-time theory was a surreptitious attempt to circumvent the decision of the Apex Court.

“Notices issued under 148A shall have to satisfy the requirements of the IT Act, including limitation.”

[57] Siemens Financial Services Pvt Ltd. Vs. DCIT [Writ Petition No. 4888 OF 2022, 2023:BHC-OS:9560-DB]
[58] Rajeev Bansal vs. Union of India [WRIT Petition No. 1086 of 2022]

CIT has powers under Section 264 to correct errors committed by an assessee, which were raised for the first time

Introduction

In ***Pramod R Agrawal,***[59] the Bombay HC held that the CIT has wide powers under Section 264 of the IT Act to correct errors committed by an assessee even if a claim was not put forth by the assessee at the time of filing of his ROI and the error was subsequently discovered by it. Section 264 of the IT Act is meant to prevent the miscarriage of justice and provide relief to an assessee, where available as per the law.

Facts

Pramod R Agrawal ("**Assessee**") had filed its ROI for AY 2007–08 disclosing long-term capital gains ("**LTCG**") from the sale of a flat in Mumbai. The Assessee was a co-owner of the said flat with three other persons, and his share was 25%. However, the Assessee had not considered an indexed cost of improvement to the tune of INR 2,95,859 at the time of filing ROI. During the course of assessment proceedings, the AO made an addition by considering the stamp duty value ("**SDV**") of such flat as per Section 50C of IT Act.

The Assessee filed an appeal before the CIT(A) against the assessment order. The CIT(A) directed the AO to refer to the Department's Valuation Office ("**DVO**") for the valuation of the subject property as per Section 50C(2) of IT Act. The DVO determined the fair market value ("**FMV**") as INR 1,57,21,000 as against the SDV of INR 1,69,23,060 providing some relief to the Assessee.

Against the assessment order passed by the AO giving effect to such directions of the CIT(A), a fresh appeal was filed by the Assessee before the CIT(A), which was dismissed in default. The Assessee came to know about it only when he received a tax recovery notice of INR 2,21,992. When the Assessee consulted another chartered accountant, he became aware that the other co-owner of the property had claimed deduction for the entire renovation expenses of INR 4,15,000 from September 1990 after indexing the same. The AO concerned had allowed one-fourth share of that claim. The Assessee was also advised that another co-owner had claimed renovation expenses of Rs.2,95,859.

Therefore, the Assessee filed a rectification application under Section 154 of the IT Act before the AO for the allowance of deduction for indexed cost of improvement of INR 2,95,859, which was rejected on the ground that such a claim was not made earlier before the AO or CIT(A). Against such an order, the Assessee filed an application before the PCIT under Section 264 of the IT Act, which was also rejected. The Assessee filed a writ petition before the Bombay HC against such order.

Issue

Does the CIT have powers under Section 264 of the IT Act to allow a deduction not claimed by Assessee in its ROI or before the subordinate authorities?

Arguments

The Assessee argued the following:

- The Section 264 of the IT Act has a wide jurisdiction and is intended to provide relief to an assessee who cannot file an appeal and has no other alternate remedy left, in order to prevent miscarriage of justice. The Hon'ble Courts have held repeatedly that the purpose of Section 264 of the IT Act is to enable the CIT to provide relief to an assessee where available as per the law, including even where an assessee has erroneously not put forth his claim at the time of filing ROI.
- The Assessee also relied on the following cases:
  - The Bombay HC ruling in the case of ***Hindustan Diamond Company Pvt Ltd***[60] and ***Smita Gupta***[61], which held that Section 264 conferred wide powers on the CIT and was intended to provide relief if an assessee was unable to approach the appellate authority and had no alternate remedy. It also held that the AO's power to make prima facie adjustments under Section 143(1) does not in any way affect the powers of the CIT under Section 264 of IT Act.
  - The ***Asmita A. Damale***[62] case, which held that while exercising his powers under Section 264 of IT Act, the CIT had to ensure that relief was provided to an assessee where available under the law as in the instant case the entitlement of the appellant to such benefit under the law was not disputed.

[59] Pramod R Agrawal Vs. Principal Commissioner of Income-tax-5 & Ors. [WP No. 2435 of 2017]
[60] Hindustan Diamond Company Pvt. Ltd. Vs. CIT (2003) 175 Taxation 91 (Bombay HC)
[61] Smita Rohit Gupta Vs. CIT (WP No. 6964 of 2022) (Bombay HC)
[62] Asmita A. Damale Vs. CIT (WP No. 676 of 2014)

- The ***Sri Selvamuthukumar***,[63] case which held that the records that may be referred by the CIT under Section 264 of the IT Act are not limited to the assessment proceedings but also include information from other sources relevant in the matter.
- The ***Shah Brothers***[64] case and ***Vijay Gupta***[65] case which held that revisional power under Section 264 of the IT Act could be exercised to meet ends of justice or when the error was subsequently discovered after filing of the ROI.

The IRA argued the following:

- An assessee could not take recourse to his ignorance and should have made such a claim at the time of filing his ROI or at the appellate proceedings held twice before the CIT(A). Further, Section 154 of the IT Act is applicable where an error is apparent from the record, which is not the case here, as the claim was never made before the AO earlier.
- Recourse could not be taken to Section 264 of the IT Act when an appeal had already been filed before the CIT(A).
- The application under Section 264 of the IT Act was filed on January 18, 2016, i.e., more than a year after the passing of the assessment order under Section 143(3) of IT Act.
- The Assessee should furnish evidences to prove the indexed renovation expenses claimed by it.

Decision

The Bombay HC held that there was no delay in filing the present application under Section 264 of the IT Act on January 18, 2016, as it was filed against the rectification order dated December 8, 2015 passed by the AO under Section 154 of the IT Act and not the assessment order.

The Bombay HC also held that Section 264 of the IT Act conferred wide powers on the PCIT/CIT to provide relief where an assessee was unable to approach the appellate authorities and had no alternate remedy available under the IT Act. There has to be application of mind by the CIT on whether an income was taxable and his powers were not limited to correct an error of the subordinate authorities. The CIT can also correct errors committed by an assessee, including where a legitimate claim had not been made in the ROI. The Bombay HC also relied upon the rulings in the case of ***Smita Gupta (supra)***, ***Asmita Damale (supra)***, and ***Sri Selvamuthukumar (supra)***, which held that CIT had wide powers under Section 264 of the IT Act and relief should be provided where the law permits the same.

It also held that the Assessee was not required to furnish evidence to prove the quantum of indexed cost of renovation expenses, claimed by it, because in the assessment order passed in case of another co-owner the AO had already accepted the amount of INR 2,95,859 as indexed cost of renovation. Therefore, the Bombay HC remanded the matter for fresh consideration for the disposal of the application filed by the Assessee as per Section 264 of IT Act.

Significant Takeaways

Section 264 of the IT Act is an alternative remedy available to an assessee to correct any errors and to advance the cause of justice under the following conditions: (i) where the facts of the case merit certain relief as per the law and (ii) where the assessee has not gone in appeal or does not want to avail remedy by way of appeal. The nature of the powers conferred on CIT under Section 264 of the IT Act is very wide; however, his powers though not arbitrary are discretionary. The CIT can exercise his discretion to grant or deny relief, bases his objective consideration of the facts of a case as also held in ***O.C.M. Limited***.[66] In fact, the CIT has no restrictions in power when giving relief, even in a case where the assessee detects mistakes because of which he was over assessed after the assessment was completed as also held in ***C. Parikh and Co.***[67] With such power comes great responsibility, and it is the duty of the CIT to analyse the facts and grant relief only in deserving cases, with proper application of mind.

