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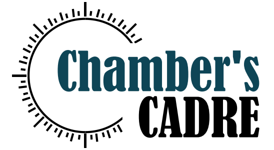

THE CHAMBER'S JOURNAL

Your Monthly Companion on Tax & Allied Subjects

Vol. XII | No. 6 | March 2024

STATUTORY INTERPRETATION OF TAX STATUTE

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Residential Refresher Course Committee

47th Residential Refresher Course on Direct Taxes held from 29th February, 2024 to 3rd March, 2024 at Taj Hotel & Convention Centre, Agra

Inaugural Session

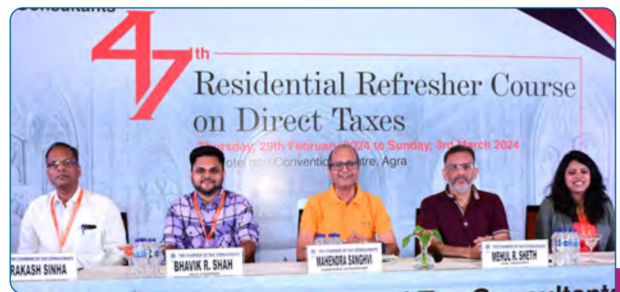
CA Haresh Kenia (President) giving his opening remarks

CA Ankit Sanghavi (Chairman) welcoming the speakers and the Delegates

Publication Release Function

CA Ravikant Kamath addressing the delegates

CA Pradeep Kapasi addressing the delegates



CA Mahendra Sanghvi addressing the delegates

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Editorial

Dear Readers,

I am penning this communication on 8th March 2024 which is observed as International Women's Day to celebrate the social, economic, cultural, and political achievements of women from around the world. The United Nations (UN) started celebrating International Women's Day and in 1977, it was officially agreed that the day will be widely observed on March 8 every year. One wonders whether International Women's Day really needs to be celebrated as it is often commercialised than the real purpose of its celebration! The fact of the matter is that there are social, economic and cultural challenges in providing women, equality in full and that gender inequality still remains and therefore celebration of International Women's Day does matter.

The theme for this year's International Women's Day for 2024, according to the United Nations is "Invest in Women: Accelerate progress". This theme is recognition of the fact that women must have economic power to be equal and independent. Through out most human history women depended on marriage for survival and education, earning and having their own identity was given the least importance. This system has changed over the last century and women have same range of choices as men be it education, financial independence etc. Nonetheless gender inequality is still there and therefore theme for 2024 is very apt. Take any area, be it agro, industrial, knowledge, science, healthcare, culture, music, arts, sports economy, administration, defence it is observed that women have contributed significantly and many of them have reached the highest positions therein and have consistently won awards and accolades for their contribution.

Recently, the Hon. Supreme Court in a landmark verdict has struck down as unconstitutional, the electoral bond scheme introduced by the Government in 2018 that allowed individuals to anonymously donate money to registered political parties by purchasing bonds from SBI which the parties could encash. After this ruling, no new bonds can be issued and unencashed bonds must be returned to SBI and refunded to donors. The Hon. Supreme Court held five administrative and legislative amendments unconstitutional viz:

- Electoral bonds scheme in its entirety
- Amendment to Representation of the People Act, 1951 which exempted parties from reporting to Election Commission of India (ECI), money received by electoral bond
- Amendment to Income Tax Act, 1961 which exempted electoral bonds from category of voluntary contribution over ₹ 20,000 for which parties must maintain account of names and details of donors.
- Amendment to Companies Act, 2013 which omitted provisions requiring companies to disclose particulars of parties to whom they have donated.
  - Amendment to Companies Act,2013 which had removed the cap on corporate contribution to 7.5% of net aggregate profits and by extension had also removed the bar on loss making companies contributing to parties.

It has held that anonymity of electoral bonds violates citizens right to information; voters need to know whether there is quid pro quo between donors and political parties; allowing loss making companies to donate limitlessly encourages quid pro quo even more.

Shri Fali S. Nariman, widely considered as one of India's finest lawyers, passed away on February 21. He was referred as the "Bhishma Pitamah' of the Indian legal fraternity, its conscience keeper and a strong guiding light for lawyers. There are many landmark Court judgements which were argued by him. Shri Mukul Rohatgi, Former Attorney General of India described him as a 'fearless lawyer and a man of all seasons'. Chief Justice of India, D. Y. Chnadrachud described him as "a great giant of an intellectual". Other legal luminaries also hailed him as one of the finest legal brains of the Country. With his death, India has lost one of the finest senior counsel and he will definitely be missed..

This issue of the Journal deals with "Statutory Interpretation of Tax Statutes". The Journal Committee needs to be complemented for inviting women professionals to author all the articles of this issue on International Women's Day! Special mention must be made of Ms. Vinita Krishnan and Ms Jagruti Sheth, members of the Journal Committee, who have been instrumental in designing the sub topics of the issue. I take this opportunity to express my deepest gratitude to all the women authors for their contribution to this initiative of the Chamber. The initiative of getting women authors to contribute to the special story in March was started by the then Journal Committee Chairman, Shri Paras K Savla and I am happy that this practice has continued in the same vein to date.

VIPUL K. CHOKSI
Editor

From the President

Dear Members,

May all our CTC members be blessed with life's colors : joy, happiness, friendship, and love. Wishing everyone a Happy Holi. Let's fill this Holi with love and joy everywhere we go.

In the wake of our recently concluded 47th Residential Refresher course (RRC) in the historic city of Agra, I am filled with profound gratitude and joy. The conference not only upheld but magnified the spirit of brotherhood that has been the hallmark of our Chamber, a testament to the vision of our respected late past president, Shri V.H. Patil Saheb. It was Shri Patil Saheb who initiated the RRC with the noble aim of fostering brotherhood among our professional community. While he is no longer with us, the overwhelming participation and the bonds of knowledge, friendship, and camaraderie that were strengthened in Agra are a tribute to his lasting legacy. I believe that if Shri Patil Saheb were to witness the unity and engagement of this year's RRC, his eyes would indeed be moistened with pride and fulfilment. The unprecedented enrolment and the enthusiastic sharing of knowledge, friendship, and professional intimacy have shown that Shri Patil Saheb's idea has not just taken root but is flourishing. As we build on the success of this year's conference, let us carry forward the torch of brotherhood, enlightenment, and professional excellence that our predecessors have passed on to us. Let us pledge to keep the legacy of Shri Patilsaheb alive, nurturing the seeds he planted with our continuous efforts and unity. Thank you for making the 47th RRC a memorable event. Your active participation and relentless spirit are what make our community vibrant and strong.

This RRC truly reflects how professionals are hungry for learning and updating their skills. Chairman of the RRC, Shri Ankit Sanghvi and his team under guidance of Advisor, Shri Kishor Vanjara deserves pat on their back as they worked tirelessly for making sure that everyone was comfortable. The RRC team's innovative ideas, including Beat Bash and the under-40 members' gathering, added fresh dimensions to the event. Excellent work, Team RRC.

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In a monumental stride for our Chamber, we are elated to introduce the inaugural National GST Moot Court Competition, a first-of-its-kind endeavor focused on Indirect Tax Law jointly with ILS Law College, Pune. This historic initiative, coinciding with the centennial celebrations of the ILS Law College - legal community, underlines our commitment to legal education and professional development. Scheduled for March 30, 2024, this event invites participants to delve deep into GST nuances, enhancing their legal acumen. We invite our members and the broader legal community to partake in and support this pioneering event, marking a significant milestone in our Chamber's legacy and contributing to the evolution of law and practice.

In a visionary stride, Prime Minister Narendra Modi has outlined an ambitious 25-year plan for India, coinciding with its centenary of independence, aiming to elevate the nation to a developed status by 2047. Under his stewardship, India is not only poised to rise from the world's fifth-largest to one of the top three global economies but is also embracing a transformative era in manufacturing, signaling a holistic advancement towards a robust, self-sustaining economy. Central to Modi's comprehensive vision is the sustainable development underpinned by infrastructural enhancements and a new-age skillset that includes artificial intelligence and innovation. This aligns seamlessly with his potential third term’s objective of revolutionizing India's manufacturing landscape. Spearheaded by adviser Arvind Virmani, the strategy aims at boosting export-oriented sectors, reducing trade barriers, and refining incentive schemes to ignite global competitiveness and draw in manufacturers through enticing tax cuts and capital support. The targeted approach towards enhancing manufacturing, aiming to increase its GDP contribution from the current 13% to 25% by 2025, demonstrates the government's resolve. Success stories of global tech giants expanding their production base in India stand testament to the initial successes of Modi's incentive-driven strategies. Moreover, this manufacturing upliftment is intricately linked with Modi's 25-year roadmap, setting a foundation for sustainable and human-centric development that seeks to position India as a pivotal hub in global supply chains. India's global stature as a trusted partner is further accentuated by Modi’s active pursuit of trade agreements with major partners like the US, UK, European Union, and Gulf nations, aiming at not only bolstering manufacturing but also creating job opportunities and enhancing international ties, as exemplified by the burgeoning India-UAE relationship during the Vibrant Gujarat Summit. This holistic vision, unveiled amidst India's G20 Presidency, embodies a commitment to global stability and a people-centric approach. As India navigates through these transformative policies, it stands on the brink of not only achieving a developed status but also reshaping the global economic and geopolitical landscape, showcasing an exemplary model of growth and cooperation. In essence, Prime Minister Narendra Modi’s intertwined strategies for India's long-term development and immediate industrial evolution reflect a

nuanced blend of ambition and pragmatism, setting a clear trajectory for the nation's journey towards being a global powerhouse by 2047.

The Student committee has organized the "Webinar Series on CA Student Orientation Course, 2024" from March 11-15. This five-day course aims to bridge the gap between academic learning and practical application, essential for CA Article Students and those navigating their professional journeys. With sessions covering diverse practice areas and essential soft skills, I strongly encourage our members, especially students and early professionals, to attend and gain invaluable insights.

In parallel, Chamber is organizing a significant event on March 15th, a Half-day Hybrid Seminar on "Restructuring of Family Owned Businesses." This seminar, in collaboration with IMC's Direct Taxation Committee and Bombay Chartered Accountants Society, will delve into the complexities and evolving dynamics of family-owned business structures. Given the current global economic changes and local regulatory updates, this seminar is a must-attend for Tax Managers, CFOs, and Tax Consultants keen on navigating the challenges and opportunities in business restructuring.

Furthermore, on March 19th, Chamber will host a vital webinar focusing on the "Key learnings from NFRA orders/ QRB reports." This session is pivotal for audit professionals and firms aiming to align with regulatory standards and expectations. I urge our members involved in auditing and compliance to register and stay ahead in maintaining the highest quality standards.

Further I want to highlight our "***17th Residential Conference on International Taxation***" set from June 20-23 at The Leela, Gandhinagar. This conference promises in-depth discussions on international taxation, transfer pricing, and the impact of technological advancements on global tax frameworks. I encourage everyone, especially those in the field of international taxation and related areas, to register and participate actively. Your active participation not only contributes to your personal growth but also to the collective strength and reputation of our community. For other programmes and details, one may refer to CTC newsletter. I look forward to your enthusiastic involvement in these events

In last month, our Chamber hosted a series of successful events: the "Internal Audit Series Part 2," a comprehensive webinar on post-acquisition implications under IBC, an engaging session on "AI in CA and Legal Practice," a lecture on the "Impact of Union Budget on Capital Market," the "47th Residential Refresher Course on Direct Taxes," and a webinar on "Mediation Training in Commercial Disputes." Additionally, focused discussions were held

on critical tax issues affecting MSMEs. The positive engagement and feedback from these events underline the importance of our continuous learning and networking efforts.

This International Women's Day, I extend my heartfelt celebration to the extraordinary strength, wisdom, and compassion of women across the globe. In our Chamber, we've uniquely commemorated this occasion by dedicating this month's journal to exploring the "Statutory Interpretation of Tax Statute," exclusively through the lenses of women professionals. This initiative not only honors the day but also underlines the invaluable contributions of women in our field. Their expertise and insights enrich our understanding and foster a more inclusive professional environment. Therefore, as we celebrate the unsung heroines and pioneers who've shaped our paths, let's also commend the women authors who've enriched this month's special story. Their dedication exemplifies the progress and empowerment we aim to foster every day. Here's to continuing our support, upliftment, and inspiration for one another, not just today, but every day. Happy International Women's Day. Let's cherish this occasion by both celebrating the remarkable contributions within our Chamber and committing to a future of equality, respect, and empowerment for all.

I conclude with best wishes to all the readers.

HARESH KENIA
President

Navigating through Ambiguities and Silences : An Introduction to the Interpretation and Construction of Tax Statutes

Shreya Rao[1]
Advocate

Overview

Rules of interpretation are critical to how we understand the law, not just to interpret ambiguities in existing provisions but also to determine how to apply existing provisions to situations left unaddressed by the law. Tax laws are much harder to interpret than other laws due to certain unique characteristics – for example, they are frequently amended and therefore rid with contradictions, they are public laws which rely extensively on private law constructs, they are laws which are strictly interpreted but also have a strong socio-economic logic which often motivates courts to look beyond the text of the legislation. A large component of tax law also pertains to tax treaties, which are subject to very different interpretation rules. Therefore, no study of tax law is complete without an adequate understanding of interpretation. This piece provides an introduction to the key rules of interpretation including the literal rule, harmonious rule, and general assumptions regarding workability of the statute, in addition to how we rely on internal and external aids. Examples from tax statutes and cases are also provided as illustrations. However, the piece concludes by noting that to interpret law is to interpret language, which can never be an entirely precise exercise.

When legislators make laws, and tax laws are no different, they have many difficult choices to make. One of these choices relates to the extent of detail required in a statute. A more detailed legislation may be more effective at communicating legislative preferences but would require more time, effort and transaction costs to put in place. Extremely bespoke/detailed laws also face other challenges: they may result in overlaps and ambiguities if not done well, they may not be nimble in their ability to respond to changing situations, and they are likely to be difficult to accomplish politically. On the other hand, a legislation that is not detailed enough will not provide sufficient certainty in its application and will leave too much to the discretion of the courts. Lawmakers

1. Palak Sethi assisted with research on this piece. Thanks to Mihir Naniwadekar for useful inputs. Any omissions or inaccuracies are mine alone.

therefore need to attempt a fine balance, where the broad contours of the law are laid out in as much detail as possible, but where the application to specific situations still requires that judgment be exercised. This makes statutory interpretation critical to our understanding of the law.

Viewed in this manner, the function of interpretation is not just to interpret ambiguities in existing provisions (i.e. interpretation), but also to step into the shoes of the law maker where situations are left unaddressed, to anticipate how the law makers would have intended the law to apply (i.e. construction). Interpretation means discerning the meaning of an enactment by assigning words their natural and ordinary meaning, while construction means the drawing of conclusions based on the underlying purpose of the law[3]. However, in practice, the line between interpretation and construction is often blurred[4].

Reading someone's mind, or trying to understand what they mean from what they say, is not easy in the simplest of situations, or with the simplest of laws. With tax law, this ask is rendered all the more complex due to the nature of the beast. No other law is subject to annual, widespread and piecemeal amendments (and consequently rid with contradictions) in the manner that tax laws are, a phenomenon that Nani Palkhivala grumblingly referred to as "precipitous tinkering"[5]. No other public law relies as heavily on private law constructs[6]. For example, in determining what should constitute a capital asset under section 2(14) of the Income Tax Act, 1961 (**"ITA"**), the reference is to "*property* of any kind", which requires us to determine what property is... a private law determination[7]. Then, there is the fact of how tax statutes (or at least their charging provisions) are required to be strictly interpreted[8]. Taxes can only be levied by the "authority of the law" i.e. by legislative mandate[9]. If there is any ambiguity, it must be interpreted in favour of the taxpayer. However, the "logic" behind tax provisions is often relied on to determine the manner in which

2. The ambiguity that the Court attempts to address must be real, and not just conjectural or fanciful. See *CIT vs. Boots Company 214 ITR 175* at paragraph 16
3. Thomas M Cooley, A Treatise on the Constitutional Limitations Which Rest upon the Legislative Power of the States of the American Union, Vol 1, page 97 c.f. GP Singh, Principles of Statutory Interpretations (AK Patnaik ed, 14th edn, Lexis Nexis 2016) at page 2
4. Earl Theodore Crawford, The Construction of Statutes, Vol. 2, 3rd Edition, Articles 4504, page 319 c.f GP Singh, supra note 4 at page 2
5. NA Palkhivala and BA Palkhivala in the Preface to the Eight Edition of Kanga J and Palkhivala N, The Law and Practice of Income Tax, vol 1 (Arvind P Datar ed, 10th edn, Lexis Nexis 2014) at page xix
6. Public laws govern the relationship between the government and a person, whereas private laws govern the relationship between persons. It is unusual for public laws (constitutional law, criminal law, international law, for example) to turn to private law as frequently as tax law does, although some laws may sit on the fringes.
7. For another example, see *CIT vs. Podar Cement Pvt Ltd (1997) (5) SCC 482* where there is extensive discussion on the provisions of the Transfer of Property Act, 1882, in relation to the interpretation of "ownership" for the purposes of section 22 of the ITA.
8. GP Singh, supra note 4 at page 20
9. The Constitution of India 1950, Article 265

they are applied. Sometimes the "logic" behind a tax provision may not be legal at all, but motivated by socio-economic factors, which are nevertheless accorded weight by courts in applying tax provisions[10], due to the role that tax laws play in accomplishing governance objectives. This is very different from criminal laws, also strictly interpreted, which are held to a more restrictive standard. Some areas in tax, such as tax treaties, are not subject to strict interpretation at all, but are read in accordance with treaty interpretation rules. This odd combination of factors makes it much harder to interpret tax statutes, and makes a sound understanding of the rules of interpretation much more important. It also does not hurt to embrace a generalist approach and learn from other areas of the law when we try to understand tax statutes.

Where do we begin?

Tax law does not operate in a vacuum. In order to read tax statutes, we rely on many of the tools applied more generally to the law. Some of these tools include the Rules of Interpretation, Internal Aids, and External Aids.

A. Rules of Interpretation

Why do we need rules of interpretation? To interpret the law is to interpret language. However, the meaning of language can vary significantly depending on the person involved. The parable of the five blind men and the elephant comes to mind. The story is as follows: five blind men, who have never seen an elephant, are curious about the animal and want to understand it better. One person who touches the trunk says that it is an animal like a snake. Another who touches the ear says it seems like a fan. Another who touches the leg says that it feels like a tree. Another who touches the side says it feels like a wall, and another who touches the tail says it feels like a rope. All of them are right, but they are all limited in perspective.

With language and the law, perspective matters, and meaning can change depending on the person seeking it. There may be situations where a sentence is understood differently by different readers (syntactic ambiguity), or where references to specific words are understood differently (lexical ambiguity). It may also be that the meaning of a sentence changes over a period of time,

10. See *CIT vs. Podar Cement Pvt Ltd (1997) (5) SCC 482* which involved questions of the application of section 22 of the ITA in relation to evacuee property. See also *CIT vs. Shahzada Nand 60 ITR 392* - The issue involved was whether a commission paid by the taxpayer to their employees could be considered an allowable expenditure under section 36(1)(ii) of the ITA. The Court emphasized that the section does not require any extra services beyond the normal duties of an employee to justify commission payment and rejected the notion that commission payments must be strictly contractual, emphasizing that they can also be voluntary and based on commercial considerations. It observed that the reasonableness of commission payments should be judged from the perspective of a normal, prudent businessman, rather than on standards set by tax authorities taking into considering socio-economic factors and commercial realities when assessing the allowability of expenditure under tax laws.

resulting in questions about whether the objectives intended by the legislature are adequately met[11]. How should we then determine what the law says, in a manner that is consistent, foreseeable and true to its spirit? The importance of rules of interpretation is that they serve as guiding lights in a world filled with many possibilities.

i) Literal Interpretation

Reading the law as it is: The first and arguably the most important rule of interpretation is the Literal Rule[12]. It states that the intent of the lawmaker is best found in the language of the statute itself. A court is duty bound to understand words in their ordinary and natural meaning, even when it leads to unfavourable results. It is not the duty of the court to make a law, and so the judiciary may not add, subtract, substitute, modify, or alter words[13] in a law to imply its own notion of justice *unless* it is to make a provision workable with the rest of the statute.

Courts have refrained, time and again, from legislating in the garb of interpretation. For example, in one case[14], the Supreme Court was required to examine whether expenses incurred towards a corporate guest house were deductible. Two separate sets of provisions were presented for the consideration of the court: section 37, which contained specific references to "residential accommodation in the nature of a guest house" but allowed limited deductions, and sections 30 and 32, which contained no specific references to guest houses but did allow deductions towards "premises" or "buildings". Section 37 was only applicable to situations not covered by sections 30-36. The court held that if the legislature had wanted to allow deductions for all premises/ buildings, it would not have included limiting provisions in section 37. Consequently, only limited deductions under section 37 were available. Given that the legislature's intention was clear and unambiguous, the court was bound to interpret it in its literal sense and not give it a meaning which would cause violence to the provisions of the statute[15].

Situations where the law is silent: When a law overlooks or does not expressly provide a for a situation which should reasonably be included, it is a case of omission (*casus omisus*)[16]. Omissions create a gap in the legal framework. However, courts cannot be trigger happy in supplying words to fill the gap even if the omissions are apparent, even if logic dictates that they are a mere defect in the wording. The only possibility available to courts is that of alternative construction, and suppressing the defect without supplying words[17]. One example relates to section 69D,

11. See Podar Cements, Ibid for an example of a situation where this happened
12. See GP Singh supra note 4 at pages 67 and 91 on reading statutes as they are, and the rule of literal construction
13. *CIT vs. Nestle India Ltd. (2005) 117 DLT 680 at paragraph 10*
14. *Britannia Industries Ltd. vs. CIT (2006) (1) SCC 646.*
15. Ibid
16. See GP Singh, supra note 4 at page 72
17. "A judge must not alter the material of which the Act is woven but he can and should iron out the creases" Lord Denning in Seaford Court Estates Ltd. v Asher, (1949) 2 All ER 155 at 164, cf. GP Singh supra note 4 at 77

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which states that if an amount is borrowed from a hundi and repaid otherwise than through an *account payee* cheque, the borrowed amount shall be treated as income. In one case, the repayment was by demand draft[18]. Since the literal construction (and insistence on payment by check) resulted in an absurdity, the court held that demand drafts were akin to cheque in terms of the transparency required by the provision[19].

Strict Interpretation in Tax: The literal rule is much stricter for tax statutes, which are required to be strictly interpreted[20]. This is due to Article 265 of the Constitution, which states that no tax can be levied or collected without the authority of law. A lawmaker enacting a tax must establish *authority* and specifically identify three components: the subject matter of the tax, the individual liable to pay the tax, and the rate at which the tax will be collected. If there is any dispute or uncertainty about these components that cannot be removed by reasonable construction, no tax can be levied[21]. For example, in a case where the Airport Authority of India Act, 1944 prescribed a developmental fee from embarking passengers, the court held that the fee was in fact a tax without adequate legislative support, and therefore not valid[22]. Other areas of law, such as contracts, are allowed equitable construction or liberal construction i.e. a form of interpretation that looks at the overall purpose of the law rather than the literal text. However, this approach does not hold currency in tax matters[23].

Assuming the law is valid and workable: The literal rule notwithstanding, courts are obligated to interpret laws in a way that gives effect to them[24]. Statutes are presumed to be constitutional and the burden to prove that they are not is on the person making the claim. Courts will not invoke the doctrine of "reading down" a law unless it violates a fundamental right or falls outside the competence of a particular legislature[25]. Similarly, if changing financial or technological developments reduce the law to a *dead letter*[26], courts may deviate from the

18. *CIT vs. Bakhear Ahamed and Co. (1996) SCC OnLine Mad 1028*
19. Ibid
20. GP Singh, supra note 4 at page 871
21. *Mathuram Agarwal vs. State of MP, AIR 2000 SC 109 at 113, c.f. GP Singh supra note 4 at 876*
22. *Consumer Online Foundation vs. UOI 2011 (5) SCC 360 at paragraph 15.* See also GP Singh, supra note 4 at page 876
23. See GP Singh, supra note 4 at page 884-885
24. "ut res magis valeat quam pereat" – it is better for a thing to have effect than to be made void. See GP Singh, supra note 4 at page 48
25. *A. Sanyasi Rao vs. Government of Andhra Pradesh (1989) 178 ITR 31 (AP)* - Addressing the controversial 44AC ITA (omitted by Finance Act 1992) which provided for presumptive tax in respect of certain trade such as liquor, timber and forest produce and it prescribed a percentage of the purchase price as "deemed to be profit" the court remarked that instead of striking down the section for imposing excessive tax rates arbitrarily, and keeping in mind the underlying object and the intension of the lawmaker, the other alternative was to give effect to the theory of "reading down" the provision to make it consistent with Article 14 and 19(1)(g). Consequently, reading it with the provisions of Section 206C the purchase price was only to be taken as a measure for the limited purpose of determining the quantum of tax to be collected under the section and any excess collection, if any would be refunded.
26. *CIT vs. Hindustan Bulk Carriers (2003) (3) SCC 57 at paragraph 21*

literal or strict rule and instead take an object-oriented approach within permissible limits.

ii) Harmonious Construction

What if a literal and strict interpretation of different provisions/legislations results in a conflict?

There is an overarching assumption regarding workability, and so courts must examine if there is a workable way of reading a statute[27], or conflicting provisions within a statute. For example, in a case relating to proceedings before the settlement commission under Chapter XIX-A of the ITA, the Supreme Court was required to examine the period for which interest is chargeable under section 234B. 234B is a general provision for interest when there is a default in payment of advance tax. Settlement commission proceedings under Chapter XIX on the other hand, are only applicable to undisclosed income. The taxpayer argued that the interest provisions are only applicable to disclosed income and not undisclosed income, and that there is no charging provision for interest on undisclosed income under the ITA. The court disagreed with this approach and adopted a harmonious construction of Chapter XIX with the interest payment provisions under the ITA, to hold that taxpayers who are party to undisclosed income proceedings before the Settlement Commission are still required to pay interest on late payment of taxes under the general provisions of the ITA[28], as that would be the only cohesive and workable approach possible.

In adopting harmonious construction, it is useful to bear in mind that harmonisation still involves a departure from the literal rule. We then need to ask deeper questions about the conflict that is sought to be "harmonised" i.e. what is the provision to which literal effect is not being given, and why, and to whose benefit? Helpfully, the law does suggest hierarchies for the resolution of some conflicts. For example, specific provisions are generally considered to override general provisions[29]. One example of this provision relates to a case[30] where an assessee jointly purchased an immovable property with another individual, each holding a 50% share. 5% was sold and the remaining 95% was transferred to a partnership firm in which the assessee was a partner. The question pertained to whether the full value of consideration in the hands of the asseesee should be determined as per section 50C (the general provision relating to transfers of a land or building at less than fair market value) or 45(3), (a specific provision relating to the transfer of capital contribution to a partnership firm). Based on the *generalia specialibus* rule, the Tribunal ruled that 45(3) would apply.

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27. GP Singh, supra note 4 at page 160. See also *CIT vs. Hindustan Bulk Carriers (2003) (3) SCC 57* "A construction which reduces the statute to a futility has to be avoided. A statute or any enacting provision therein must be so construed as to make it effective and operative on the principle expressed in the maxim ut res magis valeat quam pereat i.e. a liberal construction should be put upon written instruments, so as to uphold them, if possible, and carry into effect the intention of the parties"
28. Id. at paragraph 12 -21
29. "generalia specialibus non derogant"
30. *Nareshbhai Ishwardas Patel vs. Income-tax Officer (2023) 155 taxmann.com 141 at paragraph 11.1*

iii) Purposive Interpretation (the "Mischief Rule")

The purposive rule of interpretation is also commonly referred to as the mischief rule, was laid down in Heydon's case (1584)[31]. When the words of a provision can have more than one meaning, the rule requires the court to ask four questions: (i) what was the law before the making of the Act, (ii) What was the mischief or defect sought to be addressed (iii) How was the mischief/defect proposed to be addressed by the Act (iv) What was the reason for the proposal[32]. Based on these questions, the court tries to reconstruct the intention of the legislature, without going so far as legislating. The object of the rule is to add force to the law and supress the mischief as originally intended by the legislature[33]. However, the extent to which this can be done is left to the discretion of the court, which has subjected this rule to some criticism on account of judicial overreach. The mischief rule isn't applied often in tax matters, with some notable exceptions[34].

B. Internal Aids

Rules of interpretation in themselves may not be sufficient. Courts then need to understand which parts of the law to pay lesser or greater attention to. Internal aids to construction are found within the statute whereas external aids are found outside the statute. Some examples of internal aids are discussed below.

Learning from context: The rules of *Noscitur A Sociis and Ejusdem Generis* are examples of reading between the lines, or learning from the context of the statute. *Noscitur A Sociis* is a legal maxim which translates to a *word is known by the company it keeps*. For instance, the court applied this rule to interpret the meaning of "extinguishment of rights" under section 2(47) of ITA[35], in a situation where the assessee had received an insurance amount in compensation for the destruction of leased machinery. The question was whether the definition of transfer under section 2(47) also covered destruction of machinery. Based on the *noscitur* principle, the court noted that the other kinds of transfer contemplated by the provision (being sale, exchange etc.) contemplated the existence of both the asset and a transferee, and that the extinguishment of a right due to the extinguishment of the asset does not constitute a transfer.

Along similar lines, *ejusdem generis* refers to a situation where a group of words belonging to a class, category or genus is followed by general words. In a case where the taxpayer paid an amount as bank guarantee towards for a liquor license, the question arose as to whether it could constitute a "*tax, duty, cess or fee*" for the purpose of deductibility under Section 43B of the ITA. The court noted that there is a difference between the group pertaining to compulsory extraction authorised by law, as against amounts payable as

31. Heydon's case (1584) 3 Co. Rep. 7a, page 7b available online at https://www.bailii.org/ew/cases/EWHC/Exch/1584/J36.html last accessed on February 28, 2024
32. GP Singh supra note 4 at page 137
33. Ibid
34. See *K.P. Varghese vs. The Income Tax Officer, Ernakulam 1981 (4) SCC 173* for an example of a case where it was applied
35. *Vania Silk Mills (P) Ltd vs. CIT, Ahmedabad 1991 (4) SCC 22*

consideration under a contract. Consequently, it was held that the said amounts would not fall under section 43B[36].

Learning from the introduction: A preamble reflects the spirit of the legislation and can be an important aid to construction[37]. It is not an enacting part of the statue but is particularly useful when applying the purposive rule. Reliance on the preamble/intent is more frequently seen in tax treaty interpretation than with domestic statutes.

Clarifications within the statute (Provisos, Explanations and Non-Obstante Clauses): Statutes themselves contain clues which are vital to take note of.

For example, provisos (provisions which start with *"provided that"*) contain exceptions to the main provision. They are generally clarificatory, and widen or restrict the scope of a provision rather than introduce concepts that are entirely new[38]. One of the more litigated provisos, for instance, is the carveout for objects of general public utility in section 2(15) of the ITA (the definition of charitable purpose). The proviso states that activities in the nature of trade, commerce or business shall not be of general public utility and consequently not a charitable purpose. Explanations on the other hand can be expansive[39]. For example, much of the flavour and detail in section 9(1)(i) of the ITA is through its seven explanations, including the provisions dealing with significant economic presence and the indirect transfer tax provisions. Non obstante clauses (beginning with *"notwithstanding anything"*) are intended to override any other conflicting provisions in the statute. For example, section 58 of the ITA restricts deductibility under section 57 in specific kinds of situations. However, these provisions must continue to be read in context of the provision and the chapter[40].

C. External Aids

Recourse to external aids (material outside the statute) is taken only when doubt persists in spite of reading the statue as a whole. In a tax context for example, circulars issued by the Central Board of Direct Taxes, convey the thinking of the tax authorities and are considered binding on tax authorities[41]. While a circular cannot override a statute, or bind judicial authorities, it is useful in providing perspective[42].