> **“ The proceedings under Section 264 of the Act are intended to meet a situation faced by an aggrieved assessee unable to approach the Appellate Authorities for relief and who has no other alternate remedy available under the Act. ”**

[63] Sri Selvamuthukumar Vs Commissioner of Income-tax, Chennai-VI [2017] 79 taxmann.com 113 (Madras)
[64] Shah Bros. v. Commissioner of Income-tax [2003] 133 Taxman 937 (Bombay)
[65] Vijay Gupta v. Commissioner of Income-tax, Delhi-III [2016] 68 taxmann.com 131 (Delhi)
[66] O.C.M. Limited (London) Vs CIT [1982] 10 Taxman 209 (All.)
[67] C. Parikh and Co. v. CIT [1980] 122 ITR 610 (Gujarat)

Bombay HC dismisses the writ petition challenging the constitutional validity of capital subsidies coming within the ambit of income under Section 2(24)(xviii) of the IT Act

Introduction

The Bombay HC in ***Serum Institute of India Pvt Ltd v. Union of India***[68] recently dismissed a petition challenging the constitutional validity of the amendment to Section 2(24) by inserting the sub-clause (xviii) by the Finance Act, 2015, which brought subsidies and incentives provided by the Central Government or state governments within the meaning of term "income" and consequently taxable under the IT Act on the grounds that the domain of economic and fiscal policy formulation is primarily vested in the legislature and the executive and not the judiciary.

Facts

Serum Institute of India Private Limited ("**Assessee**") is a biotechnology company manufacturing drugs and vaccines. The Assessee had a manufacturing plant at Hadapsar, Pune, which was eligible for deduction under Section 10AA of the IT Act. It had also commissioned another manufacturing facility in the Special Economic Zone ("**SEZ**") located at Manjari, Pune, which commenced production during FY 2019–2020. The Government of Maharashtra had repeatedly issued several industrial policies and schemes to promote industries in less developed areas of the state of Maharashtra. One such scheme was the "Package Scheme of Incentives, 2013" ("**Scheme**"), which came into effect from April 1, 2013, for a period of five years. The Scheme provided for various incentives to major industries such as stamp duty concessions, exemption from electricity duty, and VAT/CST/SGST subsidy.

The Assessee qualified for the Scheme on account of being a biotechnology manufacturing unit and being an ultra-mega project. Subsequently, the Assesee made a capital investment of more than INR 1500 Crores and made its application for eligibility under the Scheme on March 27, 2018, which was approved by the State of Maharashtra in October 2018 with further amendments in March 2019. An eligibility certificate was issued to the Assessee in January 2019.

The IT Act was amended in 2015, and a sub-clause (xviii) to Section 2(24) was inserted by the Finance Act, 2015 with effect from April 1, 2016 ("**Amendment**"). The Amendment added within the ambit of "income"

> "assistance in the form of a subsidy or grant or cash incentive or duty drawback or waiver or concession or reimbursement (by whatever name called) by the Central Government or a State Government or any authority or body or agency in cash or kind to the assessee other than, -
>
> (a) the subsidy or grant or reimbursement which is taken into account for determination of the actual cost of the asset in accordance with the provisions of Explanation 10 to clause (1) of section 43 or
>
> (b) the subsidy or grant by the Central Government for the purpose of the corpus of a trust or institution established by the Central Government or a State Government, as the case may be."

The effect of the Amendment is that subsidies, grants, cash incentives, duty drawback, waivers, concessions or reimbursements provided by the Central Government or state governments either in cash or kind were included within the meaning of term "income" and consequently became taxable under the IT Act. However, it excluded subsidies, grants, or reimbursements taken into account to determine the actual cost of an asset in terms of Explanation 10 to Section 43(1) of the IT Act.

The Assessee claimed that waivers or concessions were not excluded under Section 43; therefore, the refund of sales tax/ SGST, electricity duty exemption, and the 50% exemption from payment of stamp duty as provided under the Scheme would be to be treated as income as per the Amendment. However, prior to insertion of the subclause, the subsidies, grants, or incentives a person received were in the nature of "capital receipts" and were excluded from the definition of "income" and consequently not taxable under the IT Act. Thus, the Assessee challenged the constitutional validity of the Amendment on account of it charging capital receipts to tax.

Issue

The primary issues before the HC were the following:

i. Whether the Amendment infringed various provisions of the Constitution and overstepped the legislative competence of the parliament

ii. Whether the legislature had overruled judicial precedents that distinguished capital receipts from revenue receipts by subsuming both under "income" and subjecting them to taxation

[68] Serum Institute of India Pvt Ltd v. Union of India [2023] 157 taxmann.com 107 (Bombay)

iii. Whether Article 14 is violated by the Amendment by bringing various subsidies under the ambit of taxable income is discriminatory and arbitrary since such savings are not a gain or profit that accrues to the business but rather a reduction in expenditure and the amendment indiscriminately broadened the definition of income to include subsidies without distinguishing between various types of subsidies and the purposes for which they are granted.

Arguments

The Assessee argued the following:

- The subsidy, exemptions, and waivers were meant to attract industries to invest in Maharashtra by encouraging capital investments that would indirectly create jobs and nurture the economy. The tests laid down by the SC in ***Sahney Steel & Press Works Ltd.***[69] and ***Ponni Sugars and Chemicals Ltd.***[70] held that the object for which the subsidy/assistance is given determines the nature of the incentive subsidy. In the present case, the purpose of the Scheme was to enable the Assessee to set up a new unit or expand the existing unit; thus, the receipt of the subsidy was a capital receipt.
- The legislature sought to artificially do away with the distinction between a revenue receipt and a capital receipt, without providing any legal or rationale for the same. A capital receipt being made liable to tax was in gross violation of fundamental principles of taxation; therefore, the Amendment should be read down to include only revenue receipts.
- The Amendment seeking to tax a capital receipt is in violation of Articles 246 and 265 read with Entry 82 to List 1 of Schedule VII. The Parliament cannot choose to tax as "income" an item that in no rational sense can be regarded as a citizen's income or even receipt.
- The Amendment is arbitrary and *ultra vires* to Article 14 of the Constitution since it overrules settled judicial precedents of the SC, which held that the capital subsidy was not income and could not be subject matter of tax under the Act.
- The Amendment violated Article 19(1)(g) of the Constitution since (a) the state government was encouraging the Assessee to invest in the state by providing subsidies and incentives and (b) the Central Government sought to tax the very same subsidy, thereby affecting the right to carry on business.
- It was the duty of every state government to ensure both economic and balanced development. It relied on ***Saghir Ahmed***[71] to argue that the burden of proof was on the Central Government to justify law that prima facie involved Article 19(1)(g) and Article 14 of the Constitution.

The IRA, meanwhile, argued the following:

- The Parliament has exclusive power to make laws with respect to any of the matters enumerated in List I in the Seventh Schedule to the Constitution of India. The authority of the legislature to tax income is derived from Entry 82 of List I, which empowers the Parliament to enact laws taxing income other than agricultural income.
- The Amendment did not fulfil any of the established parameters of challenging the constitutional validity of the amended provision.
- Article 265 of the Constitution of India states *"No tax shall be levied or collected except by authority of law."* Since the Amendment was duly passed by the Parliament, it was not violative of Article 265. Further, the Constitution draws a distinction between taxation statute and other laws in a way that imposition of tax is not a ground for challenging it as a restriction under Article 19(1) of the Constitution. The Constitution safeguards the right to trade under Article 19(1)(g) but does not extend this protection to the right to profit. The IRA rejected the Assessee's assertion that taxation of subsidies and concessions effectively nullifies the distinction between capital and revenue subsidies leading to the erosion of what they perceive as a benefit or savings could not be entertained.
- The courts must defer to legislative judgment in matters relating to social and economic policies and must not interfere, unless the exercise of legislative judgment appeared to be palpably arbitrary.
- The IRA relied on ***Federation of Hotel and Restaurant v. Union of India***[72] to argue that the tests for discrimination in a taxing law are less rigorous. If there were equality and uniformity within each group, the law would not be discriminatory.

[69] Sahney Steel & Press Works Ltd. v. CIT [1997] 94 Taxman. 368 (SC)
[70] CIT v. Ponni Sugars and Chemicals Ltd. (2008) 9 SCC 337
[71] Saghir Ahmed v. State of Uttar Pradesh AIR 1954 SC 728.
[72] Federation of Hotel and Restaurant v. Union of India (1989) 3 SCC 634.

- Every statute comes with a presumption of constitutionality unless proven otherwise. In the realm of fiscal laws, the presumption of constitutionality is particularly significant due to the complex nature of economic regulation.

Decision

The HC began by examining the major decisions relied upon by both the parties. In ***Sahney Steel (supra) and Ponni Sugars (supra)***, the SC had held that the purpose test and not the mechanism of payment was relevant to decide the character of the incentive. Thus, pre-2015, if the subsidy's purpose was to run the business more profitably or meet daily business expenses, it was considered a revenue receipt and thus taxable. Conversely, if the subsidy aimed at setting up a new unit or expanding an existing unit, it was deemed a capital receipt and thus not taxable under the IT Act. However, the 2015 Finance Act sought to end disputes by making all subsidies taxable unless they fell under an excluded category. The HC held that every legislation particularly in economic matters could not provide for all possible situations or anticipate all possible abuses. Laws relating to economic activities should be viewed with greater latitude than laws touching civil rights such as freedom of speech, religion, etc.

The HC relied on the decision in ***RK Garg***[73] to hold that courts must defer to legislative judgment in matters relating to social and economic policies and must not interfere, unless the exercise of legislative judgment appears to be palpably arbitrary. It would be outside the province of the HC to consider whether any immunity or exemption was necessary for inducing disclosure of black money. The HC also relied on ***Federation of Hotel and Restaurant (supra)*** to state that a taxing statute is not, per se, a restriction of the freedom under Article 19(1)(g). The policy of a tax, in its effectuation, might bring some hardship to some individual cases, but the mere excessiveness of a tax or even the circumstances that its imposition might tend towards the diminution of the earnings or profits of the persons of incidence does not, per se, and without more, constitute violation of the rights under Article 19(1)(g).

Thus, the HC held that the domain of economic and fiscal policy formulation was primarily vested in the legislature and the executive, not the judiciary. Further, it held that subsidies and concessions were inherently designed to stimulate certain economic activities or to steer the economy in a desired direction. They were not, however, intended to serve as permanent fixtures beyond the scope of taxation, especially when such benefits had fulfilled their economic purpose. The imposition of tax on these subsidies under the amended provision did not constitute "taking away" of a benefit but rather represented a recalibration of fiscal advantages in line with broader economic and policy considerations. Profits, by their nature, were subject to fluctuations resulting from various factors, taxation being but one. It was the duty of the legislature to ensure that the taxation policy reflected a balance between incentivising economic activity and ensuring the equitable distribution of fiscal resources. Section 2(24)(xviii) of the IT Act was an example of this balancing act, and its imposition was a reflection of a subsidy's life cycle coming to its fiscal fruition.

[73] R. K. Garg v. Union of India and Ors (1981) 4 SCC 675

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Thus, the HC held that concerns over profitably did not provide a tenable basis to impugn the constitutional validity of the amended provision.

Additionally, the HC noted that when the Assessee applied for the subsidy, the Amendment had been in effect for more than two years; therefore, the Assessee ought to have known it. Thus, the Assessee implicitly acknowledged and consented to the accompanying tax obligations. The legislature acted in good faith under the existing legislative policy. To dismantle this retrospectively would be to penalize compliance and create an environment of uncertainty and unpredictability in tax matters. Consequently, the HC dismissed the petition.

Significant Takeaways

The HC decision was sound and well-reasoned. It exhaustively analysed the available precedents regarding treatment of subsidies, analysis of fiscal statutes, and the role of the judiciary and the courts. This decision was important for reiterating that the legislature was the best forum to weigh issues in the fiscal domain and form policies to address them, including creating a new taxation liability, or subjecting an existing deduction to new regulatory measures to plug in specific leakages. Since the petition was ostensibly rooted in concerns over profitability, the HC rightly held that it was not enough to challenge the constitutionality of the Amendment. Further, the HC was also mindful of the wider economic impact of tax policy and noted that interfering in this particular case could open the floodgates of untenable demands from loss-incurring entities. This would likely open up fiscal legislation to manipulation and unpredictability. Hence, the HC upheld the strict standards for challenging the validity of fiscal statutes.

> **“Taxation is an economic reality that every business entity must contend with. The interplay between taxation and profitability is a complex one that is subject to numerous variables beyond merely the taxation of subsidies. The mere fact that a tax falls more heavily on certain goods or persons may not result in its invalidity.”**

Dues of the Department of Revenue to be paid as per the waterfall scheme in case of IBC proceedings.

Introduction

The SC in the case of ***Rajendra Prasad Tak***[74] clarified that IRA could demand for any dues in contravention of Section 53 of the Insolvency and Bankruptcy Code, 2016 ("**IB Code**"), which provides for the waterfall mechanism, which suggests that the dues owed to the creditors and stakeholders need to be discharged by the corporate debtor.

Facts

The corporate debtor, ***M/s KVK Nilachal Power Pvt. Ltd.*** (through Rajendra Prasad Tak) ("**Corporate Debtor**"), was approved to be sold to Power Finance Corporation Limited ("**RA**") as a going concern basis by NCLT Hyderabad *vide* an order dated December 1, 2022[75] ("**NCLT Order**"). The NCLT granted reliefs pertaining to tax liability, investigations, and proceedings relating to customs, GST, and any other applicable tax against the Corporate Debtor that is pending or may arise in future, as the Corporate Debtor was sold as a going concern to the RA.

The IRA appealed the decision before the NCLAT Hyderabad. However, NCLAT dismissed the appeal on grounds that the limitation to file the appeal under IBC had lapsed and the IRA had provided no proper reasoning to extend the said limitation period. Aggrieved by the said order, the IRA filed an appeal before the SC.

Issue

Could the past dues of Corporate Debtor be granted relief?