Other external aids include definitions from other legislations, previous legislations or the dictionary. These references should be made carefully, since words cannot be imported devoid of context. For example, there is

36. *CIT vs. McDowell and Co. Ltd (2009) (10) SCC 755 see paragraph 17-23*
37. GP Singh, supra note 4 at page 174
38. GP Singh, supra note 4 at page 215
39. Ibid at page 234
40. See *MPV Sundararamier & Co vs. State of Andhra Pradesh, AIR 1958 SC 468* c.f. GP Singh, supra note 4 at page 235, where an explanation identical to an explanation in another statute was construed differently.
41. *K.P. Varghese vs. The Income Tax Officer, Ernakulam 1981 (4) SCC 173*
42. *Kalyani Packaging Industry vs. Union of India (UOI) MANU/SC/0527/2004* – "It must be remembered that law laid down by this Court is law of the land. The law so laid down is binding on all Courts/Tribunals and Bodies. It is clear that circulars of the Board cannot prevail over the law laid down by this Court."

currently a widespread lack of clarity as to whether the tax collection at source under section 206C(1H) extends to the sale of shares. 206C(1H) refers to a sale of goods but does not define goods. "Goods" under section 2(52) of the Central Goods and Services Tax Act excludes securities. However, "goods" under the section 2(7) of the Sale of Goods Act, 1930 includes every kind of movable property including stocks and shares. While attempts may be made to provide a rationale for relying on one external aid versus another, these choices are fraught with uncertainty, and no clear-cut guidelines are provided by the law.

External aids may also include preparatory works such as the legislative history to a provision and parliamentary material. The explanatory notes that are issued every year along with the Finance Act are invaluable in communicating the thinking of the lawmakers in relation to specific provisions. Other material may include constituent assembly debates, law commission reports and speeches and debates[43]. Again, while none of these can be used as a primary tool, nor are they binding on courts, they do enable us to obtain a bigger picture.

Conclusion

The Argentinian writer Jorge Luis Borges wrote obsessively and beautifully about the inadequacies of language, how it represents reality (or fails to), and how any communication is doomed from the start due to the "an arbitrary system of grunts and squeals"[44] that we are compelled to work with. When it comes to the law, our aspirations for language are greater, and consequently, the sense of helplessness possibly more acute. If there is certainty to be found here, it is likely that it is only the interpretation tools that will get us there.

43. *K.P. Varghese vs. The Income Tax Officer, Ernakulam 1981 (4) SCC 173* "Now it is true that the speeches made by the Members of the Legislature on the floor of the House when a Bill for enacting a statutory provision is being debated are inadmissible for the purpose of interpreting the statutory provision but the speech made by the Mover of the Bill explaining the reason for the introduction of the Bill can certainly be referred to for the purpose of ascertaining the mischief sought to be remedied by the legislation and the object and purpose for which the legislation is enacted. This is in accord with the recent trend in juristic thought not only in Western countries but also in India that interpretation of a statute being an exercise in the ascertainment of meaning, everything which is logically relevant should be admissible." at paragraph 8

44. To quote GK Chesterton: "Every time one man says to another, "Tell us plainly what you mean?" he is assuming the infallibility of language: that is to say, he is assuming that there is a perfect scheme of verbal expression for all the internal moods and meanings of men…he seriously believes that these things can every one of them, in all their tones and semitones, in all their blends and unions, be accurately represented by an arbitrary system of grunts and squeals. He believes that an ordinary civilized stockbroker can really produce out of his own inside noises which denote all the mysteries of memory and all the agonies of desire." GK Chesterton, "Watts Allegorical Paintings", (1904) Duckworth & Co, London, available online at https://gutenberg.net.au/ebooks12/1201851h.html last accessed on February 24, 2024.

Interpretation in a constantly evolving socio-economic landscape: certain key provisions

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Overview

The present Article aims to gauge and understand the changes in judicial interpretation of taxing statutes with respect to certain peculiar features in the light of changing socio-economic landscape in the country. To effectively understand the trends in adoption of method of interpretation with respect to each of such peculiar facets, this article begins with analyzing the nature of taxing statutes and how the factors which distinguish a taxing statute from other statutes, influence the higher courts in construing a taxing statute. The Article proceeds to unfold rules for interpretation which have been developed with respect to peculiar components of tax statutes, inter-alia, deeming provisions, retrospective applicability of annual amendments, CBDT circulars and rules for non-obstante clauses. Further, the article, through latest rulings, seeks to understand different approaches to interpretation of international tax treaties between countries, i.e., Static and Ambulatory approach. At the end, the Article concludes with highlighting present-day statistics with respect to pendency of cases to stress upon the importance of role played by Higher Courts and the need to adopt the most suitable way of interpretation to maintain the sanctimonious balance between the interest of taxpayers and the state exchequer.

Introduction

The life of the law has not been logic: it has been experience[1], experience which encompasses the ever changing societal and economic landscape. For the function of law is to administer subjects of the dynamic society. Hence, interpretation of such law requires due consideration to its surrounding socio-economic landscape at a given point of time.

Interpretation of Statutes, a prerogative exclusively vested with the Courts and to some extent with authorities exercising quasi-judicial functions, is the fundamental tool for adjudication of claims before a judicial authority for the purpose of dispensation of justice in the society. Interpretation assumes emergence of natural complexities borne out of the nature, structure, components, and the purpose of a statute enacted by the the legislature.

"Interpretation" means action of explaining the meaning of something. For interpreting a

1. Oliver Wendell Holmes, Jr., Lecture, Lowell Institute Boston, 1881

statutory provision, Court is required to take an insight into the provision and unfold its meaning by means of well-established canons of interpretation, having regard to object, purpose, historicism of law and several other well-known factors[2]. Since Taxing statutes are Fiscal in nature, imposing statutory pecuniary liability on general public, interpretation of such statutes stands on a different footing in comparison to other statutes.

This approach inculcated a strict, i.e., literal interpretation of Taxing statutes; however, due to economic growth and factors emanating as a result of economic growth, the Courts have displayed an increasing propensity to move towards a liberal approach. The purpose of the present article is to gauge and understand the changes in judicial interpretation of taxing statutes qua the peculiar concepts such as; (i) Deeming provisions, (ii) retrospective applicability of amendments, (iii) non-obstante clauses, (iv) role of judicial precedents, (v) binding value of executive orders/circulars etc.

Interpretation of Taxing Statutes

Taxing statutes due to the subject they encompass stand on a different footing and hence cannot be tested on same principles as the law affecting civil rights[3]. In fact, in Indian jurisprudence, Taxing statutes have been subject of the ever-prevalent dichotomy of interpretation, i.e., Strict v Liberal interpretation. Earlier, the higher courts across the country accepted the notion that Taxing statutes have to be interpreted strictly, in literal sense, as there can be no equity in Tax[4]. The position as promulgated by higher courts entailed that if the language of the statue is clear and unambiguous, the court cannot discard the plain meaning, even if it leads to injustice[5]. However, particularly in cases where a provision of a taxing statute is capable of having more than one interpretation, courts lean towards the interpretation beneficial to the taxpayer.

However, different components of taxing statutes are subject to different methods of interpretation. Taxing statutes are usually comprised of; (a) Charging provisions (b) beneficial provisions (c) exemptions (d) penal provisions and (e) deeming provisions.

Interpretation of Deeming Provisions

As verb transitive, the word "deem" means to treat something as if (i) it is really something else, or (ii) it has qualities that it does not have. "Deem" is a useful word when it is necessary to establish a legal fiction either positively by "deeming" something to be something it is not or negatively by "deeming" something not be something which it is[6]. Generally, deeming provisions can be classified into: (a) provisions creating legal fiction, (b) provisions that declare law, (c) provisions declaring certain facts as established, and (d) provisions conferring discretion.

2. *Sudevanand vs. State, (2012) 3 SCC 387.*
3. *Serum Institute of India (P.) Ltd. vs. UOI, [2023] 157 taxmann.com 107 (Bombay).*
4. Rowlatt, J. in *Cape Brandy Syndicate vs. IRC, [1921] 1 KB 64, CIT vs. Ajax Products Ltd., [1965] 55 ITR 741 (SC).*
5. *Commissioner of Income Tax vs. T.V. Sundaram Iyenagar & Sons (P.) Ltd., [1975] 101 ITR 764 (SC).*
6. G.C. Thornton, Legislative Drafting 83-84 (2nd Ed. 1979).

It can be argued that the very notion of deeming provisions, particularly the ones creating legal fiction, was conceived by common law courts, specifically to reduce the friction between rigid laws and the wants of society[7]. The construction of deeming provisions, particularly the ones creating deeming fictions takes into account certain rules and principles developed by higher courts. As a foundational practice, the courts ought to ascertain the purpose of creation of the legal fiction, all consequential and incidental facts or corollaries, but, the indented construction ought not to travel beyond the purpose of its creation[8].

It is interesting to note that while interpreting a deeming provision, whenever a fact is deemed, its natural and incidental consequences are also deemed. A leading example would be section 16 and section 17 of the Income Tax Act ('**the Act**'), whereas section 16 allows taxpayer to claim standard deduction (daily expenses during employment) from the salary for the purpose of taxability, section 17 creates a legal fiction that salary includes income from pension. In the case of ***Swaroop Krishna***[9] the Hon'ble Court construed the legal fiction created by section 17, reading it in conjunction with section 16 to state that standard deduction can be claimed against pension despite the taxpayer not incurring day-to-day expenses in respect of employment, as a natural consequence of the legal fiction created under section 17 of the Act.

In the context of judicial overruling of a taxing statute by higher courts for want of jurisdiction, the legislature is precluded from validating the said statute by merely declaring the decision of the court to be invalid. However, legislature is entitled to alter the preconditions of the judgement through the use of legal fiction in order to render the judgment ineffective or otiose[1].

Retrospective Statutory Amendments

A law enacted is prima facie prospective unless it is expressly or by necessary implications made to have retrospective operation[11]. The genesis of prospective application of a statute can be derived from the maxim '*lex prospicit non respicit*' which means that the law looks forward and not backward.

The test to determine whether or not a retrospective tax is justified or not the courts have traditionally weighed two factors, the period of retrospectivity and the degree of financial burden caused to the taxpayer[12].

In the light of applicability of retrospective amendments in taxing statutes *qua* the requirement of explicit declaration for such effect, the Supreme Court in Lohia Machines Case[13], held that despite lack of explicit declaration for retrospective application of a statutory provision, if such provision is explanatory or clarificatory in nature, it must be judicially construed as retrospective.

The amendments which use the words 'for removal of doubts', 'shall be deemed always to have meant' or which are explanations to an existing provision are always treated to be a clarification for a previous provision

7. 'Legal Fictions', Glenn Scobey Warner Cornell Law, 1894.
8. *Mancheri Puthusseri Ahmed vs. Kuthiravattam Estate Receiver, (1996) 6 SCC 185.*
9. *Commissioner of Income Tax vs. Swaroop Krishna, [1985] 21 Taxman 4040.*
10. *Shri Prithvi Cotton Mills Ltd. vs. Broach Borough Municipality, [1970] 1 SCR 258.*
11. *Keshava Madhava Menon vs. State of Bombay, 1951 SCC 16*
12. *Ujagar Prints vs. Union of India, (1989) 3 SCC 488.*
13. *Lohia Machines Ltd and Anr. vs. Union of India, (1985) 152 ITR 308 (SC).*

and hence are always given retrospective application. In Indian Tax landscape, Finance Act 2012 can be cited as one of the most infamous and debatable change, as per which any company registered outsideIndia and deriving a major portion of its value from assets situated in India was deemed to have its shares located in India. This not only operated as a deeming provision creating a legal fiction, but, was also given retrospective applicability.

In the ***Vodafone ruling***[14], the Supreme Court held that the transfer of shares was indirect, taking place through a foreign entity having majority stakes in the Indian company, and hence, the aforesaid transaction cannot be regarded as transfer of capital assets situated in India, ousting the jurisdiction of the Revenue to tax the same (offshore transaction) within India. However, this decision of the Supreme Court and the consequential loss of revenue, prompted the legislature to bring in amendment to the Act by way of Finance Act 2012 to 'clarify'[15], in form of an explanation to substantive provision, that any sale of shares, albeit outside India, will be taxed in India if the subject of such sale derive their value from India.

In ***Alom Extrusions***[16], the Supreme Court, in respect of reading a newly introduced explanation/proviso to an already existing substantive provision, laid down that when a proviso/explanation is inserted to remedy undesired consequences, the proviso shall be read into the section with reasonable interpretation.

Non-Obstante Clauses and their Interpretation

Unsurprisingly, the word 'Non-Obstante' stems from Latin, to mean notwithstanding or despite a law. Developed, intending to carve out a specific area where an existing law would cease to operate, construed in this light, non obstante clauses can be again inferred to be a tool to reduce friction between existing laws and evolving societal circumstances.

A legislative tool to confer overriding effect upon a particular law over other laws, often conflicting, non-obstante clauses have now become standard in legislative drafting. The Apex Court in ***G.M. Kohli***[17], clarified that "a non-obstante clause is a legislative device which is usually employed to give overriding effect to certain provisions over some contrary provisions that may be found either in the same enactment or some other enactment, that is to say, to avoid the operation and effect of all contrary provisions."

Due to the overriding effect of non obstante clauses, the higher courts have also endorsed employing the interpretation which imputes wide and overarching effect over other provisions sought to be subdued. This can be seen from the decision of the Supreme court in the case of ***Orient Paper and Industries Ltd.***[18], wherein the court clarified that non obstante clauses are to be given widest amplitude engulfing all rules having force of law regardless of the source; be it statutory, judicial or customary, with the only exception being the Constitution of India. It would not be unreasonable to suggest that

14. *Vodafone International Holdings B.V. vs. Union of India & Anr., [2012] 17 taxmann.com 202 (SC).*
15. Explanation 5.29—For the removal of doubts, it is hereby clarified that an asset or a capital asset being any share or interest in a company or entity registered or incorporated outside India shall be deemed to be and shall always be deemed to have been situated in India, if the share or interest derives, directly or indirectly, its value substantially from the assets located in India: Section 9(1)(i), Finance Act 2012.
16. *CIT vs. Alom Extrusions Ltd., [2009] 319 ITR 306. .*
17. *Union of India vs. G.M. Kohli, 1984 Supp SCC 196.*
18. *Orient Paper and Industries Ltd vs. State of Orissa, 1991 Supp (1) SCC 81.*

the rationale behind employing non obstante clauses in legislations lies in the legislative acknowledgement of a probable conflict in different laws or, alternatively, it was intended that the scope of a provision should not be whittled down under any circumstances for unknown reasons[19].

In the event where two laws, in conflict with each other, are applicable to a particular situation, the provision carrying the non-obstante clause will be given effect to due to the overriding nature[20]. One such reason for giving overriding effect to the provision carrying non obstante clause may be that such provisions carrying non-obstante clause or beginning with a non-obstante clause are often construed as a complete code in themselves. However, in regard to the Income Tax Act, recently, there have been instances where despite a provision carrying non-obstante clause, the Courts have refrained from construing it in its widest amplitude and curtailed its scope. The Gujarat High Court recently had an occasion to construe the non-obstante clause under section 153A of the Income Tax Act, in the context of already concluded search assessment under the aforesaid section viz-a-viz re-opened assessment proceedings under section 147 of the Act qua the same assessment year[21].

The Gujarat High Court, unconvinced with the overriding effect argument raised by the Assessee in order to invalidate the reassessment proceedings initiated under section 147 of the Act, concluded that assessment already undertaken under section 153A can be reopened under section 147 despite the overriding clause in section 153A. The Court stated that non-obstante clauses are not always to be regarded as repealing clauses nor as clauses which expressly or completely supersede any other provision of the law, but merely as clauses which remove all obstructions which might arise out of the provisions of any other law in the way of the operation of the principal enacting provision to which the non-obstante clause is attached[22].

Thus, it can be ascertained that recently the understanding of the nature and purpose of non-obstante clauses seems to be shifting from overriding the application of other laws to removing obstructions from the applicability of the substantive provision carrying the non-obstante clause.

CBDT circulars; importance and binding value

The importance of CBDT circulars can be gauged from the evolving nature of the Income Tax Act which witnesses annual amendments by way of Finance Act(s) every year. For a legislation witnessing amendment with such frequency, it is only natural that a number of subject domains under the legislation might need legitimate clarifications in the form of delegated legislation. CBDT circulars/notifications derive their authority from section 119 of the Income Tax Act which vests with the Central Board of Direct Taxes, the power to promulgate such orders, instructions, and directions in the form circulars/notifications which the board deems necessary for proper administration of the Income Tax Act.

The Phraseology of the aforesaid section highlights the discretion provided to the CBDT under the scheme of the Income

19. *Ashwini Kumar Ghose vs. Arabinda Bose, (1952) 2 SCC 237.*
20. *Parayankandiyal Eravath Kanapravan Kalliani Amma vs. K. Devi, (1996) 4 SCC 76.*
21. *Amar Jewellers Ltd. vs. Assisstant Commissioner of Income Tax, [2022] 444 ITR 97 (Gujarat).*
22. Supra note 20.

Tax Act with regard to its procedure and administration especially with the objective of smooth integration of annual amendments. In conjunction to the discretion, section 119 of the Income Tax Act also makes CBDT circulars binding upon revenue authorities. The Supreme Court, in ***K.P. Varghese***[23], while referring to the earlier decision of ***Navnit lal C. Javeri***[24], held that the circulars of the CBDT are legally binding on the revenue department including all officers and persons employed in execution of the Income Tax Act, and, that such binding nature does not cease despite the circular deviating from the correct interpretation of the section and being construed differently.

CBDT circulars issued under section 119 of the Income Tax Act, beneficial to the assessee despite deviating from the strict tenor of the law and mitigating the rigour of the said law, are binding on the Revenue authorities[25]. Even though interpretation of law is exclusive function of the courts, CBDT can, by virtue of section 119, mitigate the stringency of a provision and construe it to the benefit of the tax payers. However, it is interesting to note that circulars issued by CBDT under section 119 of the Act cannot impose a higher tax burden than the one provided under the Income Tax Act, thus, ensuring that the purpose always remains to 'supplant' and not 'supplement' the law[26]. Moreover, the Apex Court in ***R&B Falcon***[27] has went ahead to opine that the CBDT is vested with the authority of interpreting the provisions of the Income Tax Act, such interpretation being in the nature of executive construction. In the context of Fringe Benefit Tax, CBDT circular no. 8 of 2005, the Supreme Court in the aforesaid case, while clarifying the concept of executive estoppel has held as under:

> *"23. Rules of executive construction in a situation of this nature may also be applied. Where a representation is made by the maker of legislation at the time of introduction of the Bill or construction thereupon is put by the executive upon its coming into force, the same carries a great weight."*

The Apex Court, while referring to the decision of House of Lords in ***Pepper vs. Hart [1993] AC 593***, validated the CBDT circular by utilising the concept of executive estoppel to preclude income tax authority from taking a contrary view to the one expressed in the circular, especially when the circular was creating a benefit in favour of the taxpayer[28].

Emanating as a consequence from the decision of R&B falcon, the revenue department was faced with a predicament wherein it was increasingly frequent for the higher courts to reject the challenge laid by the revenue to circulars beneficial for taxpayers deviating from the provisions of the Income Tax Act. However, the Supreme Court in ***Ratan Melting***[29], with respect to the issue of right of the revenue department to lay challenge in appeal to CBDT circular deviating from the statutory provisions of the Act; construed beneficially to the tax payer, reversed the position and held if the revenue is precluded

23. *K.P. Varghese vs. Income Tax Officer, 131 ITR 597 (SC).*
24. *Navnit lal C. Javeri v. K.K. Sen Appellate Asstt. CIT, [1965] 56 ITR 198 (SC).*
25. *Keshavji Ravji and Co. vs. CIT, 183 ITR 1 (SC).*
26. *CIT vs. Punalur Paper Mills Ltd., [1988] 170 ITR 37.*
27. *R&B Falcon (A) Pvt. Ltd. vs. Commissioner of Income tax, [2008] 301 ITR 309 (SC).*
28. Supra note 26.
29. *Commissioner of Central Excise, Bolpur vs. M/s. Ratan Melting & Wire Industries, 2008 taxmann.com 1649 (SC).*

from challenging the circular in appeal, it would be against the very concept of the majesty of law declared by the Supreme court and the binding effect thereof in terms of Article 141 of the Constitution.

Recently, the changes brought in by Finance Act 2021 (insertion of section 148A) and the directions given by the Apex Court in ***Ashish Agarwal***[30], came in conflict with CBDT circular dated 11.05.2022. The newly inserted section 148A, mandated a preliminary hearing and order on the issue of escapement of income and issuance of notice under section 148 of the Act. The controversy has arisen with respect to the number of assessment years for which notices under section 148A can be issued, specifically for Assessment years 2013-2014 and 2014-2015, which has pitted the changes brought in by Finance Act 2021 to the Income Tax Act against the aforesaid CBDT circular as per which due to the operation of Taxation Laws (Relaxation of Limitations and other provisions) Act 2020; brought in to reduce deadline hardship during Covid-19 pandemic, the limitation date of assessment for A.Y. 2013-2014 and 2014-2015 under section 148A and 148 of the Act stood extended. The Delhi High Court, albeit for assessment years 2016-2017 and 2017-2018, has quashed the aforesaid circular holding that the said circular cannot be allowed to stand to the extent it propounds the "Travel back in time" theory[31]. However, with respect to assessment years 2013-2014 and 2014-2015, there has been a conflict of opinion amongst different High courts across the country[32]. As a result of conflicting opinions, the issue qua assessment years 2013-2014 and 2014-2015 has not attained finality and is pending disposal before the Supreme Court.

Static vs. Ambulatory approach to treaty interpretation

Static approach, a self-explanatory method of interpretation often contrasts with Ambulatory approach in the sphere of treaty interpretation. It is interesting note that the genesis of the Ambulatory approach can be traced back to the English common law courts, specifically, the court of king's bench. The court of King's bench was termed as Ambulatory court because it followed the king's person and was held sometimes in one place and sometimes in another place; dynamic in its approach and flexible in effect.

Ambulatory approach, which is nothing but Dynamic approach inculcating present day realities while interpreting a provision of an international tax treaty between two states, as a principle, contrasts, in a literal sense, with the rules of treaty interpretation as envisaged under the Vienna convention[33].

The ***MFN Clause***[34] case can be regarded as the latest instance wherein the Apex court, in the context of applicability of Most favoured Nation clause in the tax treaty between India and Switzerland, had an occasion to evaluate and choose which method of treaty interpretation was to be employed. The Apex court in the aforesaid landmark case, was vexed with the issue of determination of

30. *Union of India vs. Ashish Agarwal, [2022] 444 ITR 1 (SC).*
31. *Ganesh Dass Khanna vs. Income Tax Officer, [2024] 460 ITR 546 (Delhi).*
32. *M/s Arati Marketing Pvt. Ltd. vs. Union of India & Ors, Keenara Industries Pvt. Ltd. vs. Income Tax Officer, [2023] 453 ITR 51 (Guj.), Touchstone Holdings (P.) Ltd vs. Income Tax Officer, [2022] 142 taxmann.com 336 (Delhi).*
33. Article 26 and Article 31, Vienna Convention on law of treaties, 1969, Done at Vienna on 23 May 1969. Entered into force on 27 January 1980. United Nations, Treaty Series, vol. 1155, p. 331
34. *Assessing Officer (International Taxation) vs. Nestle SA, [2023] 458 ITR 756.*

date of treaty between India and Slovenia which would, as a consequence, determine the imputation of lower rate as provided in India-Slovenia treaty to India-France/Switzerland/Netherlands treaties. The Apex court, diverging from the previously established position[35], held that the benefit of MFN clause cannot be granted to the treaty between India and France/Switzerland/Netherlands as the treaty between India and Slovenia has to be interpreted based on when it was signed and not when the treaty is sought to be applied; thus emanating as a consequence the lower tax rate of India-Slovenia treaty could not be imputed to India-France/Switzerland/Netherlands treaties. The Supreme court, thereby gives a static interpretation of the treaty as against an ambulatory approach for interpretation[36].

Conclusion

Changing economic landscape brings in new avenues for transactions, which implies amendments in taxing statutes to tax the income generated from such novel avenues, for e.g. (i) Equalisation Levy in Finance Act 2016 aiming to bring income generated by the digital economy within the ambit of taxation in India, (ii) Withholding Tax framework for Virtual Digital Assets in Finance Act 2022[37].

Rampant societal and economic changes accompanied by prompt amendments in tax statutes, have resulted in increased tax litigation across the country. While India's tax system has moved towards a simple and moderate rate structure resulting in a wider tax base, the prevailing system of direct taxes is beset with problems of increasing arrears of collections and pendency of appeals. The caseload pendency has increased year after year from 73.3% in 2015-16 to 82.2% in 2019-2020[38]. Considering the increased case load, the higher courts across the country have assumed a greater responsibility in utilising tools of interpretation to adjudicate pending tax matters, balancing on the tightrope to maintain parity between interest of taxpayer and the state exchequer. Keeping in mind the changing landscape, the need for higher courts to adopt an ambulatory approach to interpretation as against static approach appears to be more appropriate and adept for complete dispensation of justice and also for ensuring a flexible outlook to interpretation which reduces the impediments emanating from the binding nature of judicial decisions.

35. *Steria (india) Ltd. vs. Commissioner of Income Tax, 386 ITR 390 (Delhi)*, and, *Concentrix Services Netherlands B.V. vs. Income Tax Officer (TDS), 434 ITR 516 (Delhi).*

36. "SC Decision of Most Favoured Nation Clause", Vivek Raju P, Taxmann.com, [2023] 155 taxmann.com 655 (Article).

37. "Taxation framework of virtual digital assets", Tax, PWC India, https://www.pwc.in/tax-knowledge-hub/taxation-framework-of-virtual-digital-assets.html#:~:text=Effective%20from%201%20April%202022,through%20cryptographic%20means%20or%20others.

38. "Working Paper on Direct Taxes Litigation Management and Alternate Dispute Resolution", Supriyo De, National Institute of Public Finance and Policy New Delhi, 25.04.2023.

SS-VI-17

Interpretational issues in Exemption/Deduction Provisions

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Overview

The interpretation of exemption and deduction provisions within legal frameworks is a critical task for judges, ensuring clarity and fairness. Interpretation involves deciphering the true meaning of statutory language, balancing literal and purposive approaches. Courts typically strive to ascertain legislative intent, resorting to various principles like the literal interpretation, golden rule, mischief rule, and harmonious construction.

Taxation statutes, imposing financial burdens, demand stringent interpretation, ensuring clear legislative intent for taxation. While taxes must be explicitly imposed, exemptions and deductions are liberally construed in favor of the taxpayer, aiming to advance legislative objectives.

Several judgments of the Hon'ble Supreme Court of India and High Courts have firmly laid down the principle that a provision for deduction, exemption or relief should be interpreted liberally, reasonably and in favour of the assessee, and it should be so construed as to effectuate the object of the legislature and not to defeat it. A five-judge bench of the Supreme Court of India in the case of CC v. Dilip Kumar & Company overruled the well settled principle in Sun Export case. However, the judgment in Dilip Kumar failed to note the distinction between the interpretational approach to be adopted while construing a general exemption provision and a beneficial exemption provision, one which is legislated with an object of promotion of certain activities.

Synopsis

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Introduction

We often hear the judges of Courts and Tribunals comment "*we interpret the law and not make it*". Therefore, one of the most important tasks of a judge is to interpret the provisions of law.

As Bennion points out, the 'unit of inquiry' in statutory interpretation is 'an enactment' whose legal meaning in relation to a particular factual situation falls to be determined[1].

The essential rule is that words should generally be given the meaning which the normal speaker of the English language would understand them to bear in the context in which they are used. In a more specific sense, interpretation is required when a doubt or dispute arises about the meaning of a statutory provision. The canons of interpretation represent a position taken by the judiciary on their constitutional role in nation to those who have established the political program, those who have to carry it out and those affected by it. The canons of statutory interpretation are frequently statements, not so much of the hard and fast rules of law as of general judicial approach to the task of independent states in particular context[2].

Interpretation and Construction

The words interpretation and construction are generally used synonymously, even though jurisprudentially they are perhaps different. Interpretation means the art of finding out the true sense of an enactment by giving the words their natural and ordinary meaning, whereas construction means drawing conclusions on the basis of the true spirit of the enactment even though the same does not appear if the words used in enactment are given their natural meaning[3].

Normally, the court tries to find out the intention of the legislature in the language of the statute itself. If it feels that the legislature has expressed itself unambiguously, the court does not allow any deviation from the grammatical meaning as that is the will of the legislature. However, at times, the court, finding that the literal meaning is not quite free from ambiguity, may attempt to interpret an enactment in the light of the mischief which it is supposed to suppress.

There may be other occasions where the court may be compelled to look to the spirit of an enactment which alone could, in the opinion of the court, be the proper guide to know the legislature's will under the circumstances.

There are several rules of Statutory interpretation.

1. Bennion s 137.
2. Cross Rupert, Statutory Interpretation, 2017.
3. Bhattacharya, The Interpretation of Statutes, 2009.

Literal interpretation

The first principle of interpretation is the literal or grammatical interpretation which means that the words of an enactment are to be given their ordinary and natural meaning, and if such meaning is clear and unambiguous, effect should be given to a provision of a statute whatever may be the consequences. The basis of this principle is that the object of an interpretation is to know what the legislature intended, whatever was the intention of the legislature has been expressed by it through words which are to be interpreted according to the rules of grammar. If the language of a statute is plain, the only duty of the court is to give effect to it and the court has no business to look into the consequences of such interpretation. Similarly, the court should give technical meaning to a technical word. The words of a statute are first understood in their natural, ordinary or popular sense and phrases and sentences are construed according to their grammatical meaning, unless this leads to some absurdity or unless there is something in the context or in the object of the statute to suggest the contrary[4].

Golden Rule

The golden rule is a modification of the principle of grammatical interpretation. It says that ordinarily the court must find out the intention of the legislature from the words used in the statute by giving them their natural meaning but if this leads to absurdity, repugnance, inconvenience, hardship, injustice or evasion, the Court must modify the meaning to such an extent and no further as would prevent such a consequence[5]. On the face of it, this rule solves all problems and is, therefore, known as the golden rule. Further, since the literal meaning is modified to some extent, this approach is called the modifying method of interpretation. This rule, therefore, suggests that consequences or effects of an interpretation deserve a lot more importance because these are clues to the true meaning of a legislation.

Mischief Rule

The mischief rule of interpretation originated in Heydon's case[6], in 1584. In this case, the Barons of the Exchequer resolved[7] "that for the sure and true interpretation of all statutes in general (be they penal or beneficial, restrictive or enlarging of the common law) four things are to be discerned and considered; (1st) What was the common law before the making of the Act. (2nd) What was the mischief and defect for which the common law did not provide. (3rd) What remedy the Parliament had resolved and appointed to cure the disease of the commonwealth. And, (4th) The true reason of the remedy; and then the office of all the Judges is always to make such construction as shall suppress the mischief, and advance the remedy, and to suppress subtle inventions and evasions for continuance of the mischief, and *pro privato commodo*, and to add force and life to the cure and remedy, according to the true intent of the makers of the Act, *pro bono publico*[8]. This principle is also known

4. *Crawford vs. Spooner, (1846) 4 MIA 179, at p. 181(PC).*
5. *Tirath Singh vs. Bachitter Singh AIR 1955 SC 850.*
6. 3 Co. Rep. 7a; 76ER 637.
7. Ibid, at p. 76.
8. Quoted by Maxwell, Interpretation of Statutes, Twelfth Edition, p. 40.

as the rule of purposive construction. It has been said in ***Macmillan vs. Dent***[9], that in interpreting an Act of Parliament you are entitled, and in many cases bound, to look to the state of the law at the date of the passing of the Act, not only the common law but the law as it then stood under previous statutes, in order to properly interpret the statute in question. Thus, the mischief rule as it was originally laid down has now been modified to the extent that not only the common law but also the statute law prior to the Act being interpreted needs to be looked into.

Harmonious Construction

When two or more provisions of the same statute are repugnant, the court will try to construe the provisions in such a manner, if possible, as to give effect to both by harmonising them with each other. The court may do so by regarding two or more apparently conflicting provisions as dealing with separate situations or by holding that one provision merely provides for an exception of the general rule contained in the other. The question as to whether separate provisions of the same statute are overlapping or are mutually exclusive may, however, be very difficult to determine. The basis of the principle of harmonious construction probably is that the legislature must not have intended to contradict itself[10]. This principle has been applied in a very large number of cases dealing with interpretation of the Constitution.

A statue has various different parts such as short title, long title, preamble, marginal notes, headings, definitions, interpretation clauses, provisos, illustrations, exceptions and savings clauses, explanations, schedules and punctuation. In the case of ambiguity in the meaning of a provision, these different parts may serve as internal aid to interpretation of statutes. For instance, the Courts have held that recourse to a preamble is generally permissible to construe the provisions of the statue. Since the preamble, like recitals, contains the mischief to be remedied and the scope of the Act. Headings to a section serve the same purpose what the Preamble serves to the main Act.

In addition to internal aids, external aids can also be used for interpretation of statutes. External aids include dictionaries, circulars, notifications, textbooks, historical background, legislative history and practice.