Arguments

The IRA argued the following:

- They were not aware of the NCLT Order and the same came to their knowledge on March 10, 2023, and as per the limitation to file the appeal commenced on that day.
- The past dues could not be reduced or extinguished in case of sale of corporate debtor as a going concern. In case of sale as a going concern, both assets and liabilities were transferred to buying entity.

The Corporate Debtor submitted the following:

- that the IB Code does not prescribe any method to condone the delay beyond 45 days.
- The IB Code prevails over other tax legislations.
- Section 53 of the IB Code provides for the waterfall mechanism which decides the priority and amount of dues to be paid. The operational creditors cannot claim any priority over the preceding categories in having their debts paid off. Only claims allowed by liquidator and sanctioned by NCLT would be payable from sale proceeds in ratio and order of priority.

[74] Principal Commissioner of Customs v. Rajendra Prasad Tak Etc. 2023 (11) TMI 626 - SC Order
[75] Power Finance Corporation Ltd. Vs. KVK Nilachal Power Pvt. Ltd, IA (IBC)/960/2022 in CP (IB) No. 328/7/HDB/2018

Decision

The SC dismissed the IRA's appeal for the condonation of delay. It also provided a clarification that the dues owed to the CBIC and Department of Revenue should be paid as per the waterfall mechanism provided under Section 53 of the IBC. The NCLT in its order already granted reliefs sought for extinguishing the liabilities or obligations owed to government agencies including tax. Furthermore, a direction that all inquiries, investigations, and proceedings including but not limited to GST, VAT, Income Tax, against the Corporate Debtor, pending, present, or future in relation to any period prior to Effective Date[76] shall stand extinguished. The NCLT observed that since the sale of the Corporate Debtor was as a going concern, the RA ought not be saddled with the liabilities prior to the issue of the Effective date.

Significant Takeaways

There have been conflicting decisions previously wherein the NCLT in certain cases has rejected the resolution plans wherein a proposal for waiverof liabilities that may arise due to ongoing tax litigations was included. However, the aforementioned SC decision has provided a positive ray of hope to successful RAs that they should not be saddled with liabilities of erstwhile management—be it in the nature of government dues or tax liabilities.

The SC has reiterated the position trite in law that the IB Code overrides other laws including the Tax laws as per Section 238 of the IB Code.[77] Therefore, it goes against the spirit of the Code to saddle the RAs with historic obligations since the whole purpose of the Code is to ensure effective revival of the Corporate Debtor.

The aforesaid decision supports the judgment of the SC in ***Committee of creditors of ESIL***[78] as well as ***Ghanashyam Mishra & Sons***,[79] which laid down that the RA could not be suddenly made to face undecided claims after the plan had been accepted, as this would amount to a hydra head throwing up uncertain amounts to be paid in respect of past activities. However, since the IRA was continuously issuing notice to the company that purchased a corporate debtor under IBC as a going concern is still liable to pay past tax dues for, a clarification by the CBIC to its officers would provide the much needed relief.

“ IRA's dues will be paid as per the waterfall mechanism stipulated under Section 53 of the IB Code. ”

[76] The date on which the certificate of sale is issued to the RA, upon submission of the entire sale consideration.
[77] Pr. CIT v. Monnet Ispat & Energy Ltd. [SLP (C) No.6487 of 2018].
[78] Committee of creditors of ESIL vs. Satish Kumar Gupta, 2020 (8) SCC 531.
[79] Ghanashyam Mishra & Sons Pvt Ltd v Edelweiss Asset Reconstruction Company Ltd., (2021) 9 SCC 657.

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The service provider may contractually recover service tax from the recipient

Introduction

The Karnataka HC, in the case of ***M/s Kale Gowda Enterprises***,[80] held that Life Insurance Corporation of India ("**Appellant**"), being the recipient of services in relation to renting of immovable property was under the contractual obligation to remit the service tax that was discharged by the lessor to the IRA.

Facts

M/s Kalegowda Enterprises ("**Lessor**") owned a property in Mandya. The Lessor entered into a lease agreement with Appellant for carpet area of 30700 sq. ft. for a fixed rental fee. The Lessor had deposited service tax for rendering rental services as per its statutory liability under the Finance Act, 1994 ("**FA**"). The Lessor claimed that as service tax is an indirect tax to be recovered from service recipient, the party utilising the service, in the present case was the Appellant and, therefore, was responsible for paying the service tax to the Lessor. The Karnataka HC, by an order of a single-judge bench, held that the Appellant is obligated to remit the service tax to the Lessor, which was deposited by them with the Government.[81] Aggrieved by same, the Appellant filed a writ appeal before the Division Bench of the Karnataka HC to challenge the order of the single-judge bench.

Issue

Does the Lessor have a right to collect service tax from the service recipient, i.e., the Appellant?

Arguments

The Appellant submitted the following:

- that the liability to pay the service tax is statutorily on the service provider. However, the party liable to bear such tax is a matter of contract between the parties involved. Under the terms of the lease, the Lessor was under an obligation to pay all taxes applicable; therefore, the component of service tax was the burden of the Lessor and not that of the Appellant.
- that clause V of the lease agreement specifically provided *"The rent is inclusive of Municipal and all other taxes as are assessed and levied as on date without any deduction except Income Tax at source under section 194-I"*.
- that under clause VI of the lease agreement, the service provider was responsible *"to pay all rates/taxes/ground rent…."* Therefore, the Lessor was obliged to pay taxes to the Municipality or any other Government departments.
- that the Appellant placed reliance on the case of ***Bengal Shrachi Housing Development Limited,***[82] wherein the Apex Court discussed the difference between taxable event and taxable person and held that it was taxable person's duty to pay the tax to the treasury. Thus, the legal obligation or duty to pay the required service tax rested with the service provider, i.e., the Lessor.

The Lessor argued the following:

- that the service tax was the responsibility of the party utilising the service, i.e., the Appellant.
- That the service tax is an indirect tax to be paid by the recipient.
- hat the tax is levied on the value of the services and is not tax on the property, which is inclusive in the rental fee as per the lease agreement.
- that no clause in the lease agreement absolves the Appellants of its obligation to pay or remit the required service tax.

Decision

The Division Bench of the Karnataka HC affirmed the decision of the single-judge bench and held that though the person who provides the service is statutorily liable to pay tax, he is entitled to pass on this liability to the recipient of the service. Hence, it is the obligation of the Lessor to collect the service tax and, thereafter, remit it to the IRA. The Appellant being the person who avails the service cannot deny his liability to pay service tax. It rejected Appellant's submission that the tax was included in the rental fee as it only included tax pertaining or assessed on the leased property. It also referred to the SC's ruling in the case of ***Bengal Shrachi Housing Development Limited (supra),*** which discussed the distinction between a taxable event and the taxable person. It emphasised that service tax was an indirect tax and could typically be transferred from the service provider to the recipient of the service. It also noted that the Appellant had already started paying service tax to the Lessor for the subsequent years. Additionally, the HC also relied upon the

[80] Union of India v. M/s Kalegowda Enterprises
[81] Kalegowda Enterprises Vs Union of India Writ Petition No. 12322 of 2014 (GM-RES)
[82] Union Of India v. Bengal Shrachi Housing Development Limited, (2018) 1 SCC 311.

observations made by the Delhi HC in the case of ***Meattles Pvt. Ltd.,***[83] which indicated that the legislative intent of service tax is that the service recipient bears the service tax liability. As a result, the writ appeal was dismissed.

Significant Takeaways

The aforementioned discussed judgment categorically highlights service tax as an indirect tax payable on the value of services availed and not on the property leased to the lesseee. However, the Delhi HC case of ***Meattles Pvt. Ltd. (supra)*** is given in the context when the lease deed was entered in 2004 service tax was not applicable on rental service (introduced in 2007). In light of the specific situation, the HC held that the lessor had the right to claim the service tax paid from the lessee, as there was no contract between the parties. Additionally, in ***Rashtriya Ispat Nigam Ltd. v. M/s Dewan Chand Ram Saran***,[84] the SC held that there was nothing in law to prevent the supplier from entering into an agreement with the recipient that the burden of any tax arising out of obligations of the supplier under the contract would be borne by the recipient. When there is no agreement between the parties for shifting the ultimate liability towards indirect tax, nothing in law prevents it from recovering the same from the recipient. Hence, in current time, it is essential that the contract terms must be unambiguous to avoid dispute on the party who is responsible to bear the applicable GST.

> *"The service tax should be ultimately borne by the recipient of the service, even though the service provider is statutorily liable to pay the said tax to the exchequer."*

[83] M/S Meattles Pvt. Ltd. v. HDFC Bank Limited, 2012 SCC OnLine Del 5508
[84] Rashtriya Ispat Nigam Ltd. v. M/s Dewan Chand Ram Saran 2012(4) SCALE 58

Penalty waiver is not applicable if the assessee had collected GST but deposited within 30 days of issuance of show cause notice

Introduction

The Kerala HC ***M/S. Global Plasto Wares***[85] upheld the decision of the assessing authority to levy penalty from an assessee who collected the requisite tax but failed to deposit the same within 30 (thirty) days of the due date of payment of the tax.

Facts

M/s Global Plasto Wares ("**Petitioner**") deals with plastic products. The Petitioner had collected GST from its customer; however, it failed to deposit the same with the GST authority. Consequently, the IRA served an SCN on February 28, 2022, to show cause as to why GST collected by Petitioner should not be deposited with government along with applicable interest and penalty. The Petitioner intended to take the recourse of Section 73(8) of CGST Act, which provides that if a person chargeable with GST pays the said GST along with interest payable within 30 (thirty) days of issue of SCN, no penalty shall be payable and all proceedings in respect of the said notice shall be deemed to be concluded. Accordingly, the Petitioner paid the requisite tax and penalty on March 10, 2022, i.e., before 30 days, and hence, did not pay any penalty. However, the IRA disagreed with the Petitioner and demanded payment of the penalty. Aggrieved by the same, the Petitioner filed a writ petition before the Kerela HC, challenging the action taken by the IRA.

Issue

Would the Petitioner be subject to penalty despite paying the tax and interest within 30 days of receiving the SCN?

Arguments

The Petitioner contested the following:

The existence of an express provision, i.e., Section 73(8) of the CGST Act provides that if an assessee show caused under Section 73of the CGST Act subsequently pays tax along with interest within 30 days of receiving the notice, the assessee is not liable to pay the penalty. Therefore, the Petitioner submitted that they are compliant with the CGST Act and, resultantly, all proceedings against them were deemed to have been concluded.

The IRA submitted the following:

Section 73(8) of the CGST Act was inapplicable in cases wherein the assessee had already collected the tax but not deposited the same to the government.

The benefit of waiver of penalty was provided to a person to rectify his non-compliance where tax was short-paid because of a mistake and not when the assessee self-assessed or collected the taxes from the customer and still had not paid the same. Despite collection of the requisite taxes by the Petitioner, since the same was not credited to the government, Section 73(11) of the CGST Act was applicable. This non-obstante clause provides that a penalty under Sub-section (9) shall be payable even if tax is paid within 30 days of the SCN, when any amount of self-assessed tax or any amount collected as tax was not deposited within 30 days of the due date of the payment of the tax.

Decision

The HC undertook conjoint reading of Sub-sections 6, 8, and 9 of Section 73 of the CGST Act. Post perusal of same, it upheld the decision of the assessing authority. It held that according to Sub-sections 6, 8, and 9 of Section 73 of the CGST Act, a person subject to taxation would not be covered by Sub-section 8 and would be subject to Sub-section 11 of Section 73 of the CGST. Consequently, the person would be liable to discharge the penalty if he or she failed to deposit the requisite tax collected, within 30 days of the due date. Hence, Sub-section 8 was completely inapplicable to the facts of the current case in hand as the Petitioner had failed to deposit tax, after collection.

Significant Takeaways

The judgment categorically highlights the point that Section 73(8) of the CGST Act could be invoked if the assessee had not collected the tax. However, the aforementioned ruling could create issues in genuine cases where the assessee is unable to deposit the GST in time, even after collecting it from its customers. The CBIC had issued Circular No. 76/50/2018-GST dated December 31, 2018, which clarified that the provisions of Section 73 of the CGST Act were generally not invoked in case of delayed filing of return in Form GSTR-3B, because GST along with applicable interest was already although after the due date for

[85] M/S. Global Plasto Wares v. Assistant State Tax Officer, Thrissur, The State Tax Officer, The Joint Commissioner, Thrissur | WP(C) No. 33787 Of 2023

payment of such tax. It was accordingly clarified that the penalty under the provisions of Section 73(11) of the CGST Act would not be payable in such cases. However, a general penalty under Section 125 of the CGST Act could still be imposed after following the due process of law. Multiple HC decisions have held that if only GST was paid and interest was not paid within 30 days of the SCN, penalty was still applicable. It appears that the IRA intends to enforce penalty provisions strictly.

> **“ If a person fails to deposit the tax collected by him, he will not be entitled to any waiver of penalty. ”**

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A recipient cannot be denied ITC without the due investigation of the supplier

Introduction

In the matter of ***Suncraft Energy Private Limited***,[86] the SC dismissed the SLP filed against the decision of Calcutta HC,[87] which held that the demand notice issued to the assessee for reversing the ITC could not be sustained, as the IRA had not conducted proper inquiry against the supplier's actions.

Facts

***M/S Suncraft Energy Private Limited* (“Respondent”)** availed ITC on certain inward services such as installation and commission services. However, one of the suppliers of the Respondent did not disclose the details of the transaction with the Respondent in Form GSTR-1 for the FY 2017–18. Therefore, certain invoices from the said supplier were not reflected in the Form GSTR 2A. Consequently, the IRA issued SCN demanding the reversal of the ITC availed by the Respondent.

The SCN was adjudicated by an order dated February 20, 2023, crystallising the demand for reversal of ITC amounting to INR 6,50,511 along with applicable interest and penalty. Aggrieved by the same, the Respondent filed a writ petition before the Calcutta HC. However, the single-judge bench of the HC held that the Respondent prefer a statutory appeal before the appellate authority. Aggrieved by such an order, it preferred an appeal. The Calcutta HC passed an order dated August 2, 2023, holding that the SCN issued for reversal of ITC could not be sustained without due inquiry into the actions of the supplier (“**HC Order**”). Aggrieved by the HC Order, the IRA filed the SLP before the SC.

Issue

Is the Respondent required to reverse ITC on account of the supplier's failure to declare and pay GST to the government exchequer?