Interpretation of Taxation Statutes

Statutes imposing taxes or monetary burdens are to be strictly construed[11]. The logic behind this principle is that imposition of taxes is also a kind of imposition of penalty which can only be imposed if the language of the statute unequivocally so says. A person cannot be taxed unless the language of the statute unambiguously imposes the obligation without straining itself.

Intention of the legislature to tax must be gathered from the natural meaning of the words by which it has expressed itself. Any kind of intendment or presumption as to tax does not exist. Nothing can be drawn by implication. The language must be explicit. If the person sought to be taxed comes within the letter of the law he must be taxed,

9. (1907) 1 Ch. 107.
10. AIR 1951 SC 318
11. *CIT vs. Kasturi 237 ITR 24 (SC)*

however great the hardship may appear to the judicial mind to be[12]. On the other hand, if the Crown, seeking to recover the tax, cannot bring the subject within the letter of the law, the subject is free, however apparently within the spirit of the law the case might otherwise appear to be. In other words, if there be admissible, in any statute, what is called an equitable construction, certainly such a construction is not admissible in a taxing statute, where you simply adhere to the words of the statute.! If the words of a taxing statute are clear, effect must be given to them irrespective of the consequences. Statutes imposing pecuniary burdens are interpreted strictly in favour of those on whom the burden is desired to be imposed[13]. Whether a particular conclusion is desirable or not can be the guiding factor in reaching a decision while construing a taxing statute. Neither can the language of a taxing legislation be so stretched as to do favour to the State nor can it be so narrowed as to benefit the person sought to be taxed. If the language used in a fiscal statute is so wide as to include within it a large number of cases which perhaps were not intended to be covered, the Court has no option but to give effect to it.

If the words in taxing enactment are capable of two reasonable interpretations without doing violence to the language used, the interpretation which favours the person sought to be taxed has to be accepted. A taxing enactment does not apply by implication, and logical extensions are prohibited[14]. Equitable considerations cannot be taken into account while construing a taxing statute[15]. A taxing statute generally has no retrospective operation unless the language unequivocally makes it so.

Provisions for Deduction, Exemption or Relief

Several judgments of the Hon'ble Supreme Court of India and High Courts have firmly laid down the principle that a provision for deduction, exemption or relief should be interpreted liberally, reasonably and in favour of the assessee, and it should be so construed as to effectuate the object of the legislature and not to defeat it[16]. However, if the assessee falls within the language of the exemption, the intent cannot be used to deny him the benefit of the provisions[17]. The correct way of reading the different heads of exemption as enumerated in a section would be to treat each as a separate and distinct head of exemption[18].

Since the provision for promoting economic growth has to be interpreted liberally, the restriction on it too has to be construed so as to advance the objective of the provisions and not to frustrate it[19]. Although the exemption provisions are to be construed strictly as regards the applicability thereof to the case of the assessee, once it is found that the same is applicable, the same are required

12. *Baidyanath Ayurved Bhawan vs. Excise Commissioner, Uttar Pradesh, AIR 1970 SC 1734.*
13. *Atlas Cycle Industries Ltd. vs. State of Haryana AIR 1972 SC 121.*
14. *M/s Tala Engineering and Locomative Company Limited vs. State of Bihar AIR 1999 Pat. 62.*
15. *Partington vs. Att-Gen [1869] LR 4 HL 100.*
16. *CIT vs. South Arcot Distt. Coop. Mktg. Society Ltd., (1989) 176 ITR 117 (para 7)*
17. *CIT vs. Mahindra 144 ITR 225,239 (SC).*
18. *Kerala SCMF vs. CIT 231 ITR 814 (SC).*
19. *Balaji Tempo vs. CIT 196 ITR 188 (SC).*

to be interpreted liberally[20]. The Supreme Court in a recent judgement in the case of ***Shah Originals***[21], while dealing with the interpretation of the expression 'profits derived from the export of goods' reiterated this principle that taxing provisions, including deduction and exemption provisions, have to be interpreted strictly as regards the claim of deduction/exemption is concerned.

In ***Sun Export Corporation vs. CC***[22], the Court was considering the question whether animal feed supplements imported by the assessee could be classified as 'animal feeds' so as to qualify for exemption from customs duty in terms of notification dated 1.11.1982. Having decided the issue in the assessee's favour, the Court held that 'even assuming that there are two view possible, it is well settled, that one favourable to the assessee in matters of taxation has to be preferred.'

A five judge bench of the Supreme Court of India in the case of ***CC vs. Dilip Kumar & Company***[23] was tasked with assessing the validity of the rule established in the 3-Judge Bench decision in Sun Export, particularly concerning the interpretation of tax exemption provisions or notifications in cases of ambiguity regarding their applicability or the applicable tax rate. It was held that if there are two views possible in the interpretation of a charging section, the view in favour of the tax payer or the assessee should be preferred. However, if there is an ambiguity in an exemption notification, the benefit of such ambiguity cannot be claimed by the assessee, but must be interpreted in favour of the revenue. It was specifically clarified that the ratio in Sun Export case was not correct and all the decisions which took similar view as in Sun Export also stand overruled.

Mr Datar in his ***Kanga & Palkhivala's The Law and Practice of Income Tax***[24] comments that such a distinction made by the Hon'ble Supreme Court in Dilip Kumar is erroneous and without any basis. He adds "*It further erroneously held that one has to look at the language of the notification alone and the object and purpose of granting the exemption is irrelevant.*" He argues that if there is an ambiguity in an exemption notification it can be adequately resolved by ascertaining the object and purpose of the notification. The interpretation which promotes the object and purpose of the exemption notification should be followed irrespective of whether it is in favour of the revenue or the assessee[25].

Be that as it may, it is critical to note that in the above judgement, the Supreme Court was only dealing with the import of an exemption notification. It cannot be said to have laid down a broader principle of law that in case of an ambiguity, all exemption provisions in all statutes have to be interpreted in favour of the revenue, for it is a settled position in law that a decision is only an authority for what it decides and not what may logically follow from it[26].

More specifically, the Supreme Court did not have an occasion to consider the difference

20. *Prabhakar P. R vs. CIT 24 ITR 549 (SC).*
21. (2023) (459 ITR 385)
22. (1997) 6 SCC 564
23. (2018) 9 SCC 1
24. Eleventh Edition
25. Datar Arvind, Kanga & Palkhivala's The Law and Practice of Income Tax, Eleventh Edition,2020.
26. *State of Orissa vs. Sudhansu Sekhar Misra, (1968) 2 SCR 154 : AIR 1968 SC 647.*

between the interpretational approach to be adopted while construing a general exemption provision and a beneficial exemption provision, one which is legislated with an object of promotion of certain activities. Prior to Dilip Kumar, the Supreme Court in several cases[27] had taken note of this distinction. This line of authority was not considered in Dilip Kumar for the reason that such a question did not arise before it. This distinction has since been considered by the Supreme Court subsequently in the case of ***Government of Kerala vs. Mother Superior Adoration Convent***[28], wherein it was clarified by the Court that the ratio of Dilip Kumar will not apply to cases concerning the interpretation of a beneficial exemption provision, the interpretation whereof would continue to tilt in the taxpayer's favour, if an ambiguity was to arise. It was also clarified that Dilip Kumar cannot be said to have sub-silentio laid down a law that all exemption provisions, be it a general exemption clause or a beneficial exemption provision have to be interpreted in the revenue's favour in case of ambiguity.

The ratio of Mother Superior is also in line with the broader principle of law laid down in the landmark judgement in the case of ***CIT vs. Vegetable Products***[29] and other judgements[30] where in the context of general taxing provisions, it has been held that the matters should be decided in the taxpayer's favour where two views exist.

Conclusion

A few principles emerge from the analysis of the law on interpretation of deduction and exemption provisions-

- These provisions, like any other provision, have to be interpreted having regard to the plain language employed therein.
- While finding out the import of a word or an expression used in such provisions, a reasonable and liberal approach may be adopted considering the object thereof.
- In case where two views are possible, a general exemption provision is to be interpreted in the revenue's favour and a beneficial exemption provision is to be interpreted in the taxpayer's favour.

27. *State of Jharkhand vs. Tata Cummins Ltd. [2006] 4 SCC 57, Pondicherry State Coop. Consumer Federation Ltd. vs. Union Territory of Pondicherry [2008] 1 SCC 206, Commr. of Customs (Preventive) vs. M. Ambalal & Co. [2011] 2 SCC 74*
28. 2021 (376 ELT 242)
29. (1973) (88 ITR 192)
30. *Chandra Mohan Sinku vs. UOI 372 ITR 627; Dalmia Power Ltd. vs. ACIT 418 ITR 221.*

SS-VI-24

Interpretational issues in Anti-Abuse Provisions

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Overview

This article analyzes certain anti-abuse provisions in Indian tax law, related interpretational issues and possible approaches to interpretation in given situations. It outlines key specific anti-avoidance rules under the Income Tax Act such as thin capitalization rules, transfer pricing regulations, tax specific valuation requirements, and the general anti-avoidance rules (GAAR). The article also touches upon the principal purpose test under the Multilateral Instrument which aligns tax treaties with OECD's BEPS recommendations to combat treaty shopping and improper treaty use. A significant portion of the article examines key interpretational issues and debates surrounding anti-abuse provisions. It discusses how one factor alone is not determinative and a combination of various factors such as the object of the relevant tax provision, taxpayer's motive and surrounding circumstances are important for interpretation and application of anti-abuse provisions, so that undue harassment of taxpayers in genuine situations is avoided. The analysis covers relevant principles like substance over form and highlights the complexity of interpreting anti-abuse provisions. In this light, the article emphasizes the delicate balancing act required to uphold legislative intent, protect the tax base, and avoid unjust outcomes when applying anti-abuse measures. It argues that thoughtful, balanced interpretation is crucial for ensuring fairness while discouraging abusive tax avoidance, underscoring the need for clarity, consistency, and adaptability in this evolving area of tax law.

Abstract

This article analyses certain anti-abuse provisions in Indian tax law, related interpretational issues and possible approaches to interpretation in given situations. It outlines key specific anti-avoidance rules under the Income Tax Act such as thin capitalization rules, transfer pricing regulations, tax specific valuation requirements, and the general anti-avoidance rules (GAAR). The article also touches upon the principal purpose test under the Multilateral Instrument which aligns tax treaties with OECD's BEPS recommendations to combat treaty shopping and improper treaty use. A significant portion of the article examines key interpretational issues and debates surrounding anti-abuse provisions. It discusses how one factor alone is not determinative and a combination of various factors such as the object of the relevant tax provision, taxpayer's motive and surrounding circumstances are important for interpretation and application of anti-abuse provisions, so that undue harassment of taxpayers in genuine situations is avoided. The analysis covers relevant principles like substance over form

and highlights the complexity of interpreting anti-abuse provisions. In this light, the article emphasises the delicate balancing act required to uphold legislative intent, protect the tax base, and avoid unjust outcomes when applying anti-abuse measures. It argues that thoughtful, balanced interpretation is crucial for ensuring fairness while discouraging abusive tax avoidance, underscoring the need for clarity, consistency, and adaptability in this evolving area of tax law.

Introduction

Prior to introduction of GAAR, unless fraudulent or sham, "form" of a transaction or arrangement was determinative of tax consequences, not the "substance". In the context of tax treaty benefits, treaty shopping was permissible and lifting of corporate veil was permissible only in cases where the entity was a sham or a conduit. Under current law which has a strict anti-abuse regime both under domestic law and tax treaties, commercial substance in structures is key. The main purpose of a transaction or an arrangement determines tax consequences when the transaction or arrangement, or any step thereof, lacks commercial substance or justification. However, except certain specific anti-avoidance rules, law does not prescribe any objective criteria to define substance and it is impossible to prove intention or motive easily. This leads to challenges in interpretation and application of GAAR and similar tests under tax treaties. The specific anti avoidance rules have clearer tests and therefore, relatively easier to apply albeit with challenges in genuine situations which are not aimed at tax abuse or avoidance.

This article provides an overview of anti-avoidance provisions under the Indian Income-tax Act, 1961 (the Act). It begins by outlining major domestic anti-avoidance rules as well as international anti-abuse measures. The article highlights certain relevant rules of interpretation commonly used to interpret such provisions and also, some of the apparent issues that are faced by the taxpayers that arise at the time of the applicability of the anti-abuse provisions. Finally, it concludes by emphasising the complex balancing act required in interpreting anti-abuse rules to uphold legislative intent while avoiding undue hardship to taxpayers.

Understanding Domestic as well as International Anti-Abuse Provisions

Domestic perspective

With the aim of protecting India's tax base and tackle tax avoidance, Indian government has over time introduced several anti-avoidance rules targeting specific situations (SAAR), and general anti-avoidance rules (GAAR) which codify the 'substance over form' principle. Further, with India's ratification of the OECD's Multilateral Instrument (MLI), which seeks to address base erosion and profit shifting concerns, various tax treaties have been modified/supplemented by the provisions of the MLI. A brief overview of these anti-avoidance measures is outlined below:

SAAR

1. *Thin capitalisation norms:* The thin capitalisation rules limit tax deductibility of interest expense in case of an Indian company (or a permanent establishment of foreign company in India) having borrowed debt from, or guaranteed by, an offshore affiliate, is capped at 30% of its EBITDA for the year. This is aimed at preventing excessive interest deductions and profit shifting between associated enterprises.

2. *Transfer pricing regulations:* The transfer pricing provisions are in place to ensure that transactions between related parties are conducted at arm's length prices. This helps avoid shifting of profits from higher tax jurisdictions to low-tax jurisdictions and protecting India's tax base.

3. *Lapse of business losses in case of change in control*: Carry forward and set-off of past tax losses is denied in case of change in shareholding of a closely held company beyond 49%. The provision was introduced to avoid acquisition of loss-making companies by shareholders with the sole purpose of reducing their tax liabilities.

4. *Tax specific valuation requirements*: There are several tax specific valuation requirements such as under section 56(2)(x), section 50CA, section 56(2)(viib) which result in deemed income in the hands of the transacting entities if the specified transactions are carried out at a discount or excessive premium to the value computed as per the prescribed tax rules.

5. *Deemed dividend provisions*: These provisions were introduced to curb the practice of companies making distributions to their shareholders in forms other than as dividends to avoid the dividend distribution tax/tax in the hands of the shareholders.

GAAR

Introduced with an aim to counter harmful tax practices, the law of GAAR was introduced for the first time in formal legislation through the *Finance Act, 2012* which has finally been made effective from 1 April 2017 and there are certain grandfathering provisions and exceptions.

The intent behind introducing the legislation was to codify the doctrine of substance over form, the need for which arose due to the existence of aggressive tax planning through sophisticated structures. The substance over form doctrine takes into account the real intention of the parties, the purpose of the arrangement and the effect of the transaction.

Chapter X-A of the Act contains the GAAR provisions, which are found in Sections 95 through 102 of the Act. According to Section 96 of the Act, an “impermissible avoidance arrangement” is any arrangement made where the main purpose is to obtain a tax benefit **and** such an arrangement (a) has resulted in the misuse of the Act's provisions, whether directly or indirectly, or (b) lacks or is judged to lack commercial substance in whole or in part, or (c) was made using any means or method that is typically not used for legitimate/bona fide purposes, or (d) creates rights and obligations not normally created between parties dealing at arm’s length.

The insightful input provided by the Shome Committee enabled the Government to build-in certain safeguards so as to ensure sufficient redressal mechanisms are provided for taxpayers if GAAR is invoked.

International perspective

The Organisation for Economic Co-operation and Development (OECD) introduced the MLI as part of its Base Erosion Profit Shifting (BEPS) Action Plan. It coexists with current tax treaties in order to align them with the BEPS Action recommendations for addressing the threat of tax base erosion. On June 7, 2017, India signed the MLI in Paris. To prevent treaty abuse, MLI mandates that all parties adhere and implement a set of minimum standards relevant to the treaty.

The Principal Purpose Test (PPT), which is one of the minimum standards, allows tax treaty advantages to be refused where one of the principal purposes of an arrangement or a transaction is to receive a tax treaty benefit, either directly or indirectly.

Apart from PPT, the MLI also prescribes certain limitation of benefits conditions which are more stringent with respect to the substance requirements. However, unlike PPT, these limitations or conditions are optional and subject to the discretion of the jurisdictions as to whether to incorporate such articles/conditions in the respective tax

treaties. Further, certain countries like India-Singapore already have certain limitation of benefits (LOB) conditions in place in their respective tax treaties.

Interplay of GAAR, SAAR and tax treaty measures

Often the interpretation and application of anti-abuse rules depend on the particular facts and circumstances of the arrangements and differing scope of anti-abuse measures adds to the complexity.

When applying domestic anti-abuse rules to cross border tax matters which may be subject to the anti-abuse tests (such as PPT/LOB) under the applicable tax treaty as well, interactions between the two sets of tests must be considered. This will be increasingly relevant now as tax treaties covered by the MLI will have the PPT test (applying as minimum standard). In such scenarios, PPT and GAAR are overlapping in scope but there are certain important differences and related interpretational issues. For instance, PPT comes into play when one of the principal purposes of the arrangement is to obtain benefits under the tax treaty whereas for GAAR provisions to trigger, the main purpose of the arrangement should be to obtain tax benefits. However, GAAR rules have a specific deeming fiction which states that where the main purpose of any step or part of a transaction/arrangement is to obtain a tax benefit, the entire transaction/arrangement will be presumed to have been entered into for the main purpose of obtaining a tax benefit (unless proved to the contrary by the taxpayer). Also, PPT has a carve out for situations where the object of the tax treaty is to give such a benefit, in which case, even if the primary purpose is to obtain such benefits, PPT shall not apply.

Some countries have enacted priority guidance stating that the domestic GAAR will take precedence over tax treaties. Other countries may first apply the specific treaty anti-abuse provision before the broader domestic GAAR. In the Indian context, as per the provisions of the Act, if tax treaty provisions are more beneficial to the taxpayer, the same prevail over domestic law except the GAAR provisions. In other words, tax treaties do not override domestic GAAR and if GAAR is invoked, the tax authorities are empowered to deny treaty benefits (subject to facts). This implies that if GAAR applies to a particular arrangement, then one need not test the applicability of PPT and therefore, any distinction in the scope of GAAR and PPT may be academic in such case. Any distinction between the scope of PPT and GAAR should be more relevant where GAAR is not applicable for any reason (say where the issue is grandfathered under GAAR or there is a specific exclusion), in which case, applicability of PPT would then need to be examined.

The Central Board of Direct Taxes (CBDT) had issued a circular in 2017 clarifying certain issues that were raised on implementation of the GAAR provisions introduced back then vis-à-vis SAAR and/or treaty related anti-abuse provisions (i.e., LOB). The CBDT has clarified that there may be situations which may not be covered by the SAAR/LOB provisions and therefore, in such a case GAAR can be invoked, and these anti-abuse provisions are to coexist and should be applicable based on the facts of each case. Accordingly, tax administration does not intend to exclude applicability of GAAR to situations covered by SAAR/treaty measures, which creates more uncertainty for taxpayers and the position may evolve in due course.

Common factors analysed when tax authorities invoke an anti-abuse provision include: whether the transactions and entity structures seem artificial or contrived; whether there is conduit usage or circular cash flows through interposed entities that lack economic substance; whether the manner of carrying out transactions differs from normal commercial

practices; and whether there is evidence that a principal intention was to circumvent the object and purpose of the country's tax laws or relevant treaty provisions.

- *For example,* a company resident in Country A may establish a wholly owned subsidiary in Country B to act as a conduit for channelling income from other countries to Country A in a treaty shopping arrangement that exploits Country B's extensive tax treaty network. This type of arrangement could potentially be counteracted by the principal purpose test article in the applicable tax treaties. However, where the subsidiary in Country B is set up with the objective of raising debt, local listing, accessing local resources, attracting investors, which provide commercial advantages not just tax savings, one can counter applicability of anti-abuse provisions.
- Another instance, a multinational group could shift income and profits to a controlled subsidiary located in a low or no-tax jurisdiction through intragroup transactions that lack economic substance. While formally structured to comply with arm's length transfer pricing rules, tax authorities may challenge the arrangements under the domestic GAAR legislation as an abusive tax avoidance scheme.

Hence, GAARs and specific anti-avoidance provisions have become vital tools for counteracting tax avoidance at both the domestic and international level when taxpayers comply with the literal words but not the substance and purpose of tax laws and treaties. When applying anti-abuse rules, the totality of facts and circumstances must be carefully examined to determine whether the transactions or arrangements could be characterized as abusive in nature for tax purposes before disregarding them. Implementing anti-abuse rules requires balancing the policy aims of protecting a country's tax base and fostering investment through appropriate certainty in business tax planning.

Understanding the Interpretational Rules in India

Before we dive into the interpretational issues arising in anti-abuse provisions, below is a gist of the various rules of interpretation applicable to tax statutes in general, and anti-abuse provisions in particular.

Rules of Interpretation

Literal and strict Interpretation

The paramount principle in statutory interpretation is the literal rule, wherein the words employed in a statute are to be construed according to their natural or ordinary meaning. Applying this rule, if the meaning is clear and unambiguous, the provision of a statute is to be given effect, regardless of potential consequences. One should look squarely at the words in the light of what is expressly stated, and nothing can be implied so as to supply any assumed deficiency.

Pursuant to this rule, the court's singular responsibility is to uphold the language of the statute if it is clear, without delving into potential repercussions.

Mischief Rule

The mischief rule of statutory interpretation is one of the oldest of the rules. Its main aim is to determine the "mischief and defect" of the statute. This rule was established in Heydon's case in 1584.

It was held that the mischief rule should only be applied where there is ambiguity in the statute. Under the mischief rule, the court's role is to identify the mischief that was sort to be resolved and then interpret the statute. Courts, while applying this principle, are expected to find out the real purpose of the

enactment. This rule, thus, enables the court to identify the proper construction of the statute according to the original purpose and the mischief that was sort to be resolved by the legislators.

As per this rule, for true interpretation of a statute, four things have to be considered:

1. What was the common law before the making of the statute?

2. What was the mischief and defect for which the common law did not provide?

3. What remedy did the Parliament resolve and appointed to cure the disease of the common law?

4. The true reason for the remedy.

Golden Rule

It is known as the golden rule because it largely solves all the problems of interpretation. This rule stipulates an initial adherence to the literal rule; however, should the literal interpretation result in ambiguity, injustice, inconvenience, hardship or inequity, it mandates a departure from the literal meaning. Instead, this rule states that the interpretation must align with the purpose or intention of the legislation. This rule suggests that the consequences and effects of interpretation deserve more importance because they are the clues of the true meaning of the words used by the legislature and its intention.

Harmonious Construction

Harmonious construction is a principle in legal interpretation that emphasises the need to reconcile conflicting provisions within a statute or with different statutes dealing with the same subject matter. The goal is to achieve a harmonious and consistent interpretation that gives effect to all relevant provisions without creating conflicts. If there are different parts of a statute that seem to clash or create confusion, the court aims to find an interpretation that allows each part to have its intended effect without undermining the other parts.

Specific prevails over general

The principle of "specific prevails over general" is a key rule of interpretation in the context of tax laws. This principle provides guidance on how conflicting provisions within laws or rules should be understood.

In essence, when there is a conflict between a specific provision and a general one, the specific provision takes precedence. The rationale behind this rule is that the legislature, by providing a specific rule, likely intended to address a particular issue specifically. Therefore, when a specific rule and a general rule clash, the specific rule is considered more applicable to the given circumstances.

There are various external aids (circulars, notifications, forms, legislative history, speech of a minister, etc) as well as internal aids (provisos, explanations, definitions, judicial precedents, etc) of interpretation that are available to the experts as well as the taxpayers to interpret the law and understand the intention of the legislature.

Issues in Interpreting Anti-Abuse Provisions

Given the complex and varied provisions under the Act, it is difficult to apply a single rule of interpretation in all situations. For instance, the charging and computation provisions are concerned with creating and crystallising tax liability. The principle of strict interpretation generally applies to such provisions. As per this principle, a taxpayer cannot be subject to tax, unless it strictly falls within the purview of the provision.

With respect to exemption and deduction provisions, however, courts have adopted a liberal interpretation at times. The socio-economic objectives of the Government have often influenced the courts while seeking to give true effect to exemption provisions.

The anti-abuse provisions have been introduced to target specific forms of tax abusive behaviour. Often, deeming fictions are introduced to prevent taxpayers from exploiting loopholes in the law. While courts have emphasised that deeming fictions are to be read strictly and given full effect to, they have also often looked at the legislative intent behind the provisions along with the mischief that was sought to be remedied by it. A deeming fiction cannot be applied beyond its original context by reading the same into unrelated provisions.

The interpretation of anti-abuse provisions in a tax statute normally sparks a debate among legal experts, practitioners, scholars, courts and taxpayers. While some argue for a strict application of statutory language to curb tax avoidance, others advocate for a more purposive approach that takes into account the underlying objectives of the provisions. There is no doubt that the application of the anti-abuse provisions to a particular situation requires detailed review of the facts and circumstances of each case.

Due to the introduction of GAAR, the concept of "substance over form" lies at the heart of many interpretational disputes involving anti-abuse provisions. Courts and tribunals are often tasked with discerning the economic substance of transactions from their legal form, particularly in cases where taxpayers employ complex structures or arrangements to achieve tax benefits.

There are various rulings (both domestic as well as international) which throw light on the interpretation of such provisions. The *Duke of Westminster's case* could be considered as one of the most cited cases in the history of tax avoidance. The principle laid down in this case was that every man is entitled, if he can, to order his affairs so that the tax attaching under the appropriate acts is less than it otherwise would be. If he succeeds in doing so legally, the authorities cannot step in the shoes of the businessman and compel the taxpayer to pay an increased tax. Subsequently, in the *Ramsay case* it was held that where a transaction has pre-arranged artificial steps which serve no commercial purpose other than to save tax, then the proper effect is to tax the transaction as a whole. Accordingly, the principal in the *Ramsay case* overturned the holding in the *Duke of Westminster's case*. Another case ie, ***Furniss vs. Dawson*** which affirmed or ruled in favour of Ramsay principle (as stated above).

Having said that, over time several anti-abuse rules have been introduced in the Act, which prescribe objective tests. This shift implies a move from emphasising subjective motives in assessing the transaction, and instead focuses on objective criteria laid down by the provisions of the law. Notably, the motive behind an action is deemed less relevant under these objective tests. The rationale behind this change appears to be rooted in a desire to curtail potential mischief or misuse of the rules and ultimately safeguard the Indian tax base. By applying these objective tests, the intention is to establish a more transparent and consistent framework for identifying and addressing mischiefs. However, these objective test-driven provisions lead to a universal applicability of the provisions encompassing both sham and conduit transactions where the intention is tax avoidance as well as fair commercial transactions where the motive is not malicious. We have discussed some of these situations below:

a) Section 56(2)(x) applies in case of receipt of shares for 'NIL' or inadequate consideration and its applicability in case of receipt of shares pursuant to a bonus issue or a rights issue is a grey area. If one is to apply the rule of literal interpretation, then the provisions of Section 56(2)(x) of the Act should apply to the shares received by the shareholders on bonus/right issue as they are issued for 'NIL'/inadequate

consideration. However, courts[1] have held that the interpretation of these anti-provisions should be based on the intent of the legislature and the mischief sort to be resolved is to be looked at. Where the literal interpretation gives absurd results, the intention of the law assumes significance. The provisions of Section 56(2)(x) of the Act were introduced with the intention to prevent the practice of receiving the sum of money or the property without consideration or for inadequate consideration Courts have concluded that the provisions of Section 56(2)(x) of the Act, do not apply on bonus issue/rights issue (which is on a proportionate basis) as they are simply an apportionment of the value of their existing holding over larger number of shares and there is no tax evasion.

b) As per Section 9(1)(i) of the Act, shares of a foreign company are deemed to be situated in India, if such shares derive substantial value from India (ie, as on the "specified date", the value of Indian assets exceeds INR 10 crores and represents 50% or more of the value of all the assets owned by the target foreign company). The "specified date" has been defined to mean the date on which the accounting period of the company ends preceding the date of transfer of shares unless there is a 15% increase in the book value of the assets of the foreign company from the date of its accounting year end and the date of transfer, in which case, the date of transfer would be the specified date for valuation purposes. In situations where a foreign company owned Indian assets as on the date on which its accounting period ended prior to the date of transfer of its shares but does not own any India assets as on the date of transfer of its shares, the applicability of this provision may not be straightforward. There are two views possible – (i) as per strict literal reading of the provision, despite the foreign company no longer holding any Indian assets as on the date of transfer of its shares, the transaction could be taxable in India (based on valuation position as of the accounting year end prior to the transaction); or (ii) in the absence of any Indian assets as on the transaction date, the provision should be inapplicable in its entirety and the mechanics of computing value derived from India should not drive chargeability. While there is no judicial precedent as on date on this issue, the facts and circumstances in each situation and whether a literal reading leads to any absurdity and hardship for the shareholders, should be considered in entirety before taking a position.

c) It is a settled principle of interpretation that deeming provisions should not be given meaning wider than what it purports to, which is akin to the rule of strict interpretation. For instance, Section 2(22)(e) of the Act provides that any sum paid to the shareholders of the company by way of an advance or loan should be deemed as dividends in the hands of the shareholders. Based on the rule of literal interpretation, any advance or loans provided to the shareholders of the company would attract the provision and create a tax liability in the hands of the shareholders. However, in various rulings, courts have considered the intention and purpose of the provisions and held that where the loan or the advance was given to shareholder[2] in the ordinary course of business, the provisions of the Section 2(22)(e) of the Act should not be attracted. Accordingly,

1. *CIT vs. Dalmia Investment Co. Ltd. [1964] 52 ITR 567 (SC), Joint Commissioner of Income-tax vs. Bhanu Chopra [2022] 195 ITD 767 (Delhi – Trib.)* and *Sudhir Menon HUF vs. Assistant Commissioner of Income-tax 21(2) [2014] 148 ITD 260 (Mumbai)*

all loans/advances given to shareholders should not be deemed as dividends even though the literal reading covers them within its ambit.

d) As per Section 79 of the Act, carry forward and set-off of past tax losses is denied in case of change in shareholding of a closely held company beyond 49%. The purpose of Section 79 of the Act is to curtail misuse of benefit of carry forward and set-off of business losses of earlier years of a company and prohibits its availability in the hands of any new owner. Situations involving a change in the immediate shareholder of a company, and not the ultimate parent entity, have been subject matter of dispute in the context of this provision. In some rulings it has been held[3] that in the absence of a change in ultimate control, change in immediate shareholding alone should not attract the provisions of Section 79 of the Act. The provisions refer to beneficial ownership of shares and the courts have interpreted that liberally to consider ultimate holding akin to beneficial holding in the context of this provision.

Conclusion

The interpretational challenges surrounding anti-abuse provisions in the Act present a complex landscape for taxpayers, legal experts and authorities alike. The distinction between legitimate tax planning and impermissible tax avoidance requires a nuanced understanding of the provisions embedded in the law. The Act incorporates a range of anti-abuse measures applicable to both domestic as well as cross-border tax matters, designed to prevent strategies aimed at securing undue tax benefits.

The introduction of the GAAR marked a significant step towards codifying the doctrine of substance over form, empowering the tax authorities to determine tax consequences considering the real intention, purpose, and effect of transactions.

Internationally, the MLI provides a framework to combat treaty abuse and ensures that tax treaties are in line with global standards. The PPT within MLI acts as a safeguard against arrangements primarily aimed at securing tax benefits.

There is a delicate balance between discouraging tax avoidance and avoiding undue harassment where the tax administration and courts play an important role. There is also an intricate interplay between domestic and international rules aimed at countering tax avoidance.

As taxpayers navigate these provisions and challenges, and tax authorities seek to protect tax base erosion, a thoughtful and balanced approach to interpretation becomes paramount. Striking the right balance between upholding the legislative intent, protecting the tax base, and fostering a conducive environment for legitimate commercial activities is crucial for effective application of anti-abuse provisions and building taxpayer confidence. In this evolving tax landscape, clarity, certainty, and adaptability will be key to ensuring fair and just outcomes for all stakeholders involved.