Arguments

The Respondent submitted the following:

- It had fulfilled all the conditions enumerated under Section 16(2) of the CGST Act and that the IRA has erred in issuing the said SCN demanding reversal of the credit availed.
- The Respondent also placed reliance on the following:
  - The Press Release dated October 10, 2018, which clarified that furnishing of outwards details in Form GSTR-1 by the suppliers and the facility to view the same in Form GSTRA-2A was in the nature of taxpayer facilitation and did not affect the capacity of the taxpayer to avail ITC on self-assessment basis.
  - The Press Release dated May 4, 2018, which clarified that there would not be any automatic reversal of ITC from the buyer on the non-payment of tax by the seller. In case the seller defaults in tax payment, recovery would be made from the seller.
  - The SC judgment in the case of ***Bharti Airtel***,[88] which held that Form GSTR-2A was only a facilitator. Moreover, on a similar issue, under the erstwhile VAT regime, the Delhi HC in the case of ***Arise India Limited***[89] held that the remedy for the department would be to proceed against a defaulting selling dealer to recover such tax and not denying the ITC to the purchasing dealer.

IRA contended the following:

- The Respondent had not complied with the conditions as the supplier had not recorded its supplies to the Respondent and had not deposited GST. Hence, the conditions for availment of ITC were not fulfilled, and ITC was required to be reversed.

Decision

The SC dismissed the SLP on account of the demand being on the lower side. However, the HC held that the Respondent could not be directed to reverse ITC unless the IRA took action against the supplier. The IRA would have to come after the recipient only in the following exceptional cases : (i) a collusion between the Respondent and the seller or (ii) the seller missing or (iii) the seller had closed down its business or (iv) the seller did not have any assets of its own. The HC relied on the tax invoices and the bank statement produced by the Respondent to substantiate that the Respondent had paid the price for the goods and services rendered and the tax payable there on. Hence, the action was branded as arbitrary.

[86] Assistant Commissioner of State Tax, Ballygunje and Others v. Suncraft Energy Pvt. Ltd., 2023 (12) TMI 739 - SC ORDER
[87] M/s. Suncraft Energy Private Limited and Another v. The Assistant Commissioner, State Tax 2023 (77) G. S. T. L. 55 (Cal.)
[88] Union of India (UOI) Versus Bharti Airtel Ltd. And Ors. (2022) 4 SCC 328
[89] Arise India Limited v. Commissioner of Trade and Taxes, Delhi MANU/DE/3361/2017.

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Significant Takeaways

The judgment of the HC brings considerable relief to taxpayers grappling with similar mismatch notices and litigation. The matter has been a major source of contention and prolonged litigation, both under the erstwhile regime as well as the GST framework. While the decision provides comfort to a genuine recipient, the denial of ITC without proper investigation undertaken by the department against the buyer's supplier is very common. It highlights the need for tax authorities to conduct thorough inquiries into supplier actions before acting against recipients. This judgment upholds the importance of procedural fairness and due process in the procedure for reversal and provides a significant safeguard for businesses against unwarranted ITC denials. It also emphasises a fair and just approach to tax matters.

> **"The IRA must enforce action against the supplier before questioning the availment of ITC by the recipient."**

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ahead of the curve

CBDT introduces quarterly reporting of remittances for Units in India's IFSC in Gift City

CBDT *vide* a Notification No. 89/2023[90] dated October 16, 2023, has amended Rule 37BB of the IT Rules requiring the units in India's IFSC in Gift City to submit quarterly returns in a newly notified Form 15CD, thereby reporting details of all the remittances made by it outside India to non-residents or foreign companies in a particular quarter of a FY. These units set up in IFSC as referred to in Section 80LA(1A) of the IT Act would be required to disclose details of the remitter and the remittee and that of the remittee's country of residence and the country to which the remittance is made, along with the amount and the purpose of the remittances, in the Form 15CD. The said form needs to be furnished electronically within 15 days from the end of the quarter of the relevant FY.

Further, as per the said Notification, such units in IFSC would no longer be required to furnish information in Part D of Form 15CA, where the remittance made is not taxable in the hands of the remittee under the IT Act. The requirement to provide Forms 15CA and 15CB would continue to apply where such remittance was taxable in the hands of the remittee under the IT Act, as specified in Rule 37BB of the IT Rules. The provisions of this Notification would be applicable from January 1, 2024.

CBDT notifies amendments to rules in relation to allotment and quoting of PAN

The CBDT *vide* a Notification[91] has introduced amendments to rules governing the allotment and quoting of PAN for specific transactions. The amendments primarily affect Rules 114B, 114BA, and 114BB of the IT Rules and introduce a new Form No. 60. The amendments with regard to the same are summarised as follows:

1. **Rule 114B:** The second proviso to rule 114B, which mandated a declaration in Form No. 60 for those without a PAN entering specified transactions, has been now restricted to any person, not being a company or firm. Moreover, a new proviso has been added which requires foreign companies without taxable income in India and not having a PAN, engaging in transactions within an IFSC banking unit, to submit a declaration in Form No. 60. Form No. 60 has also been amended to incorporate the changes made in rule 114B.

2. **Rule 114BA and Rule 114BB:** Rule 114BA specifies the list of transactions, for the purposes of section 139A(1)(vii), when entered into by any person who has not been allotted a PAN, shall within such time, apply to the AO for the allotment of a PAN. A new proviso has been inserted to provide for non-applicability of the rule 114BA, if a non-resident or foreign company conducts transactions with an IFSC banking unit that involves the deposit or withdrawal of an amount through means other than that of cash or opening of a current account not being a cash credit account. However, the benefit is available if the non-resident (not being a company) or the foreign company has no income chargeable to tax in India.

3. **Rule 114BB:** Rule 114BB requires that every person, at the time of entering into a specified transaction for the purposes of section 139A(6A), quote the PAN or Aadhar number, in

[90] CBDT Notification No. 89 /2023/ F.No.370142/36/2023-TPL dated October 16, 202.
[91] Notification No. 88/2023 dated 10 October, 2023.

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documents related to such a transaction. It also mandates that every specified person for the purpose of clause (ab) of Explanation to Section 139A, who receives such a document, shall ensure that the said number has been duly quoted and authenticated. A proviso has been inserted to provide for the non-applicability of Rule should a non-resident or foreign company conduct transactions with an IFSC banking unit that involves deposit or withdrawal of an amount through means other than that of cash or opening of a current account not being a cash credit account. However, the benefit was available if the non-resident (not being a company) or the foreign company had no income chargeable to tax in India.

4. **Form No. 60:** A revised Form No. 60 is introduced for individuals or foreign companies, as per the third proviso to rule 114B, involved in transactions specified in Rule 114B without possessing a PAN. This notification aims to streamline PAN-related requirements, focusing on specific categories of transactions and entities, while also introducing a revised declaration form for compliance.