2. *G.G. Continental Trades (P.) Ltd. vs. Deputy Commissioner of Income-tax [2023] 106 ITR(T) 356 (Amritsar Tribunal)* and *Assistant Commissioner of Income-tax vs. Global Agencies (P.) Ltd. [2004] 1 SOT 510 (Delhi)*
3. *Commissioner of Income-tax vs. AMCO Power Systems Ltd [2015] 379 ITR 375 (Karnataka), BancTec TPS India (P.) Ltd vs. Pricinipal Commissioner of Income-tax [2019] 111 taxmann.com 321 (Mumbai – Trib.)* and *CLP Power India (P.) Ltd vs. Deputy Commissioner of Income-tax [2018] 93 taxmann.com 326 (Ahmedabad - Trib.)*

The Art of Treaty interpretation – Under the lens

CA Shefali Goradia CA Anita Nair

Overview

Treaty interpretation is a very nuanced subject and is only set to become growingly complex with the addition of instruments like various Multilateral Instruments to give effect to the OECD BEPS recommendations. While there is no thumb rule on treaty interpretation and is capable of divergent interpretations, this article seeks to cover at the outset, the overarching framework of the Vienna Convention on Law of Treaties, 1969 and its key guiding principles that are the backbone of international law. Aids to treaty interpretation such as preamble, protocol, unilateral measures, OECD and UN Commentaries etc. and their hierarchy have been elaborated along with ratio from global as well as Indian judicial precedents on issues on treaty interpretation. Whether a static or ambulatory interpretation ought to be followed for undefined tax treaty terms is a common issue that provokes debate in the realm of treaty interpretation which adds flavour to the discussion. Lastly, the interplay between tax treaties and domestic tax laws as regards treaty override, non-aggravation principle of tax treaties and conflicts of qualification have been dealt with since tax treaties do not operate in isolation and the interface with the domestic tax laws creates several challenges too.

Treaty interpretation is governed by international law and rich literature on the subject. It is also more often than not under the scrutiny of tax authorities and a subject matter of divergent views by various judicial forums. Given the nuances and the varied approaches and schools of thought on treaty interpretation, it is often a matter of debate whether treaty interpretation is an art or a body of science.

While this issue may remain open, undeniably the continuously evolving nuances in relation to treaty interpretation always render it an interesting topic for discussion as will gradually unfold in this article.

I. Background

Article 2 of the Vienna Convention on the Law of Treaties ('VCLT'), which applies to all treaties, provides:

> *"A treaty is an international agreement (in one or more instruments, whatever called) concluded between States and governed by international law."*

Majority of the tax treaties are modelled on the United Nations Model Convention ('UN Model') or the Organisation for Economic Co-operation and Development Model Tax Convention on Income and on Capital ('OECD Model').

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Bilateral tax treaties confer rights and impose obligations on the two contracting States, but not on third parties such as taxpayers. The approach through which access to such treaties is made available to the taxpayers depends on whether the State follows a *monist* or *dualist* system. In some States, once the treaty is concluded, it confers rights on the residents of the contracting States (*monist*). In other States, some additional action is necessary (for example, the provisions of the treaty must be enacted into domestic law) before benefits under a treaty can be given to residents of the contracting States (*dualist*).

Since India follows the *dualist* system, separate legislation is necessary for India to execute treaty-based international law. The Income tax Act 1961 ('the Act')[1] specifically requires the Indian Government to '*make such provisions as may be necessary*' in this regard '*by notification in the Official Gazette*.' Once the requisite notification is issued, a taxpayer who is covered by the treaty is entitled to seek treaty protection, if it is more beneficial than the provisions of the Act[2].

II. Framework for treaty interpretation - Vienna Convention on the Law of Treaties 1969 ('VCLT')

VCLT is an international agreement that regulates treaties among sovereign states.

Known as the "treaty on treaties", the VCLT establishes comprehensive, operational guidelines, rules, and procedures for how treaties are drafted, defined, amended, and interpreted. Although India is not a signatory to the VCLT, it still recognizes its legal standing as part of customary international law.

(A) Article 26 - "Pacta sunt servanda"

"Every treaty in force is binding upon the parties to it and must be performed by them in good faith."

This principle has been discussed in greater detail in the context of 'treaty override' in the ensuing part of the Article.

The VCLT's guidance on object, purpose and context to a treaty forms part of Article 31:

(B) Article 31 – General rule of interpretation

"1. A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.

2. The context for the purpose of the interpretation of a treaty shall comprise, in addition to the text, including its preamble and annexes:

(a) any agreement relating to the treaty which was made between all the parties in connection with the conclusion of the treaty;

(b) any instrument which was made by one or more parties in connection with the conclusion of the treaty and accepted by the other parties as an instrument related to the treaty".

1. Section 90(1).
2. Section 90(2).

3. *There shall be taken into account, together with the context:*

   (a) *any subsequent agreement between the parties regarding interpretation of the treaty or the application of its provisions;*

   (b) *any subsequent practice in the application of the treaty which establishes the agreement of the parties regarding its interpretation;*

   (c) *any relevant rules of international law applicable in the relations between the parties.*

4. *A special meaning shall be given to a term if it is established that the parties so intended."*

Article 32 – Supplementary means of interpretation

"Recourse may be had to supplementary means of interpretation, including the preparatory work of the treaty and the circumstances of its conclusion, in order to confirm the meaning resulting from the application of article 31, or to determine the meaning when the interpretation according to article 31:

(a) *leaves the meaning ambiguous or obscure; or*

(b) *leads to a result which is manifestly absurd or unreasonable."*

It will be worthwhile to delve deeper into the meaning of certain key expressions used in Articles 31 and 32 of VCLT.

B.1. Ordinary meaning

As per Klaus Vogel on Double Taxation Conventions[3], in interpreting international agreements, the text of the treaty is of primary importance (i.e. the 'ordinary meaning' of the 'terms') and the wording not of the individual provision, but that of the entire agreement in context.

Ordinary meaning of a term does not necessarily mean a meaning of daily usage but terms that have developed into 'international tax language'. The text of the treaty typically includes besides the treaty provisions, protocols and any other annexes, appendices to the treaty etc.

B.2. Object and purpose

As per Klaus Vogel on Double Taxation Conventions[4], in interpreting international agreements, the 'purpose' referred to by VCLT refers to the goal of the treaty as reflected objectively by the treaty as a whole. The 'purpose' shall influence interpretation merely by giving 'light' to the terms of the treaty. It is subordinated to the wordings of the treaty and is not by itself an independent means of interpretation.

3. Fifth edition – Vol 1, Pages 47-48.
4. Fifth edition – Vol 1, Pages 47-48.

The 'object and purpose' can be most often gauged from the preamble to the tax treaty. Article 6 of OECD BEPS Multilateral Convention to implement tax treaty related measures to prevent base erosion and profit shifting (MLI) requires adoption of a preamble to existing treaties in the below form, as a minimum standard:

> *"Intending to eliminate double taxation with respect to the taxes covered by this agreement without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance (including through treaty-shopping arrangements aimed at obtaining reliefs provided in this agreement for the indirect benefit of residents of third jurisdictions)"*

B.3. Context

The context of the treaty can be discerned from documents that may have been exchanged at the time of treaty negotiations but often these documents are often not available in the public domain. Along with the context, VCLT also refers to subsequent agreements and subsequent practice.

The recent Supreme Court ruling in the case of Nestle[5] dealing with the applicability of MFN clause in the absence of a separate notification deals in detail with the significance of 'context'. It quotes the 'International Law Commission Draft Conclusions on Subsequent Agreements and Subsequent Practice' in relation to Interpretation of Treaties and has held that:

> *"A subsequent practice is defined as consisting of conduct the application of a treaty after its conclusion which establishes the agreement of the parties regarding the interpretation of the treaty practice and ....includes any type of positive action where the physical or conduct and............ abstention from action in application of a treaty..... Simply put, practice covers what states do in their relations with one another....It also covers subsequent treaties with third States and patterns of treaties."*

B.4. Supplementary means of interpretation

Article 32 of VCLT states that "accompanying materials" that were created in the context of treaty negotiations such as elaborations on the treaty, supporting documents, position papers may only be referred as a supplementary source if they confirm the interpretation resulting under article 31 or in case of doubt. Technical Explanations, usually published by US Treasury Department and similar documents are neither part of the 'context' of the treaty nor 'accompanying materials' and therefore neither Article 31 nor 32 grant their use in treaty interpretation. They are materials only to the extent they reproduce the contents of any notes or letters exchanged between the parties.

5. *AO vs. M/s Nestle SA, [Decision dated 19.10.2023 in Civil Appeal No. 1420 of 2023] (SC).*

(C) Judicial precedents on VCLT

Several legal decisions have confirmed the application of the VCLT for tax treaty interpretations[6]. Some specific examples include:

- The Canadian Supreme Court held in the Crown Forest case[7] that "Article 31 and 32 of the Vienna Convention on the law of treaties indicate that the reference may be made to these types of extrinsic materials when interpreting international documents such as taxation conventions".
- In the Thiel case in Australia[8], the judge stated that VCLT and Article 31 "seek to codify the international law in relation to treaties".
- In a UK ruling, Comrs for Her Majesty's ***Revenue and Customs vs. Anson***[9], it was held that Article 31(1) of VCLT requires a treaty to be interpreted 'in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose'.
- Closer home, in the Indian context, in the ruling in case of ***Ram Jethmalani vs. Union of India***[10], it was held that while India is not a party to the Vienna Convention, it contains many principles of customary international law, and the principle of interpretation, of Article 31 of the Vienna Convention, provides a broad guideline as to what could be an appropriate manner of interpreting a treaty in the Indian context also.
- In the case of ***Sanofi Pasteur Holding SA vs. Department of Revenue***[11], the Court observed that the broad principle of interpretation, with respect to treaties, would be that ordinary meaning of words be given effect to, unless the context requires otherwise. Care has to be taken not to render any word, phrase, or sentence redundant, especially where it would lead to a manifestly absurd situation, particularly from a constitutional perspective[7].

III. Principles of Treaty Interpretation

Treaty interpretation, like statutory interpretation, can often lead to bonafide divergent views. At such time, principles and tools of treaty interpretation generally succeed in narrowing the range of possible interpretations to the one that most likely represents the shared understanding of the sovereign contracting states.

6. *Roy Rohatgi's 'Basic International Taxation', Second Edition, Vol 1, Page 57.*
7. *Crown Forest Industries Ltd. vs. the Queen (1992) 95 DTC (Canada).*
8. *Thiel vs. FCT (1990) ATC 4717, 4722 (Australia).*
9. [2015] STC 1777.
10. [2011] 339 ITR 107 (SC).
11. [2013] 354 ITR 316 (AP).

(A) Undefined tax treaty terms

Typically, Article 3 of tax treaties contain definitions of terms employed in the tax treaty. It is also common for certain terms to be defined in specific articles[12].

As regards undefined tax treaty terms, an extract of Article 3(2) as per OECD Model Convention is as follows:

> *"As regards the application of the Convention **at any time** by a Contracting State, any term not defined therein shall, **unless the context otherwise requires** or the competent authorities agree to a different meaning pursuant to the provisions of Article 25, have the meaning that it has **at that time** under the **law of that State** for the purposes of the taxes to which the Convention applies, any meaning under the applicable tax laws of that State prevailing over a meaning given to the term under other laws of that State."*

Since issues relating to undefined tax treaty terms are common, it may be interesting to deep dive into some of the expressions used in Article 3(2), as follows:

A.1. Static vs ambulatory approach

A perennial conundrum in relation to Article 3(2) is whether to adopt a static or a dynamic/ambulatory approach in deriving the meaning of undefined tax treaty terms.

Static approach adopts the meaning of the term at the time when the treaty was signed. In contrast, ambulatory approach seeks to derive the meaning of the undefined term at the time of application of the treaty provision.

Some guidance to throw some light on this tax dilemma is as under:

A.1.1 Extracts from OECD Model Convention 2017

> *"11. However, the question arises which legislation must be referred to in order to determine the meaning of terms not defined in the Convention, the choice being between the legislation in force when the Convention was signed or that in force when the Convention is being applied, i.e. when the tax is imposed. The Committee on Fiscal Affairs concluded that the latter interpretation should prevail, and in 1995 amended the Model to make this point explicitly.*
>
> *12. However, paragraph 2 specifies that the domestic law meaning of an undefined term applies only if the context does not require an alternative interpretation and the competent authorities do not agree to a different meaning pursuant to the provisions of Article 25.* ***The***

12. Article 10 'Dividend', Article 11 'Interest' of OECD Model Convention etc.

context is determined in particular by the intention of the Contracting States when signing the Convention as well as the meaning given to the term in question in the legislation of the other Contracting State (an implicit reference to the principle of reciprocity on which the Convention is based).

13. *Consequently, the wording of paragraph 2 provides a satisfactory balance between, on the one hand, the need to ensure the permanency of commitments entered into by States when signing a convention (since a State should not be allowed to make a convention partially inoperative by amending afterwards in its domestic law the scope of terms not defined in the Convention) and, on the other hand, the need to be able to apply the Convention in a convenient and practical way over time (the need to refer to outdated concepts should be avoided).”*

A.1.2. Klaus Vogel (Article 3)[13]

“Article 3(2)OECD and UN MC follow an ambulatory and not a static approach. This issue has been clarified in OECD MC 1992 on Article 3 and made crystal clear in the text of OECD MC 1995 by inserting the words ‘at any time’ and ‘at that time’. This clarification was regarded as necessary after the Canadian Supreme Court decided in favour of a static interpretation[14]*. However, even before the clarifications in the OECD MC and the Commentary there was nearly unanimous consensus that reference is made to the laws in force at the time of application of the treaty (ambulatory approach)……in addition it is very burdensome to determine which domestic law was in force at the time the treaty was signed as many tax treaties are in force for several decades…….. Treaties that still contain an Article 3(2) worded in accordance with OECD MC 1992 version should also be interpreted in an ambulatory way“*

A.1.3. Melford Canadian Court ruling[15]

In this case, the dispute arose on the taxation of a guarantee fee and whether it could be characterized as interest pursuant to an amendment in the domestic tax laws of Canada but which were not taxable as per the Canada-Germany tax treaty. The amendment post enactment of the tax treaty sought to impose a withholding tax

13. Page 210.

14. Canadian Supreme Court of 28 September 1982, *R vs. Melford Developments Inc. 82 DTC 6281 (1982).*

15. https://taxinterpretations.com/content/353914.

obligation in respect of guarantee fee payments (referrable to as interest). The Court held that later amendments in the domestic tax laws ought not be read into the treaty as unilateral amendments are not permissible and put the treaty at peril.

Thus, it may be inferred from the above that the OECD approach both pre and post amendment of the Model Convention favoured the ambulatory approach as the preferred approach. However, this remains an open and contentious issue.

A.2. Domestic tax law meaning vs. domestic general law meaning

The meaning of any undefined term in the tax treaty may be ascertained by reference to the meaning it has under the domestic law of that jurisdiction, whether or not a tax law. However, where a term is defined differently for the purposes of different laws in a jurisdiction, the meaning shall be derived from the law imposing the taxes to which the treaty applies (e.g. income tax) and shall prevail over all others, including those given for the purposes of other tax laws[16].

A.3. "Unless the context otherwise requires"

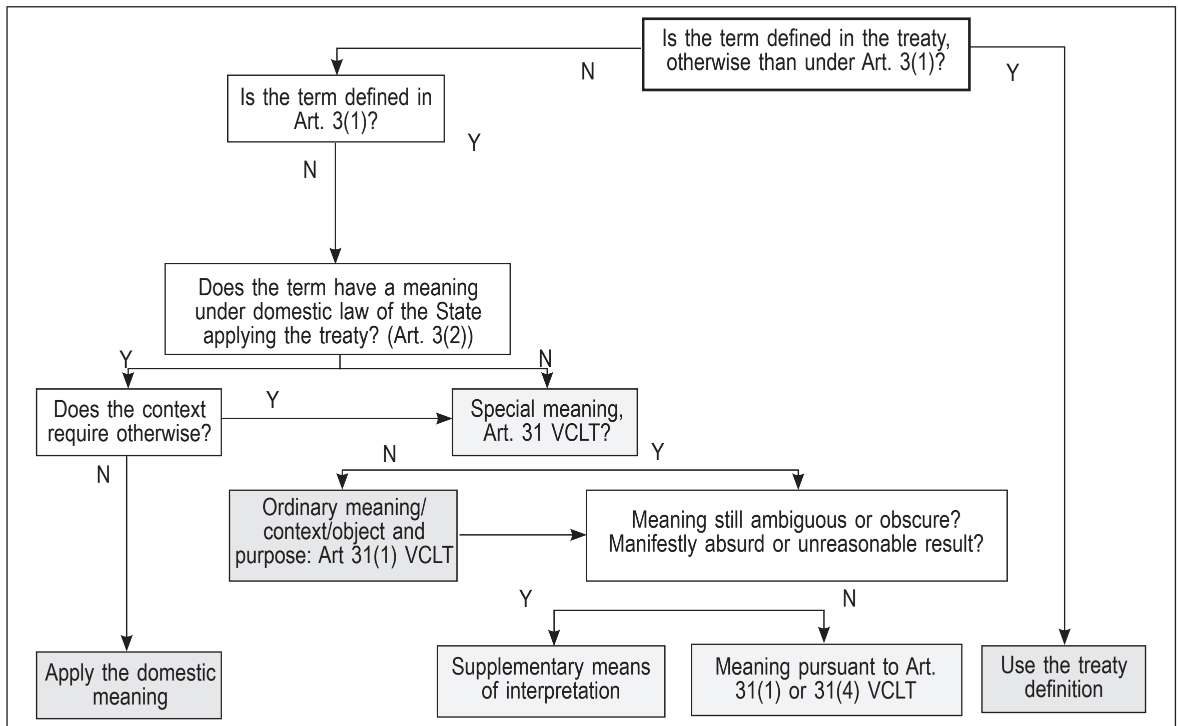
Although for an undefined term in the tax treaty, Article 3(2) provides recourse to the domestic tax law, there is a caveat that this recourse may not be adopted if the context requires otherwise. The domestic tax law meaning of an undefined tax treaty term may be resorted to unless the context indicates that a more general meaning of the term or a meaning from the context of the tax treaty could be derived.

If the "context" requires the non-application of domestic law meaning, then the related issue is how strong are the indications from the context that the domestic tax law meaning would be inappropriate in the context of the treaty. Another open issue is that if the context excludes the domestic tax law meaning then what meaning should be put in its place? One answer might be to give the term its ordinary and natural meaning giving effect to the rules of VCLT or the interpreting authority could seek to find a treaty meaning of the term employing the methods of interpretation set out in VCLT[17].

The below flowchart summarises the aforesaid discussion:

16. 2017 OECD Commentary on Article 3(2), Para 13.1.

17. Philip Baker 'Double Taxation Convention' Page E-21.



(B) Effet Utile

Effet Utile is a form of interpretation of treaties and other instruments derived from French administrative law which looks to the object and purpose of a treaty, as well as the context[18].

This principle requires that a treaty is to be interpreted as a whole, and the individual provisions within it given meaningful effect without rendering specific treaty clauses superfluous.

(C) Tax treaties are not to be interpreted like a law

While commenting on the interpretation of a treaty imported into a municipal law, it is observed in the below extract of the landmark Supreme Court ruling in the Azadi Bachao Andolan case[19]:

> *"The interpretation of a treaty imported into municipal law by indirect enactment was described by Lord Wilberforce as being*

18. Encyclopedic dictionary of International Law (https://www.oxfordreference.com/display/10.1093/oi/authority.20110803095743570#:~:text=A%20form%20of%20interpretation%20of,Encyclopaedic%20Dictionary%20of%20International%20Law%20%C2%BB).
19. [2003] 263 ITR 706 (SC).

'unconstrained by technical rules of English law, or by English legal precedent, but conducted on broad principles of general acceptation. This echoes the optimistic dictum of Lord Widgery CJ that the words 'are to be given their general meaning, general to lawyer and layman alike… the meaning of the diplomat rather than the lawyer"

Since tax treaties are an outcome of negotiation between contracting sovereign states, they are to be interpreted based on general understanding with emphasis on context and possible intention of the parties as compared to a strict legal interpretation as in the case of statutes.

IV. Aids to treaty interpretation

(A) Protocol to a treaty

In case of certain tax treaties, a protocol is signed and ratified by the Contracting States in addition to an existing tax treaty. It has the same force as the main provisions of the treaty. It typically clarifies, implements or modifies treaty provisions. E.g. Most favored Nation clause in India's tax treaties typically form part of the Protocol to the tax treaty.

(B) 'Multilateral Instrument ('MLI')

Given the extensive tax treaty network of countries, the MLI was conceived of in BEPS Action Plan 15 'Multilateral Instrument' as a mechanism to enable the modification of bi-lateral treaties without the need to renegotiate tax treaties. The tax treaties are to be read along with the provisions of MLI, wherever applicable and synthesized texts where available.

Needless to say, there are nuanced interpretation issues on MLI e.g. where there is a notification mismatch or interpretation of PPT etc. which add an additional layer of complexity to the tax treaty interpretation exercise.

(C) Model Conventions and their Commentaries

OECD and UN Model Conventions and Commentaries are important for treaty interpretation as they provide the source from which the courts of different states can seek a common interpretation. As per Klaus Vogel[20], several foreign Court rulings have relied on OECD Model Commentaries in interpreting tax treaties[21].

Although OECD and UN Model Conventions and Commentaries are not instruments made in conclusion of tax treaties and therefore not 'preparatory work' as referred to in VCLT, they are still referred to since if the contracting states have formulated the tax treaty broadly based on the OECD/UN Model Convention, it is presumed that they want the treaty provision to convey the meaning intended by the Model Commentaries. This meaning would then be considered as 'ordinary' or 'special' meaning as referred to in

20. Fifth edition, Vol 1, Page 55 and 57.

21. *US vs A.L. Burbank & Co. Ltd. on the 1942 DTC between US and Canada; Sun Life Assurance vs. Persons (UK High Court of Justice) STC 461, 513 (1984).*

Article 31 of VCLT. This would apply more so in case of OECD or UN member countries. In case of non-members this rule may be relatively less important and can be applied if the treaty text is based on the OECD/UN Model Convention and the context does not suggest a contrary interpretation. However, academic writers differ on the category into which the Commentaries may be placed in the VCLT rules of treaty interpretation[22].

Member countries that disagree with any aspect of the OECD Model Convention can include a reservation or observation on the particular provision. The OECD Model Convention also reflects the positions of non-OECD member countries.

As per Prof. Philip Baker, four questions remain open with regard to commentaries[23]:

(i) What is the legal basis for reference to commentaries?

(ii) Which version of commentaries should be referred?

(iii) Are Commentaries relevant for articles not in OECD form?

(iv) Are commentaries relevant to conventions with non-OECD states?

(i) Legal basis

As regards the legal basis for reference to Commentaries, the introduction to the 2000 version of the OECD model states the following about the status of commentaries:

"Commentaries on the articles

28. For each Article in the Convention, there is a detailed Commentary that is intended to illustrate or interpret its provisions.

29. As the commentaries have been drafted and agreed upon by the experts appointed to the Committee of Fiscal Affairs by the governments of member countries, they are of special importance in the development of international fiscal law although the commentaries are not designed to be annexed in any manner to the convention signed by member countries, which unlike the model are legally binding international instruments. They can nevertheless be of great assistance in the application and interpretation of conventions and in particular in the settlement of any disputes."

(ii) Version of commentary

The answer could depend on whether Commentaries are viewed as supplying 'ordinary meaning' to the text of the treaty or subsequent agreements i.e. based on the VCLT characterization issue raised earlier. A pragmatic approach

22. Philip Baker 'Double Taxation Conventions, Page E-13-14.

23. Philip Baker 'Double Taxation Conventions, Pages E-12 to E18.

SS-VI-44

could be adopted referring to the Commentary when the treaty was signed as well as subsequent amendments.

(iii) *Articles not in OECD form*

There seems no reason to limit recourse to the commentaries to situations where the specific article is identical to the OECD model. The Commentaries may still be useful for e.g. to explain the perceived problem to which a non-OECD-form article is addressed.

(iv) *Treaties between OECD and non-OECD states or between two non-OECD states*

The commentaries may be relevant to treaties concluded between non-OECD states where it is clear that the treaty has been concluded using OECD model and also for states which have now expressed their position on the OECD model and its commentaries.

(D) Mutual Agreement Procedure ('MAP')

MAP is the mechanism that contracting States use to resolve any disputes or difficulties that arise in the course of implementing and applying the treaty. The MAP thereby ensures that these disputes will not frustrate the treaty's goal of preventing international double taxation. Typically, a tax treaty contains a provision for this dispute resolution mechanism whereby the competent authorities of the Contracting States endeavour to resolve by mutual agreement any difficulties or doubts arising as to the interpretation or application of the Convention. They may also consult together for the elimination of double taxation in cases not provided for in the Convention.

(E) Unilateral material

Typically, unilateral material i.e. material prepared by one contracting state reflects that state's understanding of the meaning of the treaty e.g. US technical explanation, explanatory notes to treaty by a government etc. In the interest of common interpretation, there is no reason why appropriate consideration should not be given to unilateral material, but as an aid with no binding force[24].

(F) Synthesised text

OECD issued guidance for the development of 'Synthesised texts' to help users understand the impact of MLI on Covered Tax Agreements ('CTAs').

Synthesized texts may represent the unilateral or shared understanding of the contracting states in relation to MLI provisions that amend articles of a CTA. However, OECD Guidance for the development of 'Synthesised texts' recommends that suitable caveats may be added that it has no legal value and the text of MLI read alongside the CTA remain the only legal documents available.

24. Philip Baker Double Taxation Conventions, Page E-31.

(G) Parallel treaties

Interpretation using parallel treaties based on the fact that there is a similar provision in the other treaty or is absent in the other treaty, according to a school of thought may be generally low as an aid to interpretation given that each treaty is[25] a result of separate bilateral negotiations and therefore the same expression may have different meanings in different treaties.

(H) Judicial decisions

Many countries now accept the "common interpretative principle" of legal decisions on treaty interpretation. The Courts or authorities of one contracting state may take into consideration the decisions made by the courts or authorities of other contracting states or even third states[26]. In ***CIT vs. Vishakhapatnam Port Trust***[27], Justice J. Rao held:

> *"In view of the standard OECD model which is being used in various countries, a new area of general international tax law is now in the process of developing. Any person interpreting tax treaties must now consider decisions and rulings worldwide relating to similar treaties. The maintenance of uniformity in the interpretation of the rule after its international adaptation is just as important as the initial removal of divergences'".*

Select foreign court decisions on treaty interpretation are given below:

- o The Supreme Court of Canada in the case of ***The Queen vs. Alta Energy Luxembourg SARL***[28] (based on the majority's decision) dismissed the Crown's appeal in a transaction relating to transfer of shares of a Canadian company by a Luxembourg company and confirmed that, where Canada has agreed in a double-tax treaty to cede taxing rights to another country, it cannot use the general anti-avoidance rule ("GAAR")[2] to override its tax treaty. The decision notably cited VCLT and in particular Article 26 on 'good faith principles'.
- o In a UK ruling, in case of Revenue and Customs Comrs v Smallwood, the Court of Appeal held that OECD Commentaries are updated from time to time, so that they may, as in the facts of the present case, post-date a particular tax treaty. Nonetheless, they are to be given such persuasive force as aids to interpretation as the cogency of their reasoning deserves[29].

25. Roy Rohatgi 'Basic International Taxation, Second edition – Vol 1, Page 47-48.
26. Roy Rohatgi ' Basic International taxation' Second edition Vol 1, Page 47.
27. [1983] 144 ITR 146 (AP).
28. 2021 SCC 49.
29. (2010) 80 TC 536.

- o The Federal Court of Australia in the case of ***Resource Capital Fund III LP***[30] held that Australian courts have largely been taking the view that VCLT (Article 31) permits reliance on the OECD Model Convention and Commentaries in interpreting Australian tax treaties.

(I) Other aids to interpretation

Some of the other aids to treaty interpretation are:

- OECD Reports/Technical Advisory Group ('TAG') Reports
- Travaux preparatoires[31]

V. Hierarchy of interpretation

In a nutshell, the hierarchy of the process of tax treaty interpretation can be summarized as follows:

(i) Utmost importance is assigned to the clear meaning of the words in the articles of the tax treaty. Therefore, primary sources of interpretation include, in addition to the text of the treaty, the preamble, protocol, annexures and MLI provisions (where applicable).

(ii) If there appears to be an ambiguity in the meaning of certain terms, a purposive interpretation that furthers the object and purpose of the treaty is to be preferred. Article 3(2) typically provides recourse to the domestic tax laws, unless the context otherwise requires.

(iii) VCLT principles of interpretation are of prime importance and provide an overarching framework as part of customary international law, more so amongst signatories to VCLT. Indian Courts have also been typically referring to guidance provided in VCLT, although India is not a signatory to VCLT.

(iv) Klaus Vogel states that OECD and UN Commentaries may be regarded as providing 'ordinary' or 'special' meaning of undefined terms especially for member countries or non-member countries whose treaties are modelled on OECD or UN Model.

(v) Subsequent commentaries on a convention or treaty have persuasive value only, depending on the cogency of their reasoning[32].

(vi) Aids to the interpretation of a treaty such as travaux préparatoires, international case law and the writings of jurists are not a substitute for study of the terms of the convention. Their use is discretionary, not mandatory, depending, for example, on the relevance of such material and the weight to be attached to it[33].

(vii) Unilateral material prepared by a State typically only of persuasive value.

(viii) Weightage attached to parallel treaties is very low given that treaty terms are outcomes of negotiations between the concerned states.

30. [2013] FCA 363.
31. Travaux préparatoires is the name used to describe the documentary evidence of the negotiation, discussions, and drafting of a final treaty text.
32. Commissioners for HMRC and Smallwood and Another [2010] EWCA Civ 778.
33. ibid.

VI. Treaty interpretation issues when interfacing with domestic tax laws

Typically the interplay between domestic tax laws and tax treaties may vary from country to country. Some issues commonly faced in the course of this interplay are given below:

(A) Treaty override

Treaty Override refers to a situation where the domestic legislation of a State overrules provisions of a treaty. As per Indian domestic tax laws[34], the taxpayer can adopt tax treaty provisions if they are more beneficial. However, in case of improper use of treaties, general or specific anti-avoidance rules can be triggered to press into action treaty override.

Another example is a case where the legislature unilaterally enacts new domestic tax laws that are contrary to an existing treaty without the treaty having been amended or terminated.

A reference to relevant VCLT provisions is as under:

Article 26 - "Pacta sunt servanda"

"Every treaty in force is binding upon the parties to it and must be performed by them in good faith."

Article 27 'Internal law and observance of treaties'

"A party may not invoke the provisions of its internal law as justification for its failure to perform a treaty."

Such legislative action is then a violation of the treaty under international law. Consequences of such a treatment include the possibility of suspension or termination of the treaty, corresponding retaliatory measures by the other contracting state, making an official protest and invoking MAP under Article 25 or appealing to an international forum e.g. International Court of Justice.

At times even court decisions may run contrary to the common interpretation of treaty partners. Such legal decisions could amount to a treaty override. However, the state has the legislative power to reverse the effect through legislation which would be an acceptable remedy.

(B) Non-aggravation principle

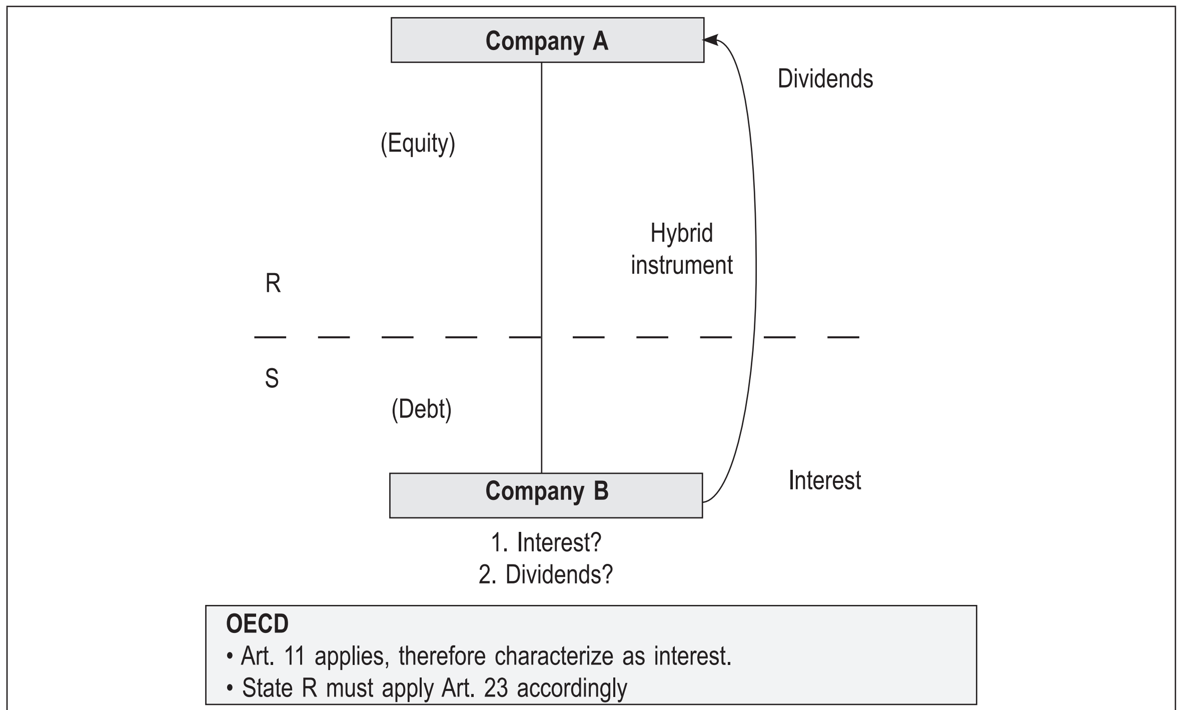
Treaties typically act as 'shields not swords' and does not create any additional tax burden and are typically only to relieve tax. However, there could be exceptions in certain cases e.g. In the case of ***Satyam Computer Services Ltd.***[35], the full Federal Court of Australia confirmed that the source rule in Article 23 of the India-Australia DTAA can result in an Australian tax liability even when a liability would not otherwise arise under Australian domestic law.

34. Section 90(2).

35. *Satyam Computer Services Limited vs. Commissioner of Taxation [2018] FCAFC (File numbers NSD 1648-1650 of 2017).*

(C) Conflicts of qualification

One of the reasons for double taxation or double non-taxation is when domestic laws of the contracting states differ in qualification/characterization of the same income. The problem that arises when the two contracting states apply different distributive rules on the same income and taxpayer due to different meanings of treaty terms in the two contracting states is called "conflict of qualification". "Conflicts of qualification" is dealt with in Article 23 of OECD commentary which states that when a conflict arises from differences in the domestic law of the contracting state, the source state domestic law provisions should prevail. Therefore, the residence state is obliged to grant relief from double taxation regardless of a different characterization in its state. However, this rule does not apply in case of a different interpretation of facts or treaty provisions between the contracting states. This has been pictorially depicted with the help of an illustration below:



VII. Concluding remarks

In this ever-changing world, treaty interpretation is also becoming more and more dynamic, nuanced and layered with new instruments like MLI getting added to the treaty interpretation toolkit. The search for the enigmatic balance between stability in order to be predictable as well as flexibility in order to stay current and relevant continues as a challenge of all times on treaty interpretation !!

Interpretation issues in Transfer Pricing Provisions

CA Aparna Khatri

Overview

While the Indian transfer pricing regulations date just a little over two decades, disputes around the same have been relatively significant in both size and volume. The Indian Courts have done a fine balancing act by safeguarding interests of both the Exchequer and the taxpayer, adopting a nuanced yet a balanced approach while deciding on disputes involving transfer pricing related matters. The Courts have resorted to different rules of interpretation/ construction, depending on the facts. Recognizing the gaps/ limited guidance available in the Indian transfer pricing law, international guidelines/ jurisprudence have seldom been referred to bring in a global perspective, while deciding local disputes. Further, considering the complexities and subjectivities involved in complying with these regulations, the Indian Courts have also referred to other external aids such the preamble, memorandum, notes to clauses, speeches made during parliament sessions and other related materials that led to the law's enactment. Last, but not the least, the role played by the Indian judiciary by settling the transfer pricing disputes by following a pragmatic approach within the four walls of the Indian legal framework is definitely noteworthy and a contributor in improving the 'Ease of doing business in India'.

While its introduction in the statue dates back just a little over two decades, dispute resolution revolving interpretation and implementation of the Indian Transfer Pricing Regulations[1] ('TPR') have ushered in an era of jurisprudence, both legally relevant and pragmatic.

This editorial aims to give a glimpse of some rules of interpretation relied upon by the Indian Courts while adjudicating on transfer pricing or 'TP' disputes. Staying abreast of global developments and adopting guidance available in other parts of the world; the Courts have, over the years, struck a fine balance between legal challenges and economic considerations, thereby contributing to the Ease of Doing Business in India.

1. Section 92 to 92F and Section 94B as contained in Chapter X of the Income Tax Act, 1961 (read with Rules thereto)

I. Rules of Interpretation/Construction

Black's Law Dictionary defines the term "interpretation" as the art or process of discovering and expounding the meaning of a statute, will, contract, or other written document. Further, the term "Construction" inter alia means the process, or the art, of determining the sense, real meaning, or proper explanation of obscure or ambiguous terms or provisions in a statute.

The Calcutta High Court[2] ('HC') stated that statutory interpretation means the process by which the courts seek to ascertain the meaning of the legislature through the medium of authoritative forms in which it is expressed. Interpretation differs from construction since the former is finding out the true sense of any form, the other is drawing of conclusion respecting subjects that lie beyond direct expression of the text.

In the following paras, application of some of these rules of interpretation/construction, by the Indian Courts in the context of transfer pricing related matters have been discussed.

1. Literal interpretation

The cardinal law of interpretation is that if the language is unambiguous, it should be read with the clear intention of the legislation. This is one of the most widely used rules of statutory interpretation as per which the law should be given its plain meaning.

In the case of Vodafone India Services Private Limited[3], the Bombay HC took cognisance of the fact that the TPR were introduced in the statute to get over transfer mispricing/ manipulation/abuse by either showing lesser consideration or higher expenses between "Associated Enterprises" ('AEs') than would be the consideration between two independent entities, uninfluenced by relationship. The Court, however, also observed that the objective of Chapter X was not to punish Multinational Enterprises and/or AEs from doing business inter se.

The Court held that whatever may be the intent of the Parliament, the courts must construe the statute strictly based on what is stated in the Act. Plain reading of Section 92(1)[4] of the Income Tax Act, 1961 ('Act') clearly required that for application of Chapter X there should be income arising from an international transaction. The Court rejected the Revenue's interpretation of the definition of the term "International Transaction" to conclude that income must be given a broader meaning to include notional income as otherwise Chapter X of the Act would be rendered otiose. Further, the Court struck down the department's approach of interpreting Section 92 and observed as under:

> *"35. ...This manner of reading a provision by ignoring/rejecting certain words without any finding that in the absence of so rejecting, the provision would become unworkable, is certainly not a permitted mode of interpretation. It would lead to burial of the settled legal position that a provision should be read as a whole, without rejecting and/or adding words thereto. This rejecting of words in a statute to achieve a predetermined objective is not permissible. This would amount to redrafting the legislation which is beyond/outside the jurisdiction of Courts."*

2. In case of *Bhagwati Prasad Kedia vs. Commissioner of Income-Tax [2001] 248 ITR 562 (CAL)*
3. [2014] 50 taxmann.com 300 (Bombay)
4. Section 92(1): Any income arising from an international transaction shall be computed having regard to the arm's length price.

Thus, the Court held that the TPR should not apply to the issue of shares by a subsidiary company to its overseas holding company at a price which was below the fair market value, which per se did not give rise to any income as per the provisions of the Act. Similar disputes in case of other assessees were pending at various fora. The issue was laid to rest with the Central Board of Direct Taxes deciding to not litigate the matter further[5].

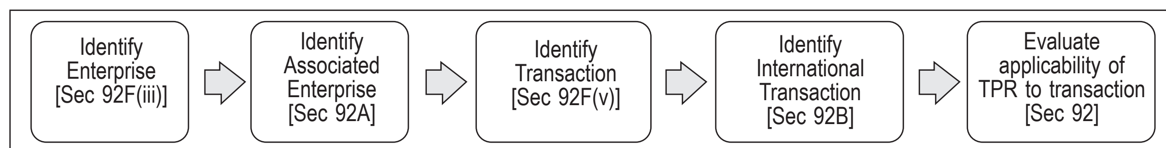
This ruling has and continues to serve as an important judicial precedent for analysing TPR applicability in case where the taxpayer is challenging taxability aspects of an international transaction.

2. Rule of Harmonious Construction

The rule of harmonious construction requires that where there are in an enactment two or more provisions which cannot be reconciled with each other, they should be so interpreted, wherever possible, as to give effect to all of them.

i. Identification of Associated Enterprises

Identification of "Associated Enterprise" or AE is one of the first steps in the TP analysis process. This is followed by identification of arrangements with such AE, evaluating whether such arrangements qualify as "International Transaction" and whether the provisions of Section 92 apply to such transactions.



Section 92A deals with definition of the term "Associated Enterprise" and states that an AE, in relation to another enterprise, means an enterprise:

(a) which participates, directly or indirectly, or through one or more intermediaries, in the management or control or capital of the other enterprise; or

(b) in respect of which one or more persons who participate, directly or indirectly, or through one or more intermediaries, in its management or control or capital, are the same persons who participate, directly or indirectly, or through one or more intermediaries, in the management or control or capital of the other enterprise.

Further, Section 92A(2) provides a list of circumstances in which, for the purposes of sub-section (1), two enterprises shall be deemed to be AEs.

Clauses	Coverage
a-d	Participation in capital (carrying voting power, loans, guarantee)
e-f	Power to appoint directors/ governing board
g-i	Control in form of commercial relationship (dependence on intangible rights, dominant supplier, major customer etc)
j-i	Control in other cases (control by individual/HUF member/relative, control in a Firm/AOP/BOI)
M	Others as may be prescribed[6]

5. Instruction no. 2/2015 dated 29 January 2015
6. No relationship has been prescribed till date.

The issue of identification of AE has been a perennial cause of disagreement between the taxpayer and the Revenue. While the latter is of the view that Section 92A(1) and 92A(2) need to be read independently and an AE relationship is established when either of the sub-sections are satisfied (and hence has a wider application); the taxpayers have argued that the two need to be read together for a narrower but more meaningful interpretation.

In the case of Page Industries Ltd[7], the assessee company, engaged in business of manufacture and sale of ready-made garments, was a licensee of the brand name 'Jockey', entitling it to the exclusive marketing of Jockey ready-made garments under an agreement with Jockey International Inc ('US Co') and paid royalty therefor. The Revenue plea was that the assessee and US Co were AEs in terms of Section 92A(2)(g)*. The assessee argued that the US company did not participate in its control, management or capital as envisaged under Section 92A(1) of the Act and accordingly, TPR compliance was not triggered in its case.

*The provisions of Section 92A(2)(g) inter alia deem two entities to be AEs where the manufacture or processing of goods or articles or business carried out by one enterprise is wholly dependent on the use of rights such as trademarks, licences, etc owned by the other enterprise.

The assessee argued that the provisions of Section 92A (1) and 92A(2) are interlinked and must be read harmoniously. The Court took cognizance of the Memorandum to the Finance Bill 2002, wherein Section 92A(2) was amended to clarify that mere fact of participation by one enterprise in management or control or capital of other enterprise, or participation of one or more persons in the management or control or capital of both the enterprises shall not make them AEs unless criteria specified in sub-section (2) is fulfilled. Further, the Court observed that the reading of the provisions, it was evident that sub-sections (1) and (2) were to be read together, failing which one of the two would become otiose, which would be against the law in view of the well settled rule of statutory limitation.

Earlier, the Hon'ble Supreme Court ('SC') too had adopted a similar position when it dismissed the Revenue's Special Leave Petition challenging the judgement of the Karnataka HC in case of Veer Gems[8].

ii. Procedural Compliances

In the case of Google India[9], the assessee filed objections to the proposed variance within 30 days from the date of receipt of draft assessment order with the Dispute Resolution Panel ('DRP') [as per Section 144C(2)(b)(i)] but inadvertently, missed filing a copy thereof with the assessing officer ('AO') [required as per Section 144C(2)(b)(ii)]. The AO proceeded to complete the assessment disregarding the objections filed by the assessee with the DRP, against which the assessee filed a writ petition with the Karnataka HC.

The Court observed that it was indisputable that the assessee must file objections to the proposed variance as contemplated under Section 144C(b) with both the DRP and the AO, but this obligation must be meaningfully and harmoniously interpreted because ultimately, if the objections are filed with

7. [TS-19-HC-2021(KAR)-TP]
8. (2017) 249 Taxman 264 (Guj)
9. [TS-723-HC-2023(KAR)-TP]

the DRP, the same must result in directions and the AO must complete assessment in the light of the directions as envisaged by Section 144C(13) of the Act. Basis the above, the HC quashed the final assessment order and consequential demand and initiation of penalty proceedings.

II. Reliance on international guidelines/ other externals aids

It is seldom said that transfer pricing is not an exact science. Much is dependent on a given set of facts and circumstances and availability of comparable instances in the public domain. The legal provisions, although detailed, provide little practical guidance in the matter. Acknowledging this gap and the fact that the Indian transfer pricing framework drew colour from, amongst others, the transfer pricing guidelines provided by the OECD[10] ('OECD TP Guidelines'), Courts in India have often referred to these and other guidelines while deciding on matters involving transfer pricing disputes.

i. Relevance of international jurisprudence/literature

The Delhi Tribunal, while adjudicating the matter in the case of BMW India[11], wherein the assessee placed reliance on (amongst others) OECD TP Guidelines, Australian Tax Office Guidelines ('ATO Guidelines') and US Regulations, made specific observations in the context of applicability/use of international jurisprudence/literature for interpreting and adjudicating on transfer pricing issues. Some key takeaways are discussed below:

a. There can be no dispute with the principle that to the extent the international guidelines are repugnant to the Indian Income Tax provisions ('ITR'), they have no role to play, and the latter will prevail, whatever may be said to the contrary in such international guidelines or any other international legislation or decision thereunder.

b. However, wherever there is no conflict with the ITR, especially where issues which may arise in a constantly developing law as far as India is concerned, in the absence of any guidelines in the ITR, there is and there can be no bar to refer to OECD TP Guidelines and International Tax Practices Jurisprudence.

c. There cannot be a blanket ban to considering/referring to judgements and orders rendered by the Courts and Tribunals in different tax jurisdictions as they definitely have a persuasive value. Similarly, the OECD/ATO/UN Model Guidelines have a persuasive value and ignoring the same would be denying the concerned Authority with the benefit of contemporaneous and relevant literature on the constantly evolving issues.

d. The benefits of knowledge on evolving issues which has been internationally debated and discussed by academicians/ experts and various stakeholders are not to be ignored with contempt and should not be treated lightly and discarded without considering.

e. The Court also observed that while the tax department at one end was arguing against applying the international guidelines/jurisprudence in the taxpayer's case; on the other end, the same department was using (i) the "bright-line test" which did not from part of the ITR but was borrowed from the US Legislation, for computing

10. Organisation for Economic Co-operation and Development

non-routine AMP spend; and (ii) OECD TP Guidelines for valuing AMP spend resulting in intangible benefits to the AE.

Considering the above observations, the Hon'ble Delhi ITAT concluded that the international tax guidelines/jurisprudence to the extent, they were not contrary to the ITR, have a key role to play.

ii. Recharacterisation of transactions[12]

In the instant case, the Revenue had appealed to the Delhi HC to restore the TP adjustment made in the case of the taxpayer. The impugned international transaction involved payment of brand fee/royalty, for use of the brand name "Kelvinator", by the Indian electronics manufacturer to its overseas affiliate. While computing the arm's length price ('ALP') of the said transaction, the Revenue observed that the taxpayer had been continuously incurring huge losses and, therefore, concluded that the payment of brand fee/royalty was unjustified as brand fee agreement with the group entity had not benefited the taxpayer in achieving profits for its operations.

The HC stated that OECD had laid down the TP Guidelines for multinational enterprises and tax administrations. These guidelines gave an introduction to the ALP principle and explained Article 9 of the OECD Model Tax Convention; and provided for "recognition of the actual transactions undertaken". The Court observed that the Guidelines recognised that barring exceptional cases, tax administration should not disregard the actual transaction or substitute other transactions for them and the examination of a controlled transaction should ordinarily be based on the transaction as it has been actually undertaken and structured by the AEs. It was further noted that there were two exceptions to the aforesaid principle and they were (i) where the economic substance of a transaction differs from its form and (ii) where the form and substance of the transaction are the same but arrangements made in relation to the transaction, viewed in their totality, differ from those which would have been adopted by independent enterprises behaving in a commercially rational manner.

The Court concluded that there was no reason for not considering OECD TP Guidelines as a valid input. Evaluating the taxpayer's facts in the present case against the guidance provided by OECD, the Hon'ble Delhi HC decided the matter in the assessee's favour.

iii. Selection of Most Appropriate Method ('MAM')

The Indian TPR do not give priority to any of the methods for benchmarking a transaction. While Rule 10C does prescribe some factors that should be kept in mind while selecting the MAM, but there is little guidance beyond that. The Courts have often referred to the OECD TP Guidelines where matters involved a conflict between the tax office and the taxpayer on methodology and approach to be followed for benchmarking the impugned transactions.

In the case of L'Oreal India[13], a company engaged in the business of amongst others, distributing products purchased from its overseas group company, the Transfer Pricing Officer ('TPO') rejected the Resale Price Method ('RPM') and applied Transactional Net Margin Method ('TNMM'). Inspite of the

11. TS-230-ITAT-2013(DEL)-TP

12. *Commissioner of Income-tax vs. EKL Appliances Ltd [2012] 24 taxmann.com 199 (Delhi)*

13. [2013] 34 taxmann.com 78

losses incurred by the assessee at net level, the Mumbai Tribunal held that the RPM is one of the standard methods and that the OECD TP Guidelines also stated that in case of distribution and marketing activities when the goods are purchased from AEs which are sold to unrelated parties, RPM is the MAM. The Hon'ble Bombay HC later affirmed the conclusion[14].

III. Reference to other externals aids

Considering the complexities and subjectivities involved in complying with TPR, the Indian Courts have from time to time also referred to other external aids such the preamble, memorandum, notes to clauses, speeches made during parliament sessions and other related materials that led to the law's enactment.

i. Need for a non-adversarial regime

In the case of GAP International[15], the Hon'ble Delhi Tribunal while giving relief to the Assessee referred to the speech given by the then Finance Minister. The Court, taking note of the observations of the lower authorities, commented that the same were neither based on any cogent reasoning nor factual reliability and that the assessments as framed gave an impression of being work of adversarial approach in tax liability determination. The Hon'ble ITAT observed that the Finance Minister had emphasised that income tax proceedings should be fair and non-adversarial in nature and that this was a sine qua none of a tax administration which usher into a rule of law which is predictable and based on sound reasoning and is not fraught with the perils of uncertainties and adversities for the taxpayers.

ii. Selection of Tested Party

In the transfer pricing world, tested party is the one whose results are compared with that of independent comparable companies while evaluating for arm' length compliance. It is one of the most crucial steps in the benchmarking process. Disputes have arisen where the taxpayer has tried to benchmark using the foreign counterpart as the tested party. Revenue has contended that the TPR require that results should be evaluated qua the Indian entity and that the foreign AE cannot be the tested party.

In the case of Almatis Alumina[16], the Calcutta HC, while holding that foreign AE could be selected as the tested party, observed that in the United Nations Practical Manual of Transfer Pricing for Developing Countries, 2013, India Chapter, it was stated that the Indian TP Administration prefers Indian comparables in most cases and also accepts foreign comparables in cases where the foreign AE is less or least complex entity and requisite information is available about the tested party and comparables. Further, the Court also referred to the Indian TP guidelines issued by the Institute of Chartered Accountants of India, vide Guidance Note on Report under Section 92E, in addition to the OECD TP guidelines.

IV. Adopting a pragmatic approach

The Indian jurisprudence contains several instances where the Courts have empathised with the taxpayer community especially considering the nuances involved in complying with TPR. The Courts have

14. TS-376-HC-2014(BOM)-TP
15. TS-667-ITAT-2012(DEL)-TP
16. TS-109-HC-2022(CAL)-TP

recognised challenges such as nascency of the law, cost benefit considerations, subjectivity involved, non-availability of data etc and where the taxpayer demonstrated genuine intent and effort, the Indian judiciary has favoured the same, thereby giving relief to such taxpayers.

In one of the cases, the Delhi HC[17] quashed the penalty levied by the Revenue Authorities on the taxpayer, under Section 271G[18]. The Hon'ble HC concurred with the observations of the Tribunal, which had concluded that the documentation rules were broad based and required documentation and information, which are voluminous and virtually unlimited; and that hence, Section 271G must be interpreted reasonably and in a rational manner.

The Hon'ble Madras HC took a similar approach in the case of SSL-TTK Ltd[19] wherein the assessee had complied partly with the documentation asked for by the TPO during the TP proceedings. The HC noted that the TPO was satisfied that whatever documents, which were called for, were produced by the assessee at a later point of time and ordered that no addition is required to be made and the assessment was completed. The HC further observed that the assessee had submitted 12 out of 16 items as called for by the TPO, which could be considered as a reasonable act of an organization acting with prudence under normal circumstances without negligence or inaction or want of bonafides. The Hon'ble HC also took cognisance of the fact that there was no finding recorded by the AO to the contrary. Thus, the Court finally dismissed the penalty levied.

Recently, the Gujarat HC dismissed the Revenue's appeal against reversal of penalty levied under Section 271(1)(c) of the Act in the case of foreign company[20] which had received royalty and fees for technical services from its Indian AE. While deciding the matter in favour of the taxpayer, the Court observed that the concept of 'Base Erosion' was a debatable one and where such two views were possible, mere difference of opinion did not justify levy of penalty.

V. Wrapping up

The above are just a few instances of the many where the Courts have honoured both the word of the law and the underlying intent, while adopting a practical and independent approach when adjudicating on transfer pricing matters. It is known fact that transactions between multinational enterprises account for the majority of cross border trade and in such case, the role of the judiciary, in resolving these disputes, definitely deserves an applaud.

17. *Leroy Somer & Controls (India) Pvt. Ltd. [TS-249-HC-2013(DEL)-TP]*
18. Penalty for non-maintenance of TP documentation
19. TS-358-HC-2021(MAD)-TP
20. *Shell Global Solutions International B.V. [TS-620-HC-2023(GUJ)-TP]*

Interpretational issues in GST

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Overview

A number of indirect taxes and levies were subsumed in GST. As is expected from such a major change, multiple amendments were subsequently made to resolve issues. Further, there have been plethora of interpretational issues, which is again expected from a such a major change. While the GST is a relatively new legislation without much jurisprudence of its own, the interpretation issues in GST would continue to be addressed by the established principles for interpretation of taxing statutes that have evolved over a period of time.

Some of these principles along with the relevant judicial precedents and the manner in which one may apply these principles in interpreting the provisions of the GST law are examined in this article. As an example, the article also seeks to analyse the term 'plant and machinery' as defined in Explanation to Section 17(5) of the Central Goods and Services Tax Act, 2017. In doing so, reference to the relevant dictionary definitions, definition provided under the Income Tax Act, 1961 and judicial precedents under the other legislations have also been made.

In addition, this article also delves in the manner of determining the classification of goods/ services under the GST law as well as the General Rules for Interpretation provided under the Customs Tariff Act, 1975.

The introduction of GST law with effect from 1 July 2017 has resulted in subsummation of various indirect taxes/levies. While it is a relatively new legislation, the principles to interpret a statute would remain the same, as laid down by various Courts. In this article, we have examined some of the key principles for interpretation of taxing statutes and few practical instances wherein principles of interpretation play an important role.

Key Principles of Interpretation of Taxing Statutes

A. General Rules for interpretation of statutes

1. Literal Rule

As per this rule, where a provision is clear and unambiguous, the words used in the Statute/legislation must be understood in their plain meaning, according to its literal and

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grammatical meaning, irrespective of its result/consequences. Even on account of hardship or inconvenience, the meaning of the language adopted by the Legislature cannot be deviated. Considering the above, a departure from this rule should be opted only in rare cases and there must be a judicial restraint in deviating from this rule.

In **Modi Sugar Mills Ltd**.[1], the Supreme Court observed that in interpreting a taxing statute, equitable considerations are entirely out of place and taxing statutes cannot be interpreted on any presumptions or assumptions. The Courts are required to look squarely at the words of the Statute and interpret them in the light of what is clearly expressed. The Courts cannot imply anything which is not expressed nor can they import provisions in the Statutes so as to supply any assumed deficiency.

However, there are certain exceptions to this rule of interpretation, some of which has been elaborated in the ensuing parts of this Article.

2. *Rule of Exceptional Construction*

Having examined the Literal Rule, it is imperative to note that in cases where the Literal Interpretation produces an unintelligible or absurd results, the Courts are empowered to deviate from the Literal Rule and resort to reading down certain words/phrases used in a Statute. However, the Courts have consistently observed that in the garb of reading down a provision, it is not open to read words and expressions not found in a provision/Statute. Thus, the Rule of reading down is to be used for the limited purpose of making a particular provision workable and/or to bring it in harmony with other provisions of the Statute. Let us now examine some instances where the Courts can deviate from the Literal Rule to interpret the taxing statutes.

a. Interpretation of the terms 'or' and 'and'

Generally, the word 'or' is interpreted to be used in a disjunctive manner whereas the word 'and' should be interpreted as being used in a conjunctive manner. If the literal reading of the words produce an unintelligible or absurd result, the word 'or' may be read as 'and' (in conjunctive manner) whereas the word 'and' may be read as 'or' (in disjunctive manner) even though the result of so modifying the words is less favourable to the subject, provided that the intention of the Legislature is otherwise quite clear[2].

In case of **Green**[3], Scrutton, LJ had inter alia observed that *"You do sometimes read "or" as "and" in a statute … But you do not do it unless you are obliged, because "or" does not generally mean "and" and "and" does not generally mean "or"*.

In **M. P. Electricity Board**[4], the word 'or' occurring in the definition of 'manufacturing process' (defined under Section 2 of the Factories Act, 1948) was interpreted as 'and'.

1. *Commissioner of Sales Tax, U.P. vs. Modi Sugar Mills Ltd. [1961 (2) SCR 189] – Para 10.*
2. *Union of India vs. Kamlabhai Harjiwandas Parekh and Others [1968 (1) SCR 463], A.G. vs. Beauchamp [1920 (1) KB 650], R vs. Oakes [1959 (2) All ER 92]* and *Sahney Steel & Press Works Ltd. Hyderabad vs. Commissioner of Income Tax Andhra Pradesh [1997 (7) SCC 764].*
3. *Green vs. Premier Glynrhonwy State Co. [LR (1928) 1 KB 561, 568].*
4. *M. P. Electricity Board, Jabalpur vs. State of Madhya Pradesh [1982 Jab LJ 1].*

b. Interpretation of the terms 'may' and 'shall'

Ordinarily, the word 'shall' would imply that the statutory provision is mandatory in nature whereas the word 'may' is an enabling word which confers capacity, power or authority and imply discretion. However, the use of the terms 'shall' or 'may' would not by in itself make the provision mandatory/discretionary. Whether a provision is discretionary or mandatory would depend on the context in which these terms are used.

In the Presidential Poll ruling[5], the Chief Justice of India speaking on behalf of the 7-Judge Bench inter alia observed that in determining whether a provision is mandatory or directory, it is relevant to examine the subject-matter, the import of the provision, the relation of that provision to the general object intended to be secured by the Act. It is the duty of the Courts to arrive at the real intention of the Legislature by carefully attending to the whole scope of the provision to be construed.

While interpreting the word 'may' under Section 54 of the Central Goods and Services Tax Act, 2017 (CGST Act), the Madras High Court in **Lenovo (India) Pvt. Ltd.**[6] had held that the time limit for filing a refund application (of 2 years) is directory and not mandatory. However, it is imperative to note that the Supreme Court in Bachahan Devi[7] observed that in cases where the interpretation of the word 'may' as directory would render the very object of the Act as nugatory, the word 'may' must mean 'shall'.

3. *Rule of ejusdem generis*

As per the rule of ejusdem generis, when particular words pertaining to a class, category or genus are followed by general words, the general words are to be construed as limited to things of the same kind as those specified. In essence, this rule dictates that the general terms subsequent to specific enumerations are to be interpreted as being restricted to the nature/class/genus of those specified.

As per the principles laid down by the Supreme Court in **Grasim Industries Ltd.**[8], the rule of ejusdem generis applies only in the following circumstances:

- The Statute contains an enumeration of specific words;
- The subjects of enumeration constitute a class or category;
- That class or category is not exhausted by the enumeration;
- The general terms follow the enumeration; and
- There is no indication of a different legislative intent.

Having examined the rule of *ejusdem generis,* it is worthwhile to examine the exceptions to the said rule as held by the Courts, some of which are set out hereunder:

5. *In Re: Presidential Poll [1974 (2) SCC 33].*
6. *Lenovo (India) Pvt. Ltd. vs. The Joint Commissioner of GST [TS-591-HC(MAD)-2023-GST]* (However, the Delhi High Court in *Sethi Sons (India) vs. Assistant Commissioner and Ors. [2023 (12) TMI 1102 (Del.)*] has doubted on the correctness of the Lenovo (India) Pvt. Ltd. ruling).
7. *Bachahan Devi and Anr. vs. Nagar Nigam, Gorakhpur and Anr. [2008 (12) SCC 372]*
8. *Grasim Industries vs. Collector of Customs, Bombay [2002 (141) ELT 593 (SC)].*

- The rule of *ejusdem generis* does not have an inverse application.
- If the specific words do not come under a genus or category, the rule of *ejusdem generis* cannot be applied.
- A single word cannot constitute a genus and hence, the rule of *ejusdem generis* is inapplicable in such cases[9].

B. Subsidiary Rules for Interpretation of Statutes

1. *Interpretation of non-obstante clause:*

Non-obstante clause is a clause/provision which begins with the phrase *'Notwithstanding anything contained in …'*. The intention behind using this phrase is to give the enacting part of the provision (in case of conflict) an overriding effect over the other provision/s or the Statute/s mentioned in the provision. Thus, a *non-obstante* clause signifies that the said provision takes **full effect regardless of** any conflicting provisions mentioned in the non-obstante provision, thereby acting as a legal mechanism to **supersede** the specified law or provision under designated circumstances.

As per the principle laid down by the Supreme Court[10], a *non-obstante* clause is usually used in a provision to indicate that the said provision should prevail despite anything to the contrary in the provision mentioned in such *non-obstante* clause. In case there is any inconsistency between the provision with *non-obstante* clause and the other provision, the provision with *non-obstante* clause would prevail over the other provision. In the absence of inconsistency, effect to both the provisions must be given.

In **Thirumalakonda Plywoods**, the Andhra Pradesh High Court observed that Sections 16(2) and 16(4) of the CGST Act are two different restricting provisions, the former providing eligibility conditions and the latter imposing time limit. Since Section 16(4) of the CGST Act is a non-contradictory provision and capable of clear interpretation, it will not be overridden by the *non-obstante* provision of Section 16(2) of the CGST Act[11].

2. *Contemporanea Expositio*

The principle of *contemporanea expositio* is used for interpreting a Statute or any other document by reference to the exposition it has received from contemporary authority. This rule can be used for interpretation of Statutes although the same will not always be decisive of the question of construction. However, a reference to the same would be highly persuasive and can be used in interpreting the statutory provisions.

Thus, ordinarily, executive and administrative officers are called to interpret certain Statutes long before the Courts may have an occasion to construe them. However, the construction so placed upon by such official will not be binding upon the Court. Despite the above, if a contemporaneous construction is placed upon an ambiguous Statute by such officials

9. Maxwell on Interpretation of Statutes, p. 327, 11th Edition and *The Maharashtra State Electricity Board vs. The Talegaon Dabhade Municipality [1965 SCC OnLine Bom 95].*
10. *Chandavarkar Sita Ratna Rao Vs. Ashalata S. Guram [1986 (4) SCC 447]* and *South India Corporation (P) Ltd. vs. Secretary, Board of Revenue, Trivandrum and Ors. [AIR 1964 SC 207].*
11. *Thirumalakonda Plywoods vs. The Assistant Commissioner, State Tax [2023-VIL-472-AP]* – This principle was relied upon by the Calcutta High Court in *BBA Infrastructure Ltd. vs. Senior Joint Commissioner of State Tax & Ors. [TS-646-HC(CAL)-2023-GST].*

and if such construction is observed and acted upon for a long period of time, it will not be disregarded by the Courts, except for the most satisfactory, cogent or compelling reasons.

Applying the aforesaid principle, one may construe that the clarifications and statements at the time of introduction of GST law are highly persuasive and hence, can be used for interpretation of the GST law. The agenda and minutes of the GST Council meetings can similarly be relied upon to interpret the GST law.

C. Miscellaneous principles for interpretation of taxing statutes

1. Binding nature of Circulars/Instructions

As per the law laid down by the Supreme Court[12], the settled position as to the binding nature of Circulars/Instructions is as under:

- Circulars/Instructions are binding on the Tax Authorities. However, they are not binding on the Courts.
- If a Circular/Instruction runs contrary to the law, they are not binding on the Tax Authorities and hence, must be ignored.