CBDT issues corrigendums on Notification Nos. 3 and 4 of 2021 regarding the format, procedure and guidelines for the submission of the Statement of Financial Transactions (SFT) for Depository Transactions, and for Mutual Fund Transactions by the Registrar and Share Transfer Agent

BThe format, procedure, and guidelines for submission of information relating to capital gains on transfer of listed securities or units of mutual funds by Depository Institutions was notified *vide* CBDT Notification No. 3 of 2021. In case of mutual fund transactions by the registrar and share transfer agents were notified *vide* CBDT Notification No. 4 of 2021 dated April 30, 2021, as per the mandate of Section 285BA of the IT Act and Rule 114E (5A) of the IT Rules. The corrigendums dated November 15, 2023, brought the following changes:

1. The original Notifications mentioned that the SFT be submitted quarterly. The corrigendums issued recently changed this to a half-yearly requirement, with submission required to be filed by October 31 and April 30.
2. S. No. 5 of Annexure A of Notification No. 3 and S. No.7 of Annexure A of Notification No. 4 regarding guidelines for preparation of the SFT mentioned the specified minimum period of holding for different asset classes.
   a. The corrigendum to Notification No. 3 did not amend the minimum holding period but added a note for units of UTI, business trust, and other units that with effect from April 1, 2023, information should be provided where more than 35% of its total proceeds are invested in the equity shares of domestic companies. However, in cases where not more than 35% of its total proceeds are invested in the equity shares of domestic companies, it would always be classified as short-term capital asset."
   b. This same change was brought about by the corrigendum to Notification No. 4 regarding the units of UTI and other units.
   c. Further, the corrigendum to Notification No. 3 introduced market-linked debentures as a short-term capital asset with no minimum holding period with effect from April 1, 2024.
3. S. No. 3 of Annexure A of Notification No. 3 prescribed that the estimated sale consideration for the debit transaction should be determined on the best possible available price of the asset with the depository such as the end of day price. The corrigendum changes the method from the best possible available price of the asset with the depository to the weighted average price on the basis of the actual value of the transactions executed.
4. S. No. 6 of Annexure A of Notification No. 3 mentions that for every debit transaction, the corresponding credit transaction should be identified using the first-in-first-out (FIFO) method. While the original notification allowed the estimated cost of acquisition for the credit to be determined on the best possible available price with the depository, the corrigendum to Notification No. 3 amended the cost of acquisition to weighted average price of the asset if the purchase was made after February 1, 2018 or end of the day price if the purchase was made before February 1, 2018. Further, it added that IPO credit would be treated as market credit and cost of the acquisition of the same will be arrived using the prescribed formula.
5. The corrigendum to Notification No. 3 additionally amended data fields 16, 17, and 18 of Annexure D as follows:
   a. Unit sale price changed from estimated sale price per unit to weighted average sale price per unit.
   b. Sale consideration changed from estimated sale consideration to estimated sale consideration at weighted average price.
   c. The guidelines for estimated cost of acquisition without indexation have changed.
6. The corrigendum to Notification No. 3 additionally amended data fields 24 to Annexure D. It added a purchase flag where

Flag B indicated that purchase was made before February 1, 2018, and Flag A indicated that purchase was made on or after February 1, 2018.

Clarification regarding the reporting details of the person making significant donations for the AY 2023–24

CBDT *vide* Circular No. 17/2023, dated October 9, 2023, provided for clarifications pertaining to audit reports for various charitable entities, such as trust or fund or institution, university or other educational institution, or hospital or other medical institution, required to be furnished for the AY 2023–24. The circular tries addressing the difficulties faced while filling details—in Form 10B and Form 10BB for the AY 2023–24 of persons who have made "substantial contribution to the trust or institution," i.e., whose total contribution from inception till the end of the relevant previous year exceeded INR 50,000. The circular provides relaxation about providing the details of such person if he makes significant donations, i.e., exceeding INR 50,000 during the relevant year itself, instead of considering the past years as well in the audit report for AY 2023–24. Furthermore, it also allows for providing the details of such person's relatives or concerns in which such a person has substantial interest as a donor (only if such details are available) to address genuine difficulties being faced while filing audit report for AY 2023–24, where such details were not available.

CBDT notifies amendments to Safe Harbour Rules

The CBDT has introduced amendments to safe harbour rules for international transactions.[92] The amendments primarily impact Rules 10TA and 10TD of the IT Rules. These amendments are summarised below:

Rule 10TA [93]:

I. "Intra-group loan" has been redefined to include a loan extended to a non-resident associated enterprise, instead of wholly owned non-resident subsidiaries only. Further, it is no longer required that such a loan be sourced in INR.

ii. The definition of "operating expense" has been amended to exclude "loss on transfer of assets or investments other than assets, on which depreciation is included in the operating expense" in place of the prior "loss on transfer of assets or investments."

iii. The definition of "operating revenue" has been amended to exclude "income on transfer of assets or investments other than assets, on which depreciation is included in the operating expense" in place of the prior "income on transfer of assets or investments."

Rule 10TD[94]:

i. The requirement for "CRISIL" credit rating has been removed in case of intra-group loans advanced in both INR and foreign currency. A definition of "credit rating" has also been introduced to provide that this term means that the credit rating was assigned to the associated enterprise by a SEBI-registered and RBI-accredited credit rating agency.

ii. Changes have also been made in the criteria for calculating interest for intra-group loans advanced in foreign currency as follows:

   a. *Interest rate determination based on loan amounts:* The interest rate for eligible international transactions should not be lower than the reference rate of the relevant foreign currency as of September 30 of the relevant FY.

   b. *Loan amount threshold:* A dual structure has been introduced for loans and classified into two tiers based on the loan amount. For loans up to INR 2.5 billion, the additional basis points over reference rates vary from 150 to 400, depending on credit ratings. Loans exceeding this threshold face higher risk, with basis points going up to 600.

iii. The "reference rate" for various major currencies such as the US dollar, Japanese Yen, UK Pound, etc., have also been provided.

The aforementioned amendments are effective from April 1, 2024.

92 Notification No. 104/2023 dated December 19, 2023
93 Rule 10TA of the IT Rules, lays down the definitions for the purposes of Rule 10TA to 10TG of the IT Rules.
94 Rule 10TD of the IT Rules lays down the circumstances that must exist for there to be an eligible international transaction for the purposes of sections 92C and 92CA of the IT Act.

REGULATORY INDIRECT TAX UPDATES

Clarification relating to export of services.

The CBIC *vide* Circular No. 202/14/2023-GST-GST dated October 27,2023 has clarified that the requirement to receive payment of consideration for the in convertible foreign exchange to qualify supply of service as export of services would be deemed to be satisfied in following scenario:

- The Indian exporters are paid the export proceeds in INR for services exported, through Special Rupee Vostro Accounts of correspondent bank(s) of the partner trading country, opened by AD banks where it is in compliances with FTP and applicable RBI Circulars.

Applicability of GST on corporate and personal guarantees

CBIC *vide* Circular No. 204/14/2023-GST dated October 27, 2023, clarified the taxability of personal guarantees and corporate guarantees. In relation to personal guarantee, provided by the director of a company, it stated that as per the RBI Circular No. RBI/2021-22/121 dated November 09, 2021 which prohibits payment of consideration in any form to the director, in lieu of providing personal guarantee. Therefore, there is no consideration. Hence, no GST would be payable on provision of personal guarantee.

However, for corporate guarantee provided by a related party on its behalf to the bank or financial institute, the activity is to be treated as a supply of service between related parties as per provisions of Schedule I of CGST Act, even when made without any consideration.