2. Interpretation of exemption notification

As per the principles laid down by the Supreme Court[13], exemption notifications are to be interpreted as under:

- General Exemption Notifications should be strictly interpreted.
- Beneficial Exemption Notifications which are granted for a particular purpose such as encouragement or promotion of certain activities should be interpreted liberally.

3. Interpretation of terms not defined in a Statute

- **Reference to Dictionary definition:** If a word/term is not defined in the Statute itself, it is permissible to refer to the dictionary definitions to find out the general sense in which that word/term is understood in common parlance[14].
- **Reference to judicial precedents under the erstwhile legislations** (such as Sales Tax/VAT/Service tax/ Central Excise): It is a settled law that when once certain words in an Act of Parliament have received a judicial construction in one of the superior Courts and the Legislature has repeated them without alteration in a subsequent Statute, it can be construed that the Legislature has used them according to the meaning which a Court of competent jurisdiction has given to them[15].

12. *The Paper Products Ltd. vs. Commissioner of Central Excise [1999 (7) SCC 84]* and *Ranadey Micronutrients and Ors. vs. Collector of Central Excise [1996 (10) SCC 387], Commissioner of Central Excise, Bolpur vs. Ratan Melting Wire and Industries [2008 (13) SCC 1]* and *Assistant Commissioner of Income Tax (Exemptions) vs. Ahmedabad Urban Development [2022 SCC OnLine 1461].*
13. *Commissioner of Customs (Import), Mumbai vs Dilip Kumar [2018-TIOL-302-SC-CUS-CB]* and *Government of Kerala vs. Mother Superior Adoration Convent [2021-TIOL-156-SC-MISC].*
14. *Nagulapati Lakshmamma vs. Mupparaju Subbaiah [1998 (5) SCC 285]* and *Star Paper Mills Ltd. vs. Collector of Central Excise, Meerut [AIR 1989 SC 2066].*
15. *Webb vs. Outrim [1907 AC 81].*

- **Reference to judicial precedents other legislations** (such as, Income-tax): While interpreting the provisions of Indirect taxes, in some cases, the Courts have relied upon the meaning of the same terms deployed by judicial precedents under the Income tax law, where the scheme of the provisions under the other legislation is identical to the scheme of the Statute (sought to be interpreted)[16].

It may however be noted that the judicial precedents under other legislations (including those under the erstwhile legislation) should be referred to only in cases where the terms are used in the same context and scheme of the Statute.

Interpretation of 'Plant and Machinery' under The GST Law – A Case In Example

Before delving upon the ambit of the phrase 'plant and machinery' provided in Explanation to Section 17(5) of the CGST Act, let us refer to the following provisions under the CGST Act concerning the use of the term 'plant and machinery':

1. Section 16 of the CGST Act is the enabling provision which determines the eligibility of Input Tax Credit (ITC) on goods/services. This right is inter alia qualified by Section 17(5) of the CGST Act which is a non-obstante provision overriding the provisions concerning eligibility of ITC as contained in Sections 16(1) and 18(1) of the CGST Act. Section 17(5) of the CGST Act carves out certain transactions/ procurements in respect of which, a recipient is not entitled to claim ITC.

2. Applying the principles discussed in the preceding part of this Article, since Section 17(5) of the CGST Act begins with a non-obstante clause, it would override the general provision i.e., Section 16(1) of the CGST Act. Accordingly, the restriction to claim ITC would apply even if the conditions laid down under Section 16 of the CGST Act are satisfied.

3. Section 17(5)(c) and 17(5)(d) of the CGST Act inter alia seeks to restrict ITC in respect of goods/services (including works contract services) for construction of an immovable property. However, an exception has been carved out to the aforesaid restriction to providing that the restriction to claim ITC would not apply in respect of 'plant and machinery'.

4. The term 'plant and machinery' is defined in Explanation to Section 17(5) of the CGST Act to-

   a. **Mean**

      - Apparatus, equipment and machinery fixed to earth by foundation or structural support
      - Used for making outward supply of goods or services or both, and
      - Includes such foundation or structural support

16. *Balar Fabrics Pvt. Ltd. vs. Union of India [2002 (142) ELT 309 (Raj.)]* Supreme Court ruling in *CIT vs. Cheniappa Mudaliar [1969 AIR SC 1068]* was relied upon since the scheme of Section 35C(1) of the Central Excise Act, 1944 was identical to Section 33(4) of the Income Tax Act, 1922.

b. **Excludes**

- Land, building or any other civil structures
- Telecommunication towers; and
- Pipelines laid outside the factory premises

5. The definition of the phrase 'plant and machinery' includes various terms such as 'apparatus', 'equipment' and 'machinery'. These terms are not defined under the GST law and hence, one may refer to the dictionary definitions as well as the interpretations provided by the judicial precedents under the other tax laws.

a. Dictionary definitions:

- Apparatus
  - o A collection of instruments, machines, tools, parts or other equipment used for a particular purpose [Collins English Dictionary]
  - o The technical equipment or machinery needed for a particular activity or purpose [Oxford English Dictionary]
- Equipment
  - o The articles or implements used for a specific purpose or activity [Black's Law Dictionary, Tenth Edition]
  - o The necessary items for a particular purpose [Oxford English Dictionary]
- Machine
  - o A device or apparatus consisting of fixed and moving parts that work together to perform some function [Black's Law Dictionary (Tenth Edition)].

b. Definition of 'plant' under the Income tax Act, 1961 (IT Act) and judicial precedents thereof:

- The term 'plant' is defined under Section 43(3) of the IT Act to include '***ships, vehicles, books, scientific apparatus and surgical equipment*** *used for the purposes of the business or profession* ***but does not include*** *tea bushes or livestock or* ***buildings*** *or furniture and fittings'.*
- On perusal of the above, it is beyond doubt that the term 'plant' specifically excludes buildings. However, in various judicial precedents, certain immovable structures were specifically held to be covered under the purview of the term 'plant and machinery' as under:
  - o Taxiways, aprons, parking bays, etc. were held as being covered

under the purview of 'plant and machinery'[17].

- o If it is impossible for the equipment to function without a building or a concrete structure, the same would qualify for inclusion in the term 'plant'[18].

6. It is also relevant to refer to the following rulings under the erstwhile CENVAT Credit Rules, 2004 (CC Rules) (though the term 'capital goods' was defined in a quite different manner under the CC Rules, without reference to the phrase 'plant and machinery'):

   a. A service provider providing port services was allowed CENVAT Credit on inputs and input services used for construction of jetty[19].

   b. CENVAT Credit on inputs/capital goods and input services used for fabricating Dry Dock (a concrete structure embedded to earth) which is further used for manufacturing ships and for rendering repair/refit services was allowed. Further, Dry Dock fabricated for manufacturing ships and providing repair services was held to be 'capital goods'[20].

7. On an application of the aforesaid judicial precedents in interpreting the definition of 'plant and machinery' under Explanation to Section 17(5) of the CGST Act, one may construe that till the time an immovable property/ structure can be considered as plant and machinery, it is possible to adopt a position that ITC of GST paid on goods/services used for its construction would be available. It may however be noted that the aforesaid view would also be dependent on the facts and circumstances of each case and on the overall scheme of the provisions of the CGST Act and the other legislations.

8. Having examined the above, let us now refer to some of the AAR/AAARs which have examined the scope and ambit of the phrase 'plant and machinery' under the GST law:

Case laws	Goods	Ratio
Konkan LNG Pvt. Ltd.[21]	Breakwater wall designed to protect jetty from hightide and forceful waves	Would not qualify as 'plant and machinery'
Atriwal Amusement Park[22]	Steel and civil structure on which water slides are installed	Qualifies as 'plant and machinery'

17. *Mumbai International Airport Pvt. Ltd.vs. Addl. CIT [2017 (11) TMI 905 ITAT Mumbai]*
18. *Commissioner of Income Tax vs. Mazagaon Dock Limited [191 ITR 460].*
19. *Mundra Ports & Special Economic Zone Ltd. vs. CCE & Cus. [2015 (39) STR 726 (Guj.)].*
20. *Pipavav Shipyard Ltd. vs. Commissioner [2016 (41) STR 151 (Tri.-Mum.)]* The matter is currently in appeal before the Supreme Court in Tax Appeal No. 709 of 2016.
21. *In Re: M/s. Konkan LNG Pvt. Ltd. [2020 (35) GSTL 499 (App. AAR)].*
22. *In Re: M/s. Atriwal Amusement Park [2020 (7) TMI 477 AAR].*

Case laws	Goods	Ratio
SHV Energy Pvt. Ltd.[23]	Construction of tank and its structural support	Qualifies as 'plant and machinery'
Tarun Realtors Pvt. Ltd.[24]	Lift, Escalator, Travellator, Water treatment Plant, Sewage Treatment Plant, HSD yard, Mechanical Car Park, DG Set and Transformers	Would not qualify as 'plant and machinery'
Synergy Global Steel Pvt. Ltd.[25]	Sewage Treatment Plant and Fire-fighting system	Would not qualify as 'plant and machinery'

The above precedents clearly outline that the determination of what qualifies as 'plant and machinery' is factual analysis.

Interpretation of HSN Entries

1. Historical Background

HSN stands for 'Harmonized System of Nomenclature' which was developed by the WCO (World Customs Organization) as a multipurpose international product nomenclature that first came into effect in 1988 with the vision of facilitating classification of goods across the world in a systematic manner. HSN is being used in more than 200 participating countries and approximately 98% of international trade stock is classified in terms of HSN.

2. Precedential Value of HSN Explanatory Notes

The Supreme Court[26], while deciding on various classification issues, referred to the HSN Explanatory Notes and observed that -

a. HSN Explanatory Notes are a safe guide to resolve disputes on tariff classification under the internationally accepted nomenclature.

b. HSN Explanatory Notes are not only of persuasive value but are entitled to greater consideration in classifying goods.

3. Arrangement of headings and sub-headings in the First Schedule to the Customs Tariff Act, 1975 (CT Act)

a. The Customs Manual 2023 issued by the CBIC as to the classification of goods explains the methodology of classification and the arrangement of headings and subheadings in the Customs Tariff as under:

23. *In Re: M/s. SHV Energy Pvt. Ltd. [2021 (4) TMI 882 - AAR].*
24. *In Re: M/s. Tarun Realtors Pvt. Ltd. [2020 (3) TMI 981 - AAAR].*
25. *In Re: M/s. Synergy Global Steel Pvt. Ltd. [2021 (48) GSTL 286 (AAR)].*
26. *L.M.L. Ltd. vs. Commissioner of Customs [2010 (258) ELT 321 (SC)], Commissioner of Central Excise, Delhi-III vs. Uni Products India Ltd. [2020 (372) ELT 465 (SC)], Collector of Central Excise, Shillong vs. Wood Craft Products Ltd. [1995 (77) ELT 23 (SC)]; Collector of Central Excise, Hyderabad vs. Bakelite Hylam Ltd. [1997 (91) ELT 13 (SC)]; Collector of Customs, Bombay vs. Business Forms Ltd. [2002 (142) ELT 18 (SC)]* and *O.K. Play (India) Ltd. vs. Collector of Central Excise, Delhi-III (Gurgaon) [2005 (180) ELT 300 (SC)].*

> *"2.1 In the Tariff Schedule,* ***commodities/products are arranged in a fixed pattern*** *with the duty rates specified against each of them.* ***The pattern of arrangement of goods in the Tariff is in increasing degree of manufacture of commodities/ products in the sequence of natural products, raw materials, semi-finished goods and fully finished goods/article/machinery, etc."***

b. A similar clarification is also included in the 'Harmonized System Compendium' published by the World Customs Organization in 2018.

> ***'As a general rule, goods are arranged in order of their degree of manufacture: raw materials, unworked products, semi-finished products, finished products****. For example, live animals fall in Chapter 1, animal hides and skins, in Chapter 41, and leather footwear, in Chapter 64.* ***The same progression also exists within the Chapters and headings.'***

4. Key General Rules for Interpretation (GIR) (For classification of goods)

a. **Specific entry to be preferred over a general entry (Rule 3(a)):**

- As per Rule 3(a), the heading which provides the most specific description shall be preferred to headings providing a more general description.
- However, when two or more headings each refer only to the part of the materials or substances contained in mixed or composite goods or only to the part of the items in a set put up for retail sale, those headings are to be regarded as equally specific in relation to those goods, even if one of them gives a more complete or precise description of the goods.
- In Uni Products (supra), this rule was applied by the Supreme Court to hold that car matting would be classified under Chapter 57 as *'Carpets and other Textile Floor Coverings'* and not under Chapter 87 as *'Vehicles Parts and accessories'*.

b. **Essential character test (Rule 3(b)):**

- Mixtures, composite goods consisting of different materials or made up of different components, and goods put up in sets for retail sale, which cannot be classified by reference to Rule 3(a), shall be classified as if they consisted of the material or component which gives them their essential character, in so far as this criterion is applicable.
- Rule 3(b) requires classification based on the material which gives it the essential characteristics. This is the test of essentiality.
- Applying this rule while holding that decorated laminated sheets are to be classified under Chapter 39,

the Supreme Court observed that the essential character of a decorative laminated sheet is its rigidity or strength and its resistance to heat and moisture. These are essentially characteristics which are imparted by resins whereas paper does not possess any of these characteristics[27].

c. In cases where the goods cannot be classified by the aforesaid rules (Rule 3(a) or Rule 3(b)), they shall be classified under the heading which occurs last in numerical order among those which equally merit consideration (Rule 3(c) of GIR).

d. While apart from the above, there also exists other rules, the classification of goods is generally governed by Rule 3 of GIR, as highlighted above.

5. Reference to classification under the CT Act

a. **Classification of goods:**

- GST rates on supply of goods are notified vide Notification no:01/2017-Central Tax (Rate) dated 28 June 2017 (GST Rate Notification). As per the Explanation appended to the said notification, the terms 'Tariff item', 'sub-heading', 'heading' and 'Chapter' shall mean respectively a tariff item, sub-heading, heading and chapter as specified in the First Schedule to the CT Act.
- Accordingly, the classification of goods under the GST law would be same as the classification of the respective goods determined under the CT Act. Moreover, the rules for the interpretation of the First Schedule to the CT Act including the corresponding the Section Notes, Chapter Notes and the General Explanatory Notes of the First Schedule would also be applicable for determining classification of goods under the GST law.

b. **Classification of services:**

- GST rates on the supply of services are notified vide Notification no:11/2017-Central Tax (Rate) dated 28 June 2017. As per the Explanation appended to the said notification, reference to 'Chapter', 'Section' or 'Heading', wherever they occur, unless the context otherwise requires, shall mean respectively as 'Chapter', 'Section' and 'Heading' in the Annexure annexed to the said notification which inter alia provides the Scheme of classification of services. This Scheme of classification of services is a modified version of the United Nations Central Product Classification (UNCPC). In this regard, CBIC had released an Explanatory

27. *Collector vs. Bakelite Hylam Ltd. [1997 (91) ELT 13 (SC)].*

Notes to the Scheme of Classification of Services based on the Explanatory Notes to the UNCPC[28].

6. Having examined the aforesaid principles, let us now refer to some of the recent judicial precedents dealing with the classification of goods.

    a. In **Parle Agro Pvt. Ltd**.[29], the Madras High Court held that GST Council is not empowered to determine the classification of 'goods' and the same can be determined in accordance with the provisions of the CT Act.

    b. In **Association of Technical Textile Manufacturers and Processors**[30], the Delhi High Court held that Tax Research Unit of CBIC cannot issue a clarification with respect to classification of goods.

    c. In **Samsung India Electronics Pvt. Ltd.**[31], it was observed that an exemption notification or a policy issued by a Ministry of the Government cannot determine the classification of goods under the Customs law.

Since GST law is in a nascent stage and as is expected from a change of such magnitude, there have been multiple amendments since its introduction. However, numerous interpretational issues still persist. These interpretational issues are likely to be resolved by the GST Appellate Tribunal once the tribunals come into existence and also, with the Courts ruling on these issues. However, till that time, for interpretation of the provisions of the GST law, reference may usefully be made to the established principles for interpretation of taxing statutes as well as the ratio laid down by various judicial precedents under the other legislations.

28. Explanatory Notes can be accessed by clicking here.
29. P*arle Agro Pvt. Ltd. vs. Union of India & Ors. [TS-577-HC(MAD)-2023-GST].*
30. *Association of Technical Textiles Manufacturers and Processors & Anr. vs. Union of India & Ors. [TS-581-HC(DEL)-2023-GST].*
31. *Samsung India Electronics Pvt. Ltd. vs. Principal Commissioner of Customs [2023-VIL-1341-CESTAT-DEL-CUS].* Similar view was also taken in *Vivo Mobile India Pvt. Ltd. vs. Principal Commissioner of Customs [2024-TIOL-149-CESTAT-DEL].*

Constitutional Interpretation of Tax laws: Recent Trends

CA Daksha Baxi

Overview

The article delves into the complexities of tax litigation in India, role of revenue department, while also examining contrasting legal positions espoused by the Supreme Court and High Court. The article meticulously examines various constitutional articles such as 253, 265, 13(3), 20 and so on along with provisions of DTAA, Black Money Act and income tax law. Focus is given on fact that courts adjudge the constitutionality of legislation by generality of its provisions. The article not only scrutinizes various judicial precedents addressing constitutional challenges to Indian laws but also emphasizes the delicate equilibrium between promoting economic activity and ensuring fair taxation.

Introduction

Tax disputes in India are very common which is evident from the large pending tax cases at various fora.

The disputes on tax matters can be taken to High Courts (**"HCs"**) and the Supreme Court (**"SC"**), only on a substantial question of law. Interestingly, the Revenue Department (**"Revenue"** or **"Tax Department"**) is the largest litigator when it comes to taxation. In many cases, even if the amount involved is small since the Revenue holds such a diametrically opposite view of the law that they need the Courts to intervene to ensure that Revenue does not lose on taxes due to incorrect application and interpretation of the law. It is the Executives within Revenue who draft the law each year through the Finance Act and they have a particular intention behind such drafting. Hence, when their intention and understanding are not upheld by the Courts, it stands to reason that they would approach the higher fora.

In recent times, we have seen some very far-reaching issues where such legal positions have been contested at the level of the SC as well as the HCs of the various States. As we know, the decision of the SC lays down the law of the land with respect to the issue on which the SC gives its ruling. As a result, where some long pending issues have been ruled upon by the SC, which have upset the principles established by the HC decisions and indeed those of the ITATs, it is normal that taxpayers and professionals are perplexed and even taken aback.

Fundamentally, the government cannot levy and collect taxes unless the Constitution of India (**"Constitution"**) has authorised it and the Government has framed the law for levy and administration of such taxation. Thus, the authority in relation to taxation is embedded in the Constitution.

Article 265 of the Constitution says that "*No tax shall be levied or collected except by authority of law*".

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Article 13(3) says, "*law includes any ordinance, order, by-law, rule, regulation, notification, customs or usage having in the territory of India, the force of law* (**"Law"**)"

Article 265 is infringed every time the Law does not authorise the tax collected. Hence, when a particular provision of tax law is interpreted and applied by the SC such that the levy of tax is upheld and it becomes the law of the land, it is indeed opportune to examine whether the said interpretation violates the basic provision of Article 265 of the Constitution. The definition of Law includes "order" but does it mean the 'order' of the government or Revenue, or also includes the order of the SC?

Against this backdrop, in this article, we will examine a few decisions/positions taken by the SC as well as HC in light of the Constitutional framework within which the laws are made and are to be interpreted and implemented. In fact, we attempt to understand the Constitutional provisions in respect of these decisions by the Courts.

In particular, we will examine three legal positions taken by the SC and the HC in the realm of taxation. These are:

1. The decision of the SC in the case of Assessing Officer Circle (International Taxation) 2(2)(2) ***New Delhi vs. Nestle SA***[1], on the application and operation of the Most Favoured Nation (**"MFN"**) Clause contained in Double Tax Avoidance Agreements (**"DTAA"**), where the SC has overturned the position taken by various HCs.

2. Interpretational rules regarding retrospectivity, particularly in the context of Black Money law.

3. Rejection of petition by the Bombay HC, by the Serum Institute of India, which challenged the amendment to the Income Tax Act (*"IT Act"*) that had the effect of characterising government subsidies, grants etc. as 'income' under the IT Act.

At the outset, it is to be acknowledged that taxes are not liked by the earners of income! In this context, giving the background of the need for taxation, Judge Oliver Wendell Holmes Jr very succinctly expressed that "taxes are the price we pay for a civilized society". In a democracy, the tax system plays a vital role by providing the State with the revenue to finance public goods and enable wealth redistribution. Through targeted government spending, redistribution aims to address societal inequalities. It is important to note that in a liberal society, no person is obligated to make any payment without their consent. Hence, the levy of tax needs the sanction of the Constitution, which the people of the country have agreed to abide by, to protect their rights and understand their obligations vis-à-vis the State as also inter-se.

We now take up each of the issues we want to analyse, separately.

1. Assessing Officer (International Taxation) vs. Nestle SA

1.1 Facts of the Case

Nestle SA, based in Netherlands, France and Switzerland, had sought lower rate of taxation at source on dividends, interest, royalties or fees for technical services (**"FTS"**) by seeking to apply the lower rates given to other OECD member countries. They sought this in pursuance of applying the MFN clause in the Protocol of the respective DTAA.

1. [2023] 155 taxmann.com 384 (SC).

1.2 Decision & Discussion

The HC had held that the Protocol would be considered as part of the DTAA itself and would not require to be separately notified for the purposes of application of the MFN clause.

The revenue filed an appeal with respect to the interpretation of the MFN clause in bilateral treaties between India and Netherlands, France and Switzerland.

In this discussion, we remain focused on the ruling of the SC which has now mandated separate notification for operationalising the MFN clause in Protocols. We will not discuss the time when the MFN would trigger, since that issue is not connected with constitutionality at all.

Before analysing the decision of the SC in the context of the Constitution, let us ascertain which of the Articles of the Constitution are relevant in this context.

The seventh Schedule of the Constitution has the Union List of matters which has the following entry 14:

Entering into treaties and agreements with foreign countries and implementing treaties, agreements and conventions with foreign countries.

Therefore, the Government is authorised under the Constitution to enter into DTAAs

Article 253 of the Constitution has conferred the power on parliament to make any law for the whole or any part of the territory of India *including implementation of treaties, agreements, or conventions with any other foreign country or countries.*

Using this power conferred in the Constitution, India has negotiated and entered into over 85 DTAAs. Courts have interpreted Article 253 to mean that when the provisions of the treaties impact the laws of India or the rights of its citizens, then such treaties must be approved by the parliament.

Pursuant to Article 253, the government is authorised under Section 90 of the IT Act to enter into DTAAs. The same section also requires that the DTAAs should be notified in order that they become part of domestic law and hence each individual DTAA is notified.

Article 51 prescribes the Promotion of international peace and security, and articulates this as follows :

The State shall endeavour to—

(a) promote international peace and security;

(b) maintain just and honourable relations between nations;

(c) *foster respect for international law and treaty obligations in the dealings of organised people with one another;* and [Emphasis Provided]

(d) encourage settlement of international disputes by arbitration.

This means that the State has resolved constitutionally to not only enter into international agreements but respect all the provisions related to international law and shall make its best efforts to fulfil its treaty obligations.

The provision of the IT Act that a taxpayer would be eligible to be governed by the provisions of the tax treaty unless the provisions of the IT Act are more beneficial to the taxpayer, can be seen to be guided by this obligation.

Article 73 sets out the extent of executive power of the Union

The provision of this Article which is relevant to this discussion is as follows:

(1) Subject to the provisions of this Constitution, the executive power of the Union shall extend--

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(a) to the matters with respect to which Parliament has power to make laws; and

(b) *to the exercise of such rights, authority and jurisdiction as are exercisable by the Government of India by virtue of any treaty or agreement:* [Emphasis Provided]

Provided that the executive power referred to in sub-clause (a) shall not, save as expressly provided in this Constitution or in any law made by parliament, extend in any State to matters with respect to which the legislature of the State has also power to make laws.

This means that the executive, i.e. the Revenue, has the same power that the government has with respect to implementing any treaty or agreement.

1.3 Conflict between Articles 253, 51 and 73 in respect of DTAA implementation

There are a plethora of judgments which have examined the issue of conflict between the power granted under Article 73 to enter into treaties and Article 253, which specifies that if the treaties impact the laws of India or affect citizens of India, then the same must be approved and notified by the parliament. If this is not done, or if the parliament refuses to grant approval to notify the DTAA, then despite the fact that the treaty is binding on the country, the country will remain in default and can be dragged to the International Court of Justice by the aggrieved treaty partner.

In ***Union of India (UOI) & Ors. vs. Azadi Bachao Andolan & Ors***[2], the SC held that the judicial consensus in India has been that section 90 is specifically intended to enable and empower the Central Government to issue a notification for implementation of the terms of a DTAA in compliance with Article 73 of the Constitution. When that happens, the provisions of such an agreement, with respect to cases to which they apply, would operate even if inconsistent with the provisions of the IT Act. The notification is made in the official Gazette.

Based on the above provisions of the Constitution, the features and process of operationalisation of a DTAA can be fairly summarised as follows:

- The structure of the DTAA is the main section with Articles dealing with various types of income and determination of its source, scope, applicability, procedures, etc. Then comes the section where the specific understanding between the contracting states in relation to certain provisions of the DTAA articles is articulated at the end, known as "protocol".
- The protocol specifies that it is an integral part of the DTAA
- Typically, the protocol gives certain examples to clarify the intentions of the parties in respect of the provisions of the DTAA.
- It also includes what is popularly termed the MFN clause.
- Such MFN clause sets out the intention of the parties with respect to when and how the same triggers, how it is to be applied and how it becomes operational. In some cases, it says that it operates automatically upon a trigger

2. 2003 (Supp4) SCR 222.

event happening and in others it sets out further action that both contracting states need to take for operationalising it.

- The fact that the protocol is an integral part of the DTAA means that when a DTAA is notified, the protocol and all the provisions of the protocol are also notified and should become part of the IT Act, just as the rest of the provisions of the DTAA are, under Section 90(2) of the IT Act. The same status that is given to applying the various articles of the DTAA should be given to the provisions of the protocol including the MFN clause.

Viewed from the above perspective, it can be argued that the application of the MFN clause has complied with all the Articles in the Constitution, i.e. it has been entered into as authorised by Article 253, notified and made part of Indian domestic law as per Article 73 and therefore, as required under Article 51 of the Constitution, the Government has the obligation to honour it.

This is the view that was taken by the HC when it ruled in favour of Nestle.

However, Revenue did not agree with this and hence approached the SC on the point of law as to whether the MFN clause provisions can be triggered automatically. Nowhere in the SC decision, the obligation under Article 51 of the Constitution is discussed. The focus has been on Article 253 and 73 of the Constitution and the fulfilment of the international obligation by India under International Law, which in case of treaties is embedded in the Vienna Convention on the Law of Treaties (**"VCLT"**) and focused on the following articles of the VCLT :

Article 26 "Pacta sunt servanda" *every treaty in force is binding upon the parties to it and must be performed by them in good faith.*

Article 27 Internal law and observance of treaties :

a party may not invoke the provisions of its internal law as justification for its failure to perform a treaty.

Article 31 General rule of interpretation

1. *A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.*

2. *The context for the purpose of the interpretation of a treaty shall comprise, in addition to the text, including its preamble and annexes:*

   (a) *any agreement relating to the treaty which was made between all the parties in connection with the conclusion of the treaty;*

   (b) *any instrument which was made by one or more parties in connection with the conclusion of the treaty and accepted by the other parties as an instrument related to the treaty.*

3. *There shall be taken into account, together with the context:*

   (a) *any subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions;*

   (b) *any subsequent practice in the application of the treaty which establishes the agreement of the parties regarding its interpretation; [Emphasis Supplied]*

   (c) *any relevant rules of international law applicable in the relations between the parties.*

4. *A special meaning shall be given to a term if it is established that the parties so intended*

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Revenue argued that favourable treatment could only be given if the trigger event was separately notified through a notification. For this, they relied on the fact that this practice was followed by the parties to the DTAAs in the past consistently in as much as whenever there was a trigger to the MFN clause, it was made applicable only after issuing of notification in the official Gazette. The DTAA partners had accepted this practice. Hence, where no such notification was issued, it should be interpreted that there was no intention of the parties to trigger the MFN benefit. They relied on clause 3(b) of Article 31 of the VCLT, which provides a general rule of interpretation for interpreting the intention of the parties to an international treaty, DTAA in this case.

The SC did not accept the argument of Nestle that once the original DTAA with the relevant protocol with automatic application of the MFN clause upon a trigger event was notified, it should be considered sufficient compliance with the Constitutional and IT Act provisions.

The SC has not debated the practice followed by the Revenue in light of Article 51 of the Constitution. This practice may have been followed in the case of the DTAAs with the Netherlands, Switzerland and France, but the following questions remain :

- As per the law laid down by the SC in this decision, if each MFN trigger should be separately notified, and if with respect to those DTAAs, there is no established practice from the past of notifying each time, would India not be in violation of its own Constitutional obligation under Article 51 and 73 in addition to violating Article 26 and 27 of the VCLT?
- In 2022, CBDT issued Circular 3 of 2022, which prescribed that benefits of the MFN clause in a tax treaty can only be claimed by taxpayers if a separate notification is issued by India specifically importing the benefits of the MFN clause. Though this provision is supported by Article 253 of the Constitution, it is internal law and does it not conflict with Article 51 of the Constitution?

Therefore is there a risk that by applying the law of the SC and the CBDT Circular of 2022, India may be infringing its own Constitution and violating treaty obligation, which may drag it to the International Court of Justice?

To this extent, it appears that there is a conflict between Article 253 and Article 51 of the Constitution. It arises because of the "dualist" practice in India as opposed to the 'monistic' practice followed in some other countries. Dualist practice means that international treaties and conventions are not, upon their ratification, automatically assimilated into municipal law (i.e. the national legal system) but would require enabling legislation. The structure and phraseology of Article 253 leaves one in no doubt, that it is when a treaty is enacted by law, or enabled through legislation, that such provisions are enforceable in India.

Perhaps such questions and more will be taken up in the review hearing which is scheduled for 8 March 2024. We shall have to wait and watch what transpires thereafter.

In this context, it is opportune to point out a decision of the Philippine Supreme Court, while dealing with an administrative issuance under domestic law. That Supreme Court upheld the right of taxpayers not to be deprived of the benefits of a tax treaty (Deutsche Bank AG G.R. No. 188550). The Supreme Court importantly also observed that non-compliance with tax treaties has negative implications for international relations and unduly discourages foreign investors, and such non-adherence is against the general

principles of international law embedded in their constitution[3].

2. Interpretational rules regarding retrospectivity, particularly in the context of Black Money law

2.1 Introduction

Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015 (**'BMA'**) was enacted on 1 July 2015. When first notified, it was meant to be effective from 1 April 2016. However, by a subsequent notification, it was made effective from 1 July 2015.

BMA is tax on income and assets in foreign countries of the residents of India if such income and assets were acquired out of income from India which was not offered to tax before sending it outside India.

The Finance Act, 2019, changed the definition of 'assessee' under Section 2(2) retrospectively from the date of applicability of BMA (i.e., 1 July 2015) to include individuals/entities that were residents when undisclosed offshore incomes were earned/undisclosed offshore assets were acquired even if later such persons became non-residents.

When introduced in 2015, BMA was applicable only to an 'assessee' as defined under Section 2(2) of BMA. This meant residents of India as per Section 6 of the IT Act. Taxpayers who were non-residents **("NR"**) or residents but not ordinarily resident (**"RNOR"**) were specifically kept outside the purview of BMA. The reason cited for this retrospective amendment was that it merely clarified the legislative intent of BMA.

2.2 Examination of Retrospectivity of BMA

As has been observed, BMA has been mired in controversy from the day it was enacted, since it was first notified to be applicable from 1 April 2016 and then an amending notification was made to notify it to become effective from 1 July 2015. When this was questioned before the Delhi HC in the case of **Gautam Khaitan**[4] the HC passed an interim order that BMA was introduced from 1 April 2016, the notification (dated 1 July 2015) amending the effective date of BMA from 1 April 2016 to 1 July 2015 was retrospective and hence, ultra vires the law and thus, the tax authorities were restrained from taking any action under the BMA.

The government immediately approached the SC and the SC set aside the Delhi HC decision and regarded this retrospectivity as valid by examining the intention of the BMA and how it was to operate in terms of when tax and punitive action under BMA was to be levied.

The SC stated as follows:

- • the scheme of the Black Money Act is to provide stringent measures for curbing the menace of black money. Various offences have been defined and stringent punishments have also been provided. However, the scheme of the Black Money Act also provided a one-time opportunity to make a declaration in respect of any undisclosed asset located outside India and acquired from income chargeable to tax under the Income-tax Act ("Lenient provision")
- There was an anomaly in the Act in respect of its effective date and the date by which the lenient declaration provision would end. While the lenient

3. Courtesy Sudin Sabnis and Tamanna Hinduja of Nangia Andersen LLP, their article in Bloomberg Tax.
4. TS-278-HC-2019(DEL).

provision would end on 31 Dec 2015, it was absurd that the effective date of BMA should be 1 April 2016.

- A conjoint reading of the various provisions reveals that the Assessing Officer could charge the taxes only from the assessment year commencing on or after 01.04.2016. However, the value of the said asset had to be as per its valuation in the previous year. Hence, even if there was no change of date in sub-section (3) of section 1 of the BMA, the value of the asset was to be determined as per its valuation in the previous year. The effective date of the BMA had been changed only for the purpose of enabling the assessee(s) to take benefit of the lenient provisions of the BMA. The power had been exercised only in order to remove difficulties. The penal provisions under sections 50 and 51 of the BMA, would come into play only when an assessee had failed to take benefit of the lenient provision under S. 59 of the BMA and neither disclosed assets covered by the BMA nor paid the tax and penalty thereon.

- The SC opined that as the penal provisions were not made retrospective, this change in the notification of BMA to be earlier than the date originally notified was not a retrospective change in law.

Note here that the SC did not even go into whether this retrospective change triggered a Constitutional violation.

However, the change effected by the Finance Act 2019 in the definition of 'assessee' under section 2(2) of the BMA is on a different footing and would need to be examined by the Court. As the issue is still to be ruled upon by the Court, our discussion here on how the provisions of the Constitution may be considered remains academic.

At the outset, it should be pointed out that retrospective changes in tax laws were upheld by the SC in the case of ***Chhotabhai Jethamal Patel & Co vs. UOI***[5] (re Excise Duty). While upholding the retrospective change in Excise Duty law, the SC said that the Parliament acting within its own legislative field had the powers of a sovereign legislature and could make a law prospectively as well retrospectively and the duties leviable under the Central Excises and Sal Act, as provided by s. 7(2) of the Finance Act, 1951, notwithstanding their imposition with retrospective effect and even if it be that they were incapable of being passed on to a buyer from the taxpayer, were "duties of excise" within the meaning of Entry 84, List I of the Seventh Schedule to the Constitution of India.

Notwithstanding the above view of the SC in 1962, we now turn to the two Articles of the Constitution, which need to be examined in determining whether a particular law or provision is retrospective or not and hence whether it can be applied or not. These are Articles 14 and 20.

Article 14 : Equality before law.—The State shall not deny to any person equality before the law or the equal protection of the laws within the territory of India.

Article 20 : 20. Protection in respect of conviction for offences.

(1) No person shall be convicted of any offence except for violation of a law in force at the time of the commission

5. 1962 AIR 1006, 1962 SCR SUPL.

of the Act charged as an offence, nor be subjected to a penalty greater than that which might have been inflicted under the law in force at the time of the commission of the offence.

(2) No person shall be prosecuted and punished for the same offence more than once.

(3) No person accused of any offence shall be compelled to be a witness against himself.

2.2.1 First let us consider Article 14 vis-à-vis BMA

This is a fundamental right and in the first place, a fundamental right is absolutely non-negotiable. No one and nothing can take it away.

This Article is a safeguard against the State's power to discriminate against individuals or groups and provide a level playing field for all citizens. Hence, the State is prohibited from discriminating against any person on any ground, including religion, race, caste, gender, place of birth, or any other personal characteristic.

So, when there is a statute which is made effective retrospectively, i.e. in respect of assets accumulated and kept outside India in the past, in order that this Article may be invoked to make the law ultra vires the Constitution, the question to answer is: does such statute discriminate in respect of any of the characteristics or any personal characteristic? In fact, the intention of the BMA seems to be to set right discrimination which prevailed against the persons who stayed in India, kept their wealth in India and paid taxes in India on their income as against those who managed to take their assets outside India and keep them outside India and did not pay any taxes in India either on the income which was taken outside India or on the assets/income kept outside India. Is that equal treatment before the law? Should they continue to receive this favoured treatment of not paying taxes in India while the people who are in India have to pay taxes? Indeed, this is a socio-economic question and NOT a legal question to address. But this Article 14 itself is just that. And as is discussed in the next section, it is the legislature that needs to bring in equality and equity in respect of taxation.

So, when a law such as BMA is enacted so that those who escaped tax in the past, are now made to pay taxes and are thus put on an equal footing as those who paid taxes on their income, it would seem that the law seeks to establish social justice and bring equality of law between those who took assets out and those who did not or could not.

The courts have held that Article 14 requires that the State shall not discriminate between persons in like circumstances and that equal laws must apply to all in the same situation. All Indian citizens are in the same situation. They should all be paying taxes when they earn income in India or from assets or business or their labour in India. Those who do not do so have caused discrimination against those who have paid taxes.

One of the attributes of this Article is that the State must follow the principles of natural justice and that a person cannot be deprived of their personal liberty without a fair hearing. This was held in the case of Maneka Gandhi.

However, a reasonable restriction is endorsed by the Courts on this right, where it is justifiable. The SC has held that the State must justify any restriction on the right to equality by showing that it is necessary and in the public interest, and that there is a reasonable and justifiable connection between the restriction and the objective it seeks to achieve.

Viewed from this perspective, BMA seems to establish justice and equality, provided of course the principles of natural justice are adhered to while proceeding against the offenders.

Those who had earned income in India while they were residents in India, but did not pay tax and accumulated such income & assets outside India, even if they have now become NR, it can be argued that they also need the same treatment as those who have remained residents. While the definition of 'resident' prior to the 2019 clarificatory amendment did not include NRs and RNORs, to be fair, the law never specified at what point in time that status had to be tested. There was a lack of clarity. It was largely assumed that the person to fall under the purview of BMA should be a resident when the foreign asset in his/her/its name is detected. This may go against the purpose of the BMA. In fact, it creates inequality in as much as those who could manage and knew that their foreign assets could come to be taxed in India at some point, had the ability on the strength of those assets to become NRs become so and escape BMA! Once again, this would appear to be discrimination against those who stayed in India. Clarifying to bring those persons within the purview of BMA should be regarded to give equality.

2.2.2 Now let us consider Article 20 vis-à-vis BMA

Clearly, retrospectivity of law is not sanctioned by the Constitution under Article 20. The Courts have held that it is always preferable to conduct things with a prospective consequence whenever any action is made a criminal offence or the penalty or punishment for any crime is raised. According to Article 20, any such law cannot be applied retrospectively. However, this paragraph does not prevent the trial itself; it merely forbids the sentencing and convicting processes.

In the case of Rattan Lal v Punjabi State, the SC opined that if the punishment is reduced, criminal legislation may be implemented retrospectively.

What this means is that retrospectivity of law is not totally forbidden under the Indian Constitution and the facts and circumstances would need to be examined. In particular, in the case of BMA the purpose of the Act itself, as stated in the preamble is :

> *to make provisions to deal with the problem of the Black money that is undisclosed foreign income and assets, the procedure for dealing with such income and assets and to provide for imposition of tax on any undisclosed foreign income and asset held outside India and for matters connected therewith or incidental thereto.*

It targets to tax undisclosed foreign income and assets located outside India and the levy of such tax is not retrospective but prospective, i.e. from Assessment Year (**"AY"**) 2016-17, i.e. after BMA has become effective. The parliament in its wisdom has passed this law to bring under the tax net, the income/ asset, which was accumulated in past, at which time it was not offered to tax in India and hence is now brought under the purview of Indian taxation. The assessee is given the opportunity to give an explanation and if the said assets/income had not escaped Indian tax in the past, then no tax under BMA would be levied. If, however, it did, then the same would become taxable from AY 2016-17 onwards, in the year when it is detected. Also, it would be charged to tax on its value in the previous year (**"PY"**) in which such asset comes to the notice of the Assessing Officer (**"AO"**).

Considering that the charging section 3(1) makes the Act effective from the AY 2016-17 and onwards, the tax under the Act can be levied on undisclosed income only from AY

2016-17 onwards and not before. Thus, the charge of tax on undisclosed foreign income can be regarded as prospective in nature.

Let us examine each leg of Article 20 :

(i) *20(1) : No person shall be convicted of any offence except for violation of a law in force at the time of the commission of the Act charged as an offence,*

Was there no tax law in India, requiring the person to pay tax when he/she/ it earned that income? The answer is clearly in the affirmative. So, whoever did not pay tax in the past, violated the tax laws in India and committed an offence, i.e. nonpayment of tax. Thus, there existed a law against tax evasion even when the offence was committed.

(ii) *nor be subjected to a penalty greater than that which might have been inflicted under the law in force at the time of the commission of the offence*

There were penalties for non-payment of taxes even when the offence was committed. However, since the penalties change each year and unless it is known exactly when the tax evasion happened, it may not be possible to determine how much total penalty would be levied in such situations. Hence, on this aspect, there may have to be some correction that is required.

(iii) *20 (2) No person shall be prosecuted* and punished for the same offence more than once.

Once the person is penalised/ punished under the BMA, clearly, he/she/it should not be penalised/punished under any other law. It does not seem that there is such provision for punishing a person under any other law for the same offence.

(iv) *20 (3) No person accused of any offence shall be compelled to be a witness against himself.*

It is observed that the tax department has been requiring assesses to sign off letters, authorising foreign financial institutions to give information to the tax department. This is a clear violation of the protection given by Article 20(3) of the Constitution and BMA should not be implemented with this violation. In this context, the SC in the case of ***Magan Lal Chaggan Lal vs. Municipal Corporation of Greater Bombay***[6] held that where the statute provides guidelines, whether express or implied, to the executive to make classification and the executive fails to meet the test, only the action of the executive will be invalid and not the statute itself. Thus, since the BMA itself does not require the offender to be a witness against itself, and yet the tax officer insists on such cooperation, that act of the executive would be regarded invalid but not the whole of BMA.

3. Constitutional validity of change in the definition of 'income' under the IT Act under which, the government grants and subsidies became income- Serum Institute of India[7]

3.1 Background

In this case of ***Serum Institute of India (P.) Ltd. vs. Union of India***, the assessee approached the Bom HC and argued that the amendment in the definition of income made by the Finance Act 2015 by adding sub-clause (xviii) to clause (24) of section 2 of the IT

6. AIR 1974 SC 2009.
7. [2023] 157 taxmann.com 107 (Bombay).

Act, such that subsidies, grants etc. given by central or state governments would be treated as income, was unconstitutional and should be struck down. The counsel of the assessee made several arguments, the following of which are the main in relation to challenging the Constitutional validity of this amendment :

- *The impugned sub-clause 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 which in no rational sense can be regarded as a citizen's income or even receipt. The Supreme Court has repeatedly held time and again that a capital receipt is not a taxable receipt, and consequently not an income, to introduce the impugned sub-clause in the teeth of the Supreme Court's decision is ultra vires the Constitution of India.*
- *The impugned sub-clause is arbitrary and ultra vires to Article 14 of the Constitution. The impugned sub-clause without any basis and reasons overrules settled judicial precedents of the Supreme Court and various High Courts which have held that the capital subsidy is not income and cannot be subject matter of tax under the Act.*
- *The impugned sub-clause is violative of Article 19(1)(g) of the Constitution. The State Government on one hand is inviting and encouraging Petitioner to invest in its State by providing subsidies and incentives, on the other hand the Central Government seeks to tax the very same subsidy thereby affecting the right to carry on business. Thus, the impugned sub-clause is violative of Article 19(1)(g) of the Constitution as it places unreasonable hardship on Petitioner…..*
- *It is open to the legislature within certain limits to amend the provisions of an Act retrospectively and to declare what the law shall be deemed to have been, but it is not open to the legislature to say that a judgment of a Court properly constituted and rendered in exercise of its powers in a matter brought before it shall be deemed to be ineffective and the interpretation of the law shall be otherwise than as declared by the Court.*

The Additional Solicitor General (**"ASG"**), representing the Government rebutted the constitutional validity arguments with the following submissions:

- *Article 265 of the Constitution of India states that "No tax shall be levied or collected except by authority of law." Sub-clause (xviii) to clause (24) of section 2 of the Act was introduced by the Finance Act, 2015 duly passed by the Parliament and is, therefore, not violative of Article 265 of the Constitution of India. Part III of the Constitution enumerates Fundamental Rights. Article 14 lists the Right to Equality and bars the State from creating unintelligible and irrational classifications. The impugned sub-clause only expanded the scope of income and all are treated on equal footing and unequals are not being treated as equals. The provisions are not discriminatory or arbitrary or violative of article 14 of the Constitution. 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 on one's right to Freedom under article 19(1) of the Constitution. The impugned sub-clause expanded the scope of income and the conditions laid down there are not in violation of article 19 of the Constitution;*

- *The judicial precedents have set an extremely limited scope of interference and on all occasions of major challenges it has upheld legislative competence and expressed restraint when it comes to fiscal statues. The judiciary 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. The Court must always remember that legislation is directed to practical problems, that the economic mechanism is highly sensitive and complex, that many problems are singular and contingent, that laws are not abstract pro-positions and do not relate to abstract units and are not to be measured by abstract symmetry, that exact wisdom and nice adaption of remedy are not always possible and that judgment is largely a prophecy based on meagre and uninterpreted experience. As held in* ***R.K. Garg vs. Union of India [1981] 7 Taxman 53/[1982] 133 ITR 239 (SC)/[1981] 4 SCC 675,*** *there is always a presumption in favour of the constitutionality of a statute and the burden is upon him who attacks it to show that there has been a clear transgression of the constitutional principles. The Court also held that laws relating to economic activities should be viewed with greater latitude than laws touching civil rights such as freedom of speech, religion etc. There, may be crudities and inequities in complicated experimental economic legislation but on that account alone it cannot be struck down as invalid. The Court must while examining the constitutional validity of a legislation of this kind be resilient, not rigid, forward looking, not static, liberal and not verbal. The Court 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 Court to consider if any particular immunity or exemption is necessary. The trial and error method is inherent in every legislative effort to deal with an obstinate social or economic issue;*

- *The Revenue Department's approach towards taxation of concessions or subsidies is nuanced and specific. The tax is levied on the concession amount or the subsidy received, not the total transaction value. This ensures that the taxation is limited to the extra benefit accrued due to the state's incentive schemes, thereby upholding the principles of fairness and equity in taxation.*

- *The Constitution safeguards the right to trade under article 19(1)(g) but does not extend this protection to the right to profit. Petitioner's assertion that taxation of subsidies and concessions under the impugned sub-clause effectively nullifies the distinction between capital and revenue subsidies leading to the erosion of what they perceive as a benefit or savings cannot be entertained. They are not, however, intended to serve as permanent fixtures beyond the scope of taxation, especially when such benefits have fulfilled their economic purpose. The imposition of tax on these subsidies under the amended provision does not constitute an "taking away" of a benefit but rather represents a recalibration of fiscal advantages in line with broader economic and policy considerations……. It is the duty of the legislature to ensure*

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> *that taxation policy reflects a balance between incentivizing economic activity and ensuring the equitable distribution of fiscal resources. Section 2(24)(xviii) is a manifestation of this balancing act,…..*

3.2 HC's analysis and reasoning

The HC, after considering all the submissions and analysing all the judicial precedents cited by both, the petitioner and the ASG, gave their own findings as follows :

There is very limited scope in the challenge to constitutional validity. The fulcrum of the constitutional challenge is the question of legislative competence. Every legislation is an experiment in achieving certain desired ends and the trial and error method is inherent in every such experiment. The law is very clear that the legislature should be allowed some play in the joints because it has to deal with complex problems which do not admit of solution through any doctrine or straight jacket formula and this is particularly true in the case of legislation dealing with economic matters, where, having regard to the nature of the problems required to be dealt with, greater play in the joints has to be allowed to the legislature. Every legislation, particularly in economic matters, cannot provide for all possible situations or anticipate all possible abuses. As held in ***R. K. Garg***[8], every legislation particularly in economic matters is essentially empiric and it is based on experimentation. There may be crudities, inequities and even possibilities of abuse but on that account alone it cannot be struck down as invalid. These can always be set right by the legislature by passing amendments. The Court must therefore adjudge the constitutionality of such legislation by the generality of its provisions. Laws relating to economic activities should be viewed with greater latitude than laws touching civil rights such as freedom of speech, religion etc. Moreover, there is always a presumption in favour of the constitutionality of a statute and the burden is upon him who attacks it to show that there has been a clear transgression of the constitutional principles. The legislature understands and correctly appreciates the needs of its own people, its laws are directed to problems made manifest by experience and its discrimination is based on adequate grounds. In adjudging constitutionality, the Court may take into consideration matters of common knowledge, matters of common report, the history of the times and may assume every state of facts which can be conceived existing at the time of legislation. The Court must while examining the constitutional validity of legislation in economic matters "be resilient, not rigid, forward-looking, not static, liberal, not verbal". It 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 Court to consider if any particular immunity or exemption is necessary or not for the purpose of inducing disclosure of black money. The trial and error method is inherent in every legislative effort to deal with an obstinate social or economic issue and if it is found that any immunity or exemption granted under the Act is being utilised for tax evasion or avoidance not intended by the legislature, the Act can always be amended and the abuse terminated.

8. [1981] 7 Taxman 53/[1982] 133 ITR 239 (SC)/[1981] 4 SCC 675.

The Bom HC referred to several other judicial precedents and quoted what the SC in the case of the *Federation of Hotel and Restaurant*[9] *said ……The doctrine of reasonableness and non-arbitrariness encapsulated under Article 14 of the Constitution becomes a touchstone for testing the validity of a fiscal statute. It is now well settled that taxing laws are not outside Article 14. However, having regard to the wide variety of diverse economic criteria that go into the formulation of a fiscal policy, legislature enjoys a wide latitude in the matter of selection of persons, subject matter, events, etc., for taxation……..Decisions of the judiciary on the matter have permitted the legislatures to exercise an extremely wide discretion in classifying items for tax purposes, so long as it refrains from clear and hostile discrimination against particular persons or classes.*

The HC thus held that, though taxing laws are not outside Article 14, having regard to the wide variety of diverse economic criteria that go into the formulation of a fiscal policy, the legislature enjoys wide latitude in the matter of taxation. Legislative assumption cannot be condemned as irrational. Judicial veto is to be exercised only in cases that leave no room for reasonable doubt. Constitutionality is presumed. Every statute, including fiscal statutes, comes with a presumption of constitutionality unless proven otherwise. The onus falls on the petitioner to demonstrate a clear transgression of constitutional principles. In the realm of fiscal laws, the presumption of constitutionality is particularly significant due to the complex nature of economic regulation. Since these laws are instrumental in the financial governance of the state and are often the outcome of detailed economic planning and consideration, Courts are inclined to approach them with deference. Unless a fiscal statute is manifestly arbitrary or discriminatory in its provisions or its operation, it is typically upheld. This allows for a broad range of discretion for the legislature in determining the classes of individuals or entities that are subject to or exempt from taxation, as long as there is a rational basis for such a classification.

Further, the Court held 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, of course, bring in some hardship in some individual cases. But that is inevitable, so long as law represents a process of abstraction from the generality of cases and reflects the highest common factor.

The Court also reasoned that …..the domain of economic and fiscal policy formulation is primarily vested in the legislature and the executive. The judiciary's role is limited to ensuring conformity with the Constitution without delving into the policy merits. Furthermore, this presumption ensures stability and predictability in fiscal policies, which are essential for economic growth and development. Overturning fiscal statutes could lead to economic chaos and undermine the authority of the legislative body. Therefore, Courts must balance the necessity to uphold constitutional mandates with the practical implications of interfering with legislative judgments in fiscal matters. …..the Courts have only the power to destroy, not to reconstruct.

Having delved into various judicial precedents on the subject and analysed the same vis-à-vis the arguments presented by the counsel of the petitioner, with regard to the insertion of this definition in the IT Act transgressing the right enshrined in Part III of the Constitution, the HC reasoned as follows :

……. It is no more res integra that the examination of the Court begins with a

9. [1989] 46 Taxman 47/178 ITR 97 (SC)/[1989] 3 SCC 634.

presumption in favour of constitutionality. This presumption is not just borne out of judicial discipline and prudence, but also out of the basic scheme of the Constitution wherein the power to legislate is the exclusive domain of the legislature/Parliament. This power is clothed with the power to decide when to legislate, what to legislate and how much to legislate. Thus, to decide the timing, content and extent of legislation is a function primarily entrusted to the legislature and in the exercise of judicial review, the Court starts with a basic presumption in favour of the proper exercise of such power. The process of testing validity is not to sneak into the prudence or proprieties of the legislature in enacting the impugned provision. Nor is it to examine the culpable conduct of the legislature as an appellate authority. The only examination of the Court is restricted to the finding of a Constitutional infirmity in the provision, as is placed before the Court. In the absence of a finding of any Constitutional infirmity in a provision, the Court is not empowered to invalidate a provision...... The approach of constitutional Courts ought to be different while dealing with fiscal statutes....... The general principles of exclusion and inclusion do not apply to taxing statutes with the same vigour unless the law reeks of Constitutional infirmities......No doubt, fiscal statutes must comply with the tenets of the Constitution. However, a larger discretion is given to the legislature in statutes than in other spheres.

The Court then referred to the decision in the case of the SC in ***State of Madhya Pradesh vs. Rakesh Kohli & Anr.***, where the Court observed as follows :

"*This Court has repeatedly stated that legislative enactment can be struck down by Court only on two grounds, namely (i) that the appropriate legislature does not have competence to make the law, and (ii) that it does not take away or abridge any of the fundamental rights enumerated in Part III of the Constitution or any other constitutional provisions....*".

The above exposition has been quoted by the SC with approval in a catena of other cases including ***Bhanumati & Ors. vs. State of Uttar Pradesh & Ors., State of Andhra Pradesh & Ors. vs. Mcdowell & Co. & Ors.*** *and* ***Kuldip Nayar & Ors. vs. Union of India & Ors.,*** *to state a few."*

Additionally, the HC also relied on several other judicial precedents in support of its view of not interfering with the fiscal laws, and one notable principle that the court cited is :

...the Court is not concerned with the wisdom or unwisdom, the justice or injustice of the law as Parliament and State Legislatures are supposed to be alive to the needs of the people whom they represent and they are the best judge of the community by whose suffrage they come into existence.....

As regards contravention of Article 19(1)(g) of the Constitution, the Court agreed with the submission of the ASG and said that .....*The Constitution safeguards the right to trade under article 19(1)(g) but does not extend this protection to the right to profit.*

Hence, where the change in law brings about a reduction in profit, it cannot be treated as an infringement of the right to Trade, given by the Constitution.

3.3 Conclusion and decision of the HC

- While dealing with economic legislation, this Court would interfere only in those few cases where the view reflected in the legislation is not possible to be taken at all. The case of the petitioner certainly does not fall within this exception. We also do not find that by inserting the impugned subclause

there is any perversity or gross disparity resulting in clear or hostile discrimination.

- In the very nature of taxing statutes, the legislature holds the power to frame laws to plug in specific leakages. The mere fact that the institution of tax by virtue of the impugned sub-clause falls more heavily on the petitioner cannot result in its invalidity.
- In our view, the amendment to section 2(24) by the insertion of subclause (xviii) of the Finance Act, 2015, is a perfect example of a legislative endeavour to align the definition of "income" with the evolving economic landscapes and judicial precedent of it being an inclusive and elastic term. The submissions of the petitioner though appear to be of fiscal concern were, in our view, more an argument of diminished profits and a narrow interpretation of income which the Apex Court has time and again expanded. The submissions of the petitioner fall short of appreciating the overarching legislative intent to foster a comprehensive and equitable taxation regime.
- it is the duty of the legislature to ensure that taxation policy reflects a balance between incentivizing economic activity and ensuring the equitable distribution of fiscal resources.

This decision is very important, as it has analysed a plethora of judicial precedents dealing with Constitutional challenges to fiscal laws. It can be said that in respect of fiscal laws, challenging any particular provision constitutionally or even a law pertaining to taxation, is not seen by the Courts with much favour as the Courts hold a view that fundamentally, the legislature has the constitutional right and authority to enact them and it is only they, as elected representatives of the people of the country and as the body which is given the responsibility to govern and administer the country fairly and facilitate the growth of the economy, who knows and can decide what taxes to levy, when to levy, how to levy and the courts would not be willing to interfere with this right and authority of the legislature unless what is being challenged is absolutely and patently unconstitutional.

It would seem that similar logic and reasoning are likely to apply in case of the change in the definition of 'assessee' under the BMA and as already discussed, it is very less likely to be struck down as being unconstitutional.

In Conclusion

The issue in the case of Nestle is on a different footing since it is not simply the constitutionality but also affects the fulfilment of India's obligations and commitments under International Law. Hence, as is already commented in the first section, it is the International Law and practice and not the Constitution of India alone which will need to be considered to determine whether or not that decision may need a re-look. There is no unconstitutionality in entering into DTAAs which include protocols or the requirement of notifying them separately. But whether this requirement can be shown to be a practice which is accepted by the DTAA partners and therefore there will not be a breach of India's international obligation as also infringes Article 51 of the Constitution, is what would need to be examined.

As regards the retrospectivity of the Black Money Act or the change in the definition of income to include within its ambit the government subsidies etc, as the Courts have argued, these are fiscal laws and unless there is patent unconstitutionality in them, the Courts are unlikely to strike them down.

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HOT SPOT

Analysis of Inspection Reports issued by NFRA on Audit Firms

CA Milan Mody

Background

Section 132 of the Companies Act, 2013 (the Act) empowers the National Financial Reporting Authority (NFRA) to

- monitor compliance with Auditing and Accounting Standards
- oversee the quality of audit services and suggest measures for improvement in quality

NFRA initiated audit quality inspection of:

- Deloitte Haskins and Sells LLP,
- M/s BSR & Co LLP,
- Price Waterhouse Chartered Accountants LLP,
- SRBC & Co LLP and
- M/s Walker Chandiok & Co. LLP.

The inspections were initiated in December 2022. The inspection reports were issued after a gap of almost one year i.e. in December 2023. The chronology of events forms part of the inspection reports.

The inspection covered a review of firm-wide quality controls, adherence to Standard on Quality Control (SQC)-1, Code of Ethics, applicable laws and rules and a review of individual Audit Engagement Files for the annual statutory audit of financial statements March 31, 2021. The 2022 inspection emphasized crucial aspects of the Firms' quality control systems, including leadership responsibilities, auditor independence, the acceptance and continuation of audit clients, engagement quality control and the internal quality inspection program of the Audit Firms.

Three significant audit areas - Revenue, Trade Receivables and Investments - were identified due to their higher risk of material misstatement in each inspected audit engagement.

Factual content

Findings in the reports are classified into five categories, namely,

- Independence,
- Deficiency in audit procedures,
- Documentation,
- Internal policies & practices and
- Regulatory non-compliance.

The findings in the inspection reports are summarized within the mentioned categories as follows:

A. Independence

- Audit firm did not furnish to NFRA information regarding network entities and the non-audit services rendered by those entities to the firm's audit clients. In absence of which compliance with independence requirement of

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code of conduct and SQC could not be evaluated.

- The independence policy did not recognize the direct and indirect relationship between the audit firm and its network members. This resulted in violation of section 141 and 144 of the Act.
- Audit firm was engaged in providing non-audit services that posed a self-review threat.
- Network firms offered non-audit services to the overseas holding companies of NFRA-governed audit clients.
- In respect of Network agreement, the observations were:
- not provided
- no board to oversee the network as per network agreement
- absence of legally enforceable network agreement resulting in a lack of clarity regarding the assignment of responsibilities
- An audit firm's assessment of independence compliance revealed that 35% of the Partners, the sole Executive Director, 55% of the Directors and 38% of the Senior Managers/Managers had failed to report financial relationships as mandated by the firm's independence policies.
- It was additionally discovered that in one audit firm there was no established system for assessing the proportion of fees derived from non-audit services in comparison to the statutory audit fee, with the aim of identifying potential threats to independence.

B. Deficiency in audit procedures

- An audit firm did not conduct necessary audit procedures related to impairment of investment where they neglected to execute any audit procedures to identify impairment indicators, instead, erroneously relied on valuation reports that were two years old.
- In a different instance, while performing an audit of impairment of investment in subsidiary for Standalone Financial Statements, an audit firm mistakenly assumed 100% ownership by the auditee, overlooking the actual 84.18% equity share. This error resulted in the incorrect conclusion that no impairment loss was needed. Furthermore, the audit file lacked the detailed calculation sheet for the Enterprise Value, adding to the audit deficiencies in this case.
- In yet another case, the audit firm determined that no impairment was necessary for the investment in an associate company of an auditee company, citing the issuance of shares to unrelated market participants at a value higher than the carrying value. However, no audit procedures were conducted to confirm the independence of these market participants from the auditee company.
- Audit Firms were noted to be in violation of SQC-1 and Standards on Auditing. Regarding SQC-1, one audit firm failed to document the basis or rationale for consultation decisions, while another audit firm exhibited non-compliance with SA 700 by having a Signing Partner different from the Engagement Partner.
- One audit firm neglected to reassess and reclassify audit risk during interim audit in accordance with SA 315 and its internal policy manual.
- The financial exposures of an auditee company were comprised of loans, share investments and corporate guarantees for subsidiaries' obligations.

Investments accounted for nearly 76% of the Balance Sheet size and the total exposure to specific subsidiaries and associates amounted to Rs. 4,037.91 crores, representing 41.40% of the auditee company's net worth as of March 31, 2021. In this case, an audit firm erroneously considered the impact of potential adjustments as 'material' instead of acknowledging it as 'material and pervasive, 'which would have led to an 'Adverse' or 'Disclaimer of Opinion'.

- An audit firm failed to provide documentation for the review of management's 12-month cash flow projections and obtaining financial support assistance and management agreement from the ultimate holding company, as stated in the Key Audit Matter section of the auditee company's Independent Auditor’s Report. Additionally, the audit firm submitted an unsigned and undated document, an extract from the Management Agreement with the ultimate holding company, with its validity remaining uncertain.

- In one case, an audit firm determined materiality levels using the average Profit before Tax (PBT) over the past 3-5 years and did not revise overall materiality and performance materiality based on actual PBT resulting in inadequate audit work and non-compliance with SA 450.

- The audit firm overlooked a fundamental error in the disclosure of an auditee company's accounting policy for revenue. The significant accounting policy related to the recognition and measurement of revenue at the fair value of consideration received or receivable did not align with the Ind AS 115 requirements, which requires revenue recognition and measurement at the Transaction Price.

- There were cases where audit firm failed to conduct substantive audit procedures to verify the accuracy and correctness of the price details applied to the actual generated invoices, neglected to assess the control for verifying invoice-wise matching of customer collections, chose sample size that did not align appropriately with the level of risk, those engagement team members interviewed by the inspection team lacked clarity on the process of selecting the value for the Assurance Factor used for sample selection.

- Engagement Quality Control Review (EQCR) Partners did not comply with SQC-1 and SA 220 that requires the EQCR partner to document the performance of the procedures for the quality review and the Firm's Engagement Quality Control Manual requirements, which mandate the EQCR Partner to review and approve crucial documents.

- An auditee company performed an impairment assessment on its investments, calculating the recoverable amount following Ind AS 36. This involved estimating future cash flows using Value-in-Use, considering factors like business growth rate and discount rate. However, an audit firm did not independently assess the reasonableness of the recoverable amount derived with inflated growth rates, despite the company's historical growth rate being substantially lower.

- When the results of integrity testing on auditee companies by reviewing their backgrounds in the audit firm’s database were unfavorable, there were no alternative procedures performed by the audit firm to evaluate the integrity of potential or current clients. Sole reliance on the firm’s database as the exclusive source for assessing the integrity of

client personnel was inadequate and did not meet the standards outlined in SQC-1. Additionally, there was a lack of audit documentation related to the assessment of the audit firm's competence and capabilities to undertake the engagement.

- The disclosed accounting policy of an auditee company indicated the utilization of a provision matrix derived from historical default rates adjusted for forward-looking estimates. However, in practice, no provision matrix was applied. Additionally, an audit firm did not verify how the management adjusted historical default rates to incorporate forward-looking estimates.