Recently, *vide* Notification No 52/2023- Central Tax dated October 26, 2023, the Central Government has prescribed a special valuation rule. As per the new rule, the value shall be deemed to be either 1% of the amount of guarantee offered or the actual consideration paid, whichever is higher. The new rule does not allow to value it any nominal consideration even when it is a tax neutral situation (i.e. when recipient is eligible for full input tax credit) as available to any other business as per valuation rules. Thus, making mandatory requirement to deposit GST at higher of 1% of corporate guarantee amount or actual consideration.

Instruction regarding applicability of GST on secondment

The CBIC *vide* Instruction No. 05/2023-GST- dated December 13, 2023 mentions that the SC in the case of ***Northern Operating Systems Private Limited***[95] held that secondment of employees by overseas companies to Northern Operation Systems Private Limited ("**NOS**") is a taxable supply, and thus service tax was chargeable. The Instruction provides that issues relating to taxability of secondment services are not only restricted to the erstwhile service tax regime, but are present in the GST regime as well. Therefore, the Instruction has issued advisory that the NOS case should not be implemented uniformly in all secondment cases as various forms of agreements concerning the secondment of employees from an overseas group company to an Indian entity exist. The tax implications in each scenario may vary, contingent upon the specific details of the contract and other associated terms and conditions. Each case demands a thorough examination of its unique factual circumstances,

[95] CC, CE & ST, Bangalore (Adj.) etc. v. Northern Operating Systems Private Limited 2022 (5) TMI 967 - Supreme Court.

including the contractual terms between the overseas company and the Indian entity, to ascertain the taxability or its scope under GST. Further the Instruction guided that demand must be raised for secondment cases under section 74 of the CGST Act only in cases of willful fraud or misstatement and the evidence of the same should be made part of the SCN.

Option to convert SEZ IT park to non-processing area

SEZ *vide* Notification No. G.S.R. 881(E) dated December 06, 2023 has amended the SEZ Rules, 2006 to provide for Non-processing areas in Information Technology ("**IT**") or Information Technology Enabled Services ("**ITES**") Special Economic Zones. It provides that:

(a) The Board of Approval ("**BoA**"), on the request of the Developer of IT or ITES SEZ, has the power to permit demarcation of certain area in an IT or ITES SEZ as non-processing areas for IT or ITES SEZ, subject to the conditions specified by BoA.

(b) The BoA approval for non-processing areas for IT or ITES SEZ is permissible only after the repayment by the Developer of tax benefits attributable to non-processing areas for IT or ITES SEZ or tax benefits already availed for creation of shared social or commercial infrastructure and other facilities to be used by both IT or ITES SEZ and non-processing areas for IT or ITES SEZ, without interest.

(c) No tax benefits shall be available on operation and maintenance of common infrastructure and facilities in such part.

The businesses engaged in IT or ITES in a non-processing area shall be subject to provisions of all laws, as are applicable to any other entity operating in domestic tariff area.

Hybrid working permitted in SEZ units

SEZ *vide* Notification No. G.S.R. 824(E) dated November 7, 2023, has amended the SEZ Rules, 2006 to provide for Hybrid working. It provides the following:

1. The employees permitted to work in hybrid mode are
    a. employees of IT or ITES;
    b. completely incapacitated employees;
    c. employees that are travelling; and
    d. off-site working employees.
2. The unit permitting hybrid work covers all its employees and is required to maintain a list of employees working in hybrid mode and intimate the same to the development commissioner.
3. The unit is required to ensure export revenue of the resultant products or services to be accounted for by the unit to which the employee is permitted for hybrid work.
4. The SEZ unit is permitted to provide duty-free laptops, desktops, and other goods to hybrid working employees, with the condition that the supplied goods are duly accounted for.
5. The hybrid working is permitted till December 2024.

Clarification regarding the applicability of GST on certain services

CBIC *vide* Circular No. 206/18/2023-GST dated October 31, 2023, clarified the applicability of GST on the following:

1. *"Same line of business":* For instance, passenger transport service is covered under SAC 9964 and renting of motor vehicles designed to carry passengers is covered with operator under SAC 9966. Not leasing of motor vehicles without operator (SAC 9973) will attract GST and compensation cess at the same rate as supply of motor vehicles by way of sale.
2. *Supply of electricity by the real estate companies, malls, airport operators, etc., to their lessees or occupants:* When electricity is supplied in conjunction with the renting of immovable property and/or the maintenance of premises, it constitutes a composite supply. The applicable GST rate is determined by the rate applicable to the principal supply, i.e., the GST rate for renting of immovable property and/or maintenance of premises, as the case may be. In cases where real estate owners, resident welfare associations (RWAs), real estate developers, etc., act as pure agents for supplying electricity, the value of this supply will not be included in the overall value of their service. However, if they charge for electricity on an actual basis (i.e., the same amount for electricity charged by the State Electricity Boards or DISCOMs), then they will be considered to be operating as pure agents for this specific supply.
3. *Services by way of job work for conversion of barley into malt:* Irrespective of end-use, conversion of barley into malt amounts to job work in relation to food products and thereby attracts 5% GST.

4. *District Mineral Foundations Trusts (***DMFTs***) set up by the state governments are governmental authorities and eligible for exemptions:* DMFT set up by the state governments are governmental authorities and therefore eligible for the same exemptions from GST as available to any other governmental authority.

5. *Supply of pure services and composite supplies by way of horticulture/horticulture works:* In cases where the value of goods constitutes not more than 25 per cent of the total value of supply, supply of pure services and composite supplies by way of horticulture/horticulture works made to CPWD are eligible for exemption from GST.

Clarification regarding the determination of the place of supply in various cases

CBIC *vide* Circular No. 203/15/2023-GST dated October 27, 2023, clarified the place of supply of services for the following:

1. *Supply of service of transportation of goods, including through mail and courier :* In cases where the location of the recipient of the services is available, the place of supply will be the location of the recipient of the services. In cases wherein location of recipient of services is not available, the location of the supplier of services will the place of supply.

2. *Advertising sector :* Advertising companies frequently engage in obtaining space on billboards or hoardings mounted on buildings or land across different states from various suppliers or vendors. The arrangements between the advertising company and its vendors can vary, and examples of such arrangements may include the following:

   a. Where there is a supply or sale of physical space on the hoarding or structure (considered as immovable property) owned by the vendor to the advertising company, with the rights to use the designated space on the hoarding or structure for the display of their advertisements, the place of supply will be the location where such a hoarding/structure is located.

   b. In cases wherein the vendor provides a service to the advertising company without involving the sale of space or the sale of rights to use the space on the hoarding or structure (considered as immovable property), there is no transaction constituting the sale of advertising space or the supply by way of granting rights to use immovable property. In such cases, the place of supply is as per Section 12(2) of the IGST Act, i.e., the location of in case of the registered person and the location of the recipient or the location of supplier in case of the non-registered person.

3. *Supply of the co-location services:* Co-location services are in the nature of "hosting and information technology (IT) infrastructure provisioning services." The place of supply will be the location of the recipient of the co-location service. It will not be construed as the location of the immovable property. In instances where the contractual arrangement between the supplier and the recipient is specifically limited to leasing physical space along with basic infrastructure, excluding hosting and information technology (IT) infrastructure provisioning services, and where the recipient is solely responsible for the maintenance, operation, monitoring, and surveillance of servers and related hardware, such a service provision is categorised as the renting of immovable property. In such instances, the place of supply of services will be the location of the immovable property.

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

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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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