C. Documentation

- All relevant information were not consolidated in one location, the physical files were neither scanned and incorporated in the electronic files, nor cross-referenced to the electronic files, the date of procedure completion was not recorded within the document. Any audit evidence once reviewed and signed as final, could be altered, edited or modified in the audit documentation tool without impacting the initial signoff. Moreover, the tool did not mandate a sign-off for any necessary modifications and also allowed the inclusion of blank audit working papers.
- In one instance, audited Financial Statements and Auditor's Reports were not located in the Audit File. Additionally, independence declarations from certain engagement team members were not present in the audit file. Further, evidence related to the performance of the Engagement Quality Control Reviewer was absent from the audit file. In one particular case, audit files included incomplete working papers without sufficient evidence of the EQCR being conducted.
- In other cases, documents pertaining to the total investment in securities were absent. An audit firm only recorded observations in 1 out of 4 domains of IT general controls and failed to include these observations in the audit report. The audit firm did not document the rationale for not recognizing applicable types of revenue, revenue transactions and assertions as a fraud risk. Also, sufficient information, such as the source and timing of data acquisition from clients, was not provided.
- An audit firm conducted internal inspections of a sample of audit engagement files and selected areas for review but the basis for selecting the audit areas was not documented.
- The audit file lacked the audited company's policy on related party transactions and the audit firm did not verify the management assertion that the related party transactions were conducted on an arm's length basis.
- The audit documentation did not include an assessment regarding the treatment of the forward contract in respect of subsidiary (80% holding), which was designed to acquire the remaining 20% shares from NCI in the future. It did not address whether this should be incorporated into the business combination accounting at the acquisition date or treated as distinct transactions. Key factors, such as the NCI holder's continuous involvement in value changes and receipt of dividends, were also not taken into account. The consideration for the remaining 20% shares met the criteria for being treated as 'Contingent Consideration' under Ind AS 103.

D. Internal policies & practices

- Concerning inadequate internal policies and practices, an audit firm noted the

Audit Committee as TCWG. Further, policies addressing complaints and allegations related to non-compliance with professional standards, regulatory and legal requirements were absent.

E. Regulatory non-compliance

- Regarding adherence to the Act, an audit firm omitted reporting the violation of Section 186(4) of the Act as the purpose of the loan/guarantee/securities pledged was undisclosed in the Financial Statements.
- An auditee company, having 92 subsidiaries and 52 associate companies, was found non-compliant with Section 186 of the Act and the Companies (Number of Layers) Rules, 2017. Supporting evidence was missing for an audit firm's contention that Section 186 does not apply, based on the holding company's NBFC classification as 'Core Investment Company Non-Deposit taking-Systemically Important' (CIC-ND-SI) with assets exceeding Rs. 100 crores. Accordingly, this non-compliance should have been reported in CARO, 2016.

Views & conclusion

NFRA stated that these inspections were aimed to identify areas and possibilities for enhancing the Audit Firms' quality control system and the weaknesses or deficiencies highlighted in the inspection reports should be viewed as opportunities for improvement.

As a response to the inspection reports, the Audit Firms have stated that they are dedicated to supporting NFRA's mission to safeguard public interest by enhancing audit quality, maintaining trust with stakeholders, making continuous improvements to their quality management system and take necessary actions for compliance with policies, rules and laws.

NFRA's inspection of firms beyond top audit firms may reveal more/diverse observations, with some holding potential significance. Other audit firms can utilize these reports as a source of guidance to address gaps in their audit procedures and documentation. NFRA, along with the Institute of Chartered Accountants of India can use their collective data to publish relevant literature that can serve as references for appropriate audit procedures and audit work papers. One message which is very clear that the **Auditing Standards should be followed both in letter and spirit. Substance and form both need to be abided**.

Some additional facts in respect of the Inspection Reports:

- o The inspection reports were issued after providing the Audit Firms with a hearing opportunity.
- o The time available for audit vis-à-vis the time available for such inspection should be considered while reaching any conclusion.
- o Presumably, the expectation is to retain audit documentation in electronic format. NFRA does not address the risk of changes with audit documentation when stored physically. This would be especially true for mid-sized Indian CA firms.
- o Inspection reports did not consider evaluation of the sufficiency of the documentation and details provided subsequent to the inspections.
- o The inspection reports state that the sample of individual audit engagement selected is not representative of the firm's total population of audit engagements.
- o The inspection report state that findings should be considered as opportunity for improvement in audit quality. They are not intended to be either rating or a marketing tool for the audit firm.

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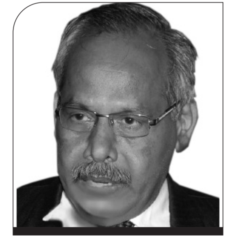
DIRECT TAXES

Supreme Court



Keshav B. Bhujle
Advocate

1 *Principal CIT vs. Emmsons International Ltd.; [2023] 460 ITR 718 (SC): Dated 03/01/2024:*

Business expenditure — Loss on account of fluctuation in rate of foreign exchange — Derivative contracts entered into by assessee to hedge against exchange risk in respect of export proceeds receivable in foreign exchange — Loss allowable — Supreme Court dismissed SLP: S. 37(1) of ITA 1961: A. Y. 2012-13

For the A. Y. 2012-13, the Tribunal reversed the disallowance of the notional foreign exchange loss made by the Assessing Officer u/s. 37 of the Income-tax Act, 1961.

The Delhi High Court dismissed the appeal filed by the Revenue and held that the forward contracts entered into by the assessee were not by way of trading per se in foreign exchange derivatives but derivative contracts to hedge its exchange risk in respect of export proceeds receivable by it in foreign exchange, and consequently, the Central Board of Direct Taxes Circular No. 3 of 2010 dated March 23, 2010 had no application.

On a petition by the Revenue for special leave to appeal the Supreme Court held as under:

> "No case for interference is made out in exercise of our jurisdiction under article 136 of the Constitution of India. The special leave petition is, accordingly, dismissed."

2 *Principal CIT vs. L and T Valves Ltd.; [2023] 461 ITR 157 (SC): Dated 03/10/2023:*

International transactions — Determination of arm's length price —Determination by aggregation of sales to associated enterprises with sales to other enterprises transactions — Proper — TPO short listing transactions where prices charged to associated enterprises less than that charged to unrelated parties and making upward transfer pricing adjustment in respect of price charged to associated enterprises — Not proper — Supreme Court dismissed SLP: S. 92C of ITA 1961: A. Y. 2004-05

In ***Pr. CIT vs. Audco India Ltd. [2024] 461 ITR 152 (Bom)***) the High Court held that the Tribunal was right in determining the arm's length price of sales to associated enterprises on the comparison of the aggregation of transactions of associated enterprises and other enterprises (taking the arithmetical

mean) did not call for any interference and that the approach of the Transfer Pricing Officer short listing only those transactions where the prices charged to the associated enterprises was less than that charged to unrelated parties in the United States of America and making an upward transfer pricing adjustment in respect of the price charged by the assessee to its associated enterprises was contrary to the clear provisions of law.

On a petition by the Revenue for special leave to appeal the Supreme Court held as under:

> "This court is of the opinion that the impugned order does not call for interference. The special leave petition is accordingly dismissed."

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3 *Mangalam Publications vs. CIT; [2023] 461 ITR 159 (SC): Dated 23/01/2024:*

Reassessment — Notice after four years — Reason to believe income had escaped assessment — Books of account and other documents seized by department during search operations and not returned — Assessee unable to draw balance-sheet in absence thereof and filing returns for A. Ys. 1990-91, 1991-92 and 1992-93, unaccompanied by balance-sheet — AO subsequently obtaining balance-sheet as on 31/03/1989 submitted by assessee to bank for obtaining credit, and comparing balance in capital account of partners of assessee as on 31/03/1993 shown in balance-sheet for A. Y. 1993-94 filed with return, inferring income had escaped assessment — Commissioner (appeals) holding balance-sheet furnished to bank not reliable — AO could not have placed reliance thereon — dehors balance-sheet, no other material coming into possession of AO to entertain belief that income of assessee for three assessment years had escaped assessment — While framing initial assessments for years in question, AO on independent analysis of incomings and outgoings of assessee passing assessment orders u/s. 143(3) — No case that assessee had made false declaration — Returns not accompanied by balance-sheet not treated as defective by AO — Subsequent subjective analysis of AO that income of assessee was much higher than that assessed — Mere change of opinion — Reassessments not justified: Ss. 139(9)(f), 145(1), 147, 148 and 149(1)(b)(iii) of ITA 1961: A. Ys. 1988-89 to 1993-94

The assessee-firm was engaged in the business of publication of newspapers, weeklies and other periodicals. Pursuant to a search on December 3, 1985, its books of account and other documents were seized by the Department. Since its books were in the custody of the Department and had not been returned, the assessee filed its returns for the A. Ys. 1990-91, 1991-92 and 1992-93, without filing the balance-sheet and statement of accounts with the return of income. However, it filed profit and loss accounts and statements showing the source and application of funds. The assessments for these years were completed u/s. 143(3) of the Income-tax Act, 1961, making certain additions and disallowances. For the A. Y. 1993-94, the assessee submitted the profit and loss account as well as the balance-sheet with the return of income. After completion of the assessments, the Assessing Officer got copies of the profit and loss account and balance-sheet as on March 31, 1989 furnished by the assessee-firm to the bank. While examining the balance-sheet, the Assessing Officer noticed that

the balance in the capital account of all the partners of the assessee-firm together was ₹ 1,85,75,455 as on March 31, 1993 whereas the capital of the partners as on December 31, 1985 was only ₹ 2,55,117. On the ground that the income assessed for all the years was not commensurate with the increase in the capital from 1985 to 1993, the Assessing Officer issued notices of reassessment to the assessee and to the partners for the A. Ys. 1988-89 to 1993-94 on March 29, 2000. The objections of the assessee that the balance-sheet as on March 31,1989 was prepared only for the purpose of obtaining a loan from the bank and could not be relied upon for Income-tax assessment was rejected. Reassessment was made for the A. Ys. 1990-91, 1991-92 and 1992-93 determining the income which had escaped assessment by first allocating the income among the partners and thereafter apportioning the sum to the three assessment years in proportion to the sales declared by the assessee in these assessment years.

The Commissioner (Appeals) held that as the assessee had failed to disclose all material facts necessary to make assessments because the return fell short of the requirements in section 139(9)(f) of the Act, it could not be said that the reassessment proceedings were barred by limitation in terms of the proviso to section 147. He took the view that since the assessee had filed its balance-sheet as on December 31, 1985 with the return for the A. Y. 1986-87, no balance-sheet was filed in the interregnum because the relevant materials were seized by the Department in the course of a search and seizure operation and were not yet returned, and the next balance-sheet was filed as on March 31, 1993, that the profit and loss account and the balance-sheet furnished to the bank were not reliable, and that the unexplained portion, if any, of the increase in capital and current account balance with the assessee had to be analysed on the basis of the balance-sheets filed as on December 31, 1985 and March 31, 1993. He made a detailed examination of the facts whereafter he enhanced the assessment fixing the unexplained income for the A. Ys. 1987-88 to 1993-94 and thereafter apportioning it in respect of the three assessment years. The assessee filed appeals to the Tribunal and the Department filed cross-objections. The Tribunal allowed the appeals filed by the assessee, holding that the re-examination carried out by the Assessing Officer was not based on any fresh material or evidence and that the reassessment orders could not be sustained on the basis of the balance-sheet filed by the assessee before the bank. It set aside the orders of reassessment for the three assessment years as affirmed and enhanced by the Commissioner (Appeals).

The Kerala High Court allowed the appeal filed by the Department and set aside the order of the Tribunal and remanded the appeals to the Tribunal for consideration on the merits after notice to the parties.

The Supreme Court allowed the appeals filed by the the assessee and held as under:

"i) It is true that section 139 places an obligation upon every person to furnish voluntarily a return of his total income if such income during the previous year exceeded the maximum amount which is not chargeable to Income-tax. The assessee is under further obligation to disclose all material facts necessary for his assessment for that year fully and truly. However, while the duty of the assessee is to disclose fully and truly all primary and relevant facts necessary for assessment, it does not extend beyond this. Once the primary facts are disclosed by the assessee,

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the burden shifts on to the Assessing Officer.

ii) A return filed without the regular balance-sheet and profit and loss account may be a defective one but not invalid. A defective return cannot be regarded as an invalid return. The Assessing Officer has the discretion to intimate the assessee about the defects and it is only when the defects are not rectified within the specified period that the Assessing Officer may treat the return as an invalid return. Ascertaining the defects and intimating them to the assessee for rectification, are within the realm of discretion of the Assessing Officer. It is for him to exercise the discretion. The burden is on the Assessing Officer. If he does not exercise the discretion, the return of income cannot be construed as a defective return.

iii) The reasons recorded by the Assessing Officer leading to formation of his belief that income of the assessee had escaped assessment for the assessment years in question, showed that the only material which came into his possession subsequently was the balance-sheet of the assessee for the A. Y. 1989-90 obtained from the bank. After obtaining this balance-sheet, the Assessing Officer compared it with the balance-sheet and profit and loss account of the assessee for the A. Y. 1993-94. On such comparison, the Assessing Officer noticed significant increase in the current and capital accounts of the partners of the assessee. On that basis, he drew the inference that the profits of the assessee for the three assessment years under consideration would be significantly higher which had escaped assessment. Therefore, he recorded that he had reason to believe that due to omission or failure on the part of the assessee to disclose fully and truly all material facts necessary for the assessments, income chargeable to tax for the three assessment years had escaped assessment.

iv) What the Assessing Officer did was to cull out the figures discernible from the balance-sheet for the A. Y. 1989-90 obtained from the bank and compare them with the balance-sheet submitted by the assessee for the A. Y. 1993-94 and thereafter arrive at the conclusion. In the first appellate proceedings, the Commissioner (Appeals) held that the profit and loss account and the balance-sheet furnished to the bank were not reliable and had discarded it. That being the position, the Assessing Officer could not have placed reliance on the balance-sheet submitted by the assessee for the A. Y. 1989-90 to the bank for obtaining credit. Dehors such balance-sheet, there was no other material in the possession of the Assessing Officer to come to the conclusion that income of the assessee for the three assessment years had escaped assessment. On the basis of the "balance-sheet" submitted by the assessee before the bank for obtaining credit which was discarded by the Commissioner (Appeals) in earlier appellate proceedings of the assessee itself, the Assessing Officer upon a comparison thereof with a subsequent balance-sheet of the assessee for the A. Y. 1993-94 which was filed by the assessee and was on record,

erroneously concluded that there was escapement of income and initiated reassessment proceedings.

v) It was not the case of the Department that the assessee had made a false declaration.

vi) While framing the initial assessment orders of the assessee for the three assessment years in question, the Assessing Officer had made an independent analysis of the incomings and outgoings of the assessee for the relevant previous years and thereafter had passed assessment orders u/s. 143(3) of the Act. An assessment order u/s. 143(3) is preceded by notice, enquiry and hearing u/s. 142(1), (2) and (3) as well as u/s. 143(2). If that be the position and when the assessee had not made any false declaration, it was nothing but a subsequent subjective analysis of the Assessing Officer that income of the assessee for the three assessment years was much higher than that assessed and therefore, had escaped assessment. This was nothing but a mere change of opinion which could not be a ground for reopening of assessment.

vii) Admittedly, the returns for the three assessment years under consideration were not accompanied by the regular books of account. Though under sub-section (9)(f) of section 139, the Assessing Officer could have treated such returns as defective returns and intimated the assessee to remove the defect failing which the returns would have been invalid, the materials on record did not indicate that the Assessing Officer had issued any notice to the assessee bringing to its notice such defect and calling upon the assessee to rectify the defect within the period as provided under the provision. Though the assessee could not maintain and file regular books of account with the returns in the assessment proceedings for the three assessment years in question, none the less it had prepared and filed the details of accounts as well as incomings and outgoings for each of the three assessment years and these were duly verified and enquired into by the Assessing Officer in the course of the assessment proceedings thus culminating in the orders of assessment u/s. 143(3). In other words, the Assessing Officer had accepted the returns submitted by the assessee for the three assessment years under question. As a matter of fact, in none of the three assessment years, had the Assessing Officer issued any declaration that the returns were defective.

viii) Thus, the Tribunal was justified in coming to the conclusion that the reassessments for the three assessment years under consideration were not justified."

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DIRECT TAXES
High Court

Jitendra Singh
Advocate

Radha Halbe
Advocate

Harsh Shah
Advocate

1 *Rohan Korgaonkar vs. DCIT [2024] 159 taxmann.com 321 (Bombay)*

Intimation - section 143(1) of the Income Tax Act, 1961 – scope of adjustment – delay in depositing employee's contribution to PF and ESIC within the due date prescribed under the respective Acts – disallowance made under section 36(1)(va) while processing the return under section 143(1) of the Act is justified

Facts

The assessee failed to deposit employee's contributions to ESI and PF in the employees' accounts before the due date under the PF/ ESI Acts for the relevant assessment year. However, the contributions were deposited before the due date for filing return under Section 139(1) of the Act for the assessment year 2018-2019. The assessee while filing its return claimed deductions with respect to the said payment made to ESI and PF. The AO while processing the return under section 143(1)(a)(iv) disallowed the claim of deductions made for delayed ESI and PF contributions under Section 36(1)(va). On appeal the first appellate authority upheld the view of the AO. The assessee challenged the order of the CIT(A) before the Appellate Tribunal. The Appellate Tribunal also confirmed the view of the lower authorities. The Assessee being aggrieved by the order of the Tribunal filed an appeal before the Hon'ble Bombay High Court under section 260A of the Act.

Decisions of the Hon'ble Court

Hon'ble High Court referring to the order passed by the Hon'ble Supreme Court in the case of ***Checkmate Services Pvt. Ltd. vs. CIT [2022] 448 ITR 518 (SC)*** dismissed the appeal filed by the assessee on the ground that deductions can be claimed or adjustments can be made under section 143(1)(a)(iv), read with Section 36(1)(va) only when the employer deposits the contributions in the employees' accounts on or before the due date prescribed under the Employees Provident Fund/ Employees State Insurance Act. Provisions of section 36(1)(va) applies to the disallowance of delayed payment of employee's contribution regardless of whether the assessment order is passed under Section 143(1)(a) or Section 143(3) of the IT Act.

Note:- Hon'ble High Court has also considered and refused to accept the order passed by Income Tax Appellate Tribunal, Mumbai in the case of ***M/s P. R. Packaging Service vs Assistant of Commissioner of Income Tax, ITA No. 2376/MUM/2022***, decided by the ITAT 07/12/2022 wherein the Tribunal had distinguished the order passed by the Hon'ble apex court in the case of ***Checkmate***

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Services Pvt. Ltd (supra) on the ground that the assessment order before the Supreme Court was passed under section 143(3) and hence, not applicable to assessments made under section 143(1) of the Act.

the Principal Commissioner, and solely on this ground the reassessment was liable to be quashed. The Court held that sanction by the Principal Commissioner cannot be a mechanical one.

2 ***Aruna Surulkar vs. ITO [2024] 158 taxmann.com 677 (Bombay)***

Reassessment - Sanction for issue of notice - section 151 of the Income Tax Act, 1961 – non application of mind while granting sanction to issue notice under section 148 of the Act - unjustified

Facts

During the assessment year 2018-19, the assessee has purchased an immovable property. The AO has issued a notice issued under Section 148A(b) to initiate the reassessment proceedings. Thereafter, the AO passed the order under Section 148A(d) of the Act observing that the assessee had violated the provisions of section 50C of the Act pertaining to the valuation of property purchased by the assessee for taxation purposes. The AO had also issued notice under Section 148 to reopen the assessment for the assessment year 2018-19. Being aggrieved, the Assessee filed a Writ Petition before the Hon'ble Bombay High Court challenging the notice issued under section 148A(b), order passed under section 148A(d) as well as notice issued under section 148 of the Act.

Decisions of the Hon'ble Court

Hon'ble High Court was pleased to allow the Writ Petition filed by the Assessee and quashed the notice issued under section 148 of the Act by observing that Section 50C of the Act did not apply to buyers. Hon'ble Court further noted that there was total "non-application of mind" by both, the AO and

3 ***K. S. Bilawala vs. PCIT [2024] 158 taxmann.com 658 (Bombay)***

Central Board of Direct Taxes- Instructions – Section 119 – Application for condonation of delay to file revised returns – 'genuine hardship' to be interpreted liberally – Belief that extra taxes have been paid tantamount to 'genuine hardship'

Facts

During the relevant assessment year 2022-23, the assessee received compensation/award on account of its land compulsory acquired under the provisions of the Right to Fair Compensation and Transparency in Land Acquisition, Rehabilitation and Resettlement Act, 2013. The assessee while filing its return of income declared the said compensation award as other receipts and offered the same for tax. Subsequently, the assessee realized that that this award should not have been offered to tax. The assessee, therefore, filed an application before the concerned authority seeking condonation of the delay and for leave to file revised return under section 119(2)(b) of the Act. This application of the assessee was rejected vide the impugned order on the ground that the assessee had not submitted any genuine hardship caused due to delay in the application. Therefore, the application of the assessee for condonation of delay would not be entertained.

Decisions of the Hon'ble Court

Hon'ble Bombay High Court was pleased to allow the writ petition filed by the assessee by observing that there cannot be a straight

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jacket formula to determine what is genuine hardship. The fact that if an assessee feels he has paid more tax than what he was liable to pay will certainly cause hardship and that will be certainly a 'genuine hardship'. The power to condone the delay has been conferred to enable the authorities to do substantial justice to the parties by disposing the matters on merits. While considering these aspects, the authorities are expected to bear in mind that no applicant stand to benefit by lodging delayed returns. Refusing to condone the delay can result in a meritorious matter being thrown out at the very threshold and cause of justice being defeated. As against this, when the delay is condoned, the highest that can happen is that a cause would be decided on merits after hearing the parties. Therefore, the delay in filing the revised return of income is condoned.

4 *Fayeza Muffadal Contractor vs. NFAC [2024] 296 Taxman 164 (Bombay)*

Faceless Assessment - Section 144B of the Income-tax Act, 1961 – order passed without serving the notice physically through courier or speed post in the absence of email id being registered in the PAN database – bad in law – SOP dated 3rd August 2022 to be strictly followed even in non faceless scenarios. [Sections 144 and 147]

Facts

The Assessee before the Hon’ble High Court is an NRI. In the absence of any taxable income being generated in India, the assessee was not required to file return of income under section 139 of the Act for the relevant assessment year 2014-15. During the year under consideration, the assessee purchased an immovable property in India. Being an NRI, the developer of the property filed Form 26QB on behalf of the assessee and mentioned his email Id while filing the said form. The assessee has provided her no and her tax consultants no in the e-filing portal. The tax consultant received a SMS on his mobile number (being secondary contact provided on e-filing portal) intimating that response was to be submitted for notice issued under section 271(1)(b) and section 271(1)(c) for the relevant Assessment Year 2014-15. Upon receipt of this SMS; the tax Consultant logged into the e-filing portal of the assessee and discovered that there were several notices and orders appearing on the e-proceeding portal. The tax consultant also found that the show cause notices for completion of assessment under section 144B, the final assessment order and consequential notices were sent to the email address of the developer as mentioned in the Form 26QB as filed by him on behalf of the assessee. The assessee, being unaware of the proceedings in her case, she did not appear before the assessing officer and an ex-parte order came to be passed raising a huge demand. The assessee filed a Writ Petition challenging the defect in service of notices and orders in her case.

Decisions of the Hon’ble Court

Hon’ble High Court was pleased to allow the writ petition filed by the assessee by observing that if email id was not available in the portal, the notices should have been served physically upon assessee at least by courier or speed post. Hon’ble Bombay High Court, therefore, quashed the Orders and notices and set aside the assessment order and remanded for de novo consideration.

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DIRECT TAXES
Tribunal

CA Nikhil Mutha CA Viraj Mehta CA Kinjal Bhuta

1 ***Modi Rubber Ltd [ITA No.6866/Del/2018 dated 8.02.2024] [AY 2012-13]***

Section 48 – Sale of shares of subsidiary company – Part consideration subject to indemnity payout kept in an escrow account, jointly controlled by the parties – Not taxable in the year of transfer of shares

Facts of the case

The assessee Company is engaged in manufacture, selling and trading of automotive tyres, tubes and flaps. The assessee sold its shareholding in the wholly owned subsidiary, M/s Modi Tyre Company Ltd (MTCL) to M/s Continental India Ltd (CIL) on 15.07.2011 for a total agree consideration of ₹ 117.62 crores. A certain part of the consideration of ₹ 25.48 crores was not paid to the seller but kept aside in an Escrow Account (EA) to meet certain contingencies (like indirect tax exposure, etc) which may arise in next few years. The parties entered into EA agreement dated 12.07.2011. Until adjustment of the amount, the funds in EA would be kept in fixed deposits and interest thereon would be reinvested and become part of EA itself. Operation of the EA was under joint instructions of the assessee and CIL. The amount was to be released to assessee after 2nd year, 4th year and 8th year. In wake of the EA where sum of ₹ 25.48 crores was retained to meet potential liability, the assessee filed a revised computation of income in the course of assessment proceedings and made downward revision of the sale consideration by the amount transferred to EA. The Assessing Officer declined to entertain such revised computation of LTCG. The Assessee subsequently received an amount of ₹ 6.35 crores comprising of ₹ 1.92 crores of principal amount and interest of ₹ 4.43 crores. The interest was offered to tax in respective years of accrual. A settlement agreement dated 27.06.2018 was entered by the parties. Thus, out of an amount of ₹ 25.48 crores transferred to EA, the assessee could realise only an amount of ₹ 1.92 crores. The Assessing Officer declined to entertain such revised computation of LTCG. The CIT(A) also dismissed the appeal of the assessee on this issue.

Held

The Hon'ble Tribunal observed that it is a common business phenomenon that in most merger and acquisition transactions involving sale of business or controlling interest, a certain part of the sale consideration is not directly paid to the seller but is kept aside to meet certain contingencies which may raise in the next few years. This amount is retained in an EA with an Escrow Agent with instructions as to how the amount is to be utilized and paid to the seller, depending upon the happening of certain events.

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The Hon'ble Tribunal relied on the decision of the Hon'ble Bombay High Court in the case of ***Dinesh Vazirani (445 ITR 110)***, wherein under similar fact pattern, the Court held that real income would be computed only by taking into real sale consideration i.e., after reducing amount withdrawn from the EA. As per the High Court, the liability was contemplated in the SPA itself and had to be taken into account to determine the full value of consideration. Thus, the Court held that the seller had received only the net amount (after reducing the adjustments from EA) and that such reduced amount should be taken as full value of consideration for the purpose of section 48 of the Act.

Thereafter, the Hon'ble Tribunal referred to the decision of the Hon'ble Madras High Court in the case of ***Carborundum Universal Ltd (130 Taxmann.com 133)***. The Hon'ble HC examined the clauses of the Business Sale Agreement and noted that the retention amount had been retained for the purpose of ensuring that sufficient funds would be available to indemnify the purchaser against any damages or losses arising from indemnification for breach of warranty, other losses, unpaid account receivables and other obligations. It noted that admittedly, no indemnification amount had to be to be given under either of the four heads and entire amount was received by the assessee without any deduction and was offered to tax by the assessee in subsequent year. Thus, the High Court held that the amount transferred to EA is liable to be taxed in the hands of the assessee in the year of transfer.

In light of the above diverse judgment, the Hon'ble Tribunal observed that on a nuanced consideration of covenants and conditions of business sale agreement, escrow agreement and attendant factual matrix in the present case, the facts in the present case are identical to the case of ***Dinesh Vazirani's case***. In the instant case also a shadow had been cast on the legally enforceable right to receive of the assessee on such consideration set apart in the EA owning to staggering liabilities quantified post transfers of shares. On circumspection of factual matrix, the Hon'ble Tribunal held that with all objectivity in command, we are of the opinion that the facts marshalled and case built up by the assessee is quite comprehensible and plausible. Thus, the Hon'ble Tribunal held that amount transferred to EA forms part of agreed consideration but not necessarily form part of 'full value of consideration received or accruing' as a result of transfer of capital asset. The Hon'ble Tribunal further held that the amount recovered from EA in later years shall be taxable in respective year of receipt or accrual.

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2 ***Manish Mehta vs. ITO [ITA No. 2679/Mum/2023 dt. 31.01.2024] (AY: 2009-10)***

Sec. 68 – Information received from Investigation Wing – Allegation that accommodation entry was taken from entity managed by Bhanwarlal Jain–Rajendra Jain–Gautam Jain Group – No evidence that amount was credited in books of accounts of the assessee – Impugned additions were deleted

Facts

Information was received from Director General of Income Tax (Investigation), Mumbai that the Appellant has taken accommodation/ hawala entries to the tune of ₹ 2,25,87,732/- from M/s Sankhala Exports Pvt. Ltd., a company forming part of Bhanwarlal Jain–Rajendra Jain–Gautam Jain Group allegedly engaged in providing accommodation entries for bogus purchases and bogus unsecured loans & advances. Therefore, after recording reasons for reopening assessment under Section 147 of the Act case was reopened. After considering the submissions of the

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appellant Ld. AO made addition u/s 68 on account that Appellant had failed to discharge the onus cast upon the Appellant under Section 68 of the Act. CIT(A) also confirmed the addition made by AO. Being aggrieved by the same, appeal is filed before Hon. ITAT.

Held

Hon. ITAT held that Appellant has declared 'Nil' income after claiming exemption under Section 10(2A) of the Act in respect of his share in the profits of the partnership firm M/s K D Mehta. Balance sheet does not reflect any credit in the name of M/s Sankhala Exports Pvt. Ltd. as on 31/03/2009. Appellant has also placed on record, a copy of bank account maintained with Bank of India to show that the Appellant had not received any loan during the relevant previous year from Sankhala Exports Pvt. Ltd. The aforesaid documents support the stand taken by the Appellant that during the relevant previous year, the Appellant had not taken any unsecured loan from M/s Sankhala Exports Pvt. Ltd. There is nothing on record to support the finding returned by the Ld. AO. In the absence of any material to show that a sum of ₹ 2,25,87,732/- was credited in the books of the Appellant addition cannot sustain. Therefore, in absence of any evidence, the Hon. ITAT deleted the addition.

3 *Udaykumar Shah vs. ITO [ITA No. 883/Mum/2023 dt. 07.02.2024] (AY 2014-15)*

Section 68 – Sale of Shares – All documents available – No penny Stock Transaction - Exemption cannot be denied

Facts

Assesse's claim of exempt income of ₹ 1,49,58,500/- on account of Long Term Capital Gain (LTCG) from the sale of shares - "M/s Comfort Fincap Ltd."; which was alleged as penny stock. Ld. AO considered such amount as sham transaction. CIT(A) also dismissed the appeal of the assessee. Being aggrieved, appeal is filed before Hon. ITAT.

Held

Hon. ITAT held that similar issue in case of assessee;s wife was decided in favour and Hon. ITAT relied on the coordinate bench decision. Assessee had submitted all documentary evidences, including contract notes, details of issued cheques, and bank statements, to support the legitimacy of the LTCG as like the cases relied upon by Hon. ITAT. Hon. ITAT relied on coordinate bench case in which it is held that the income generated by the assessee cannot be held bogus only on the basis of the modus operandi, generalisation, and preponderance of human probabilities. In order to hold income earned by the assessee as bogus, specific evidence has to be brought on record by the Revenue to prove that the assessee was involved in the collusion with the entry operator/stock brokers for such an arrangements. In absence of such finding, it is not justifiable to link the fact or the finding unearthed in case of some third party or parties with the transactions carried out by the assessee. Further the case laws relied by the AO are with regard to the test of human probabilities which may be of greater impact but the same cannot used blindly without disposing off the evidence forwarded by the assessee. There were not brought any evidence from independent enquiry to corroborate the allegation. Referring to judicial decisions, including those by the High Courts and ITAT, the ITAT held that suspicion alone cannot be the basis for rejecting the taxpayer's claims and thereby deleted the addition and allowed the asseesee's appeal.

4 *Shri Kailash Math Trust [ITA No. 1177/PUN/2023 dated 5 January 2024]*

Section 80G/Form 10AB – Existing Trust - Time limit for provisionally registered trust seeking regular registration – ITAT invokes harmonious interpretation and holds the application within the specified time limit

Facts of the case

The Assessee-Trust had commenced its activities from 04.03.1974. The Assessee-Trust received provisional approval u/s 80G(5) on 19 August 2022 for period up to AY 2025-26. As per clause (iii) of first proviso to section 80G(5) of the Act, the Assessee was required to make an application for final approval *'within six months from the date of commencement of activities or at least six months prior to expiry of the period of the provisional approval, whichever is earlier'*. Following the first limb of the clause, the Assessee-Trust was required to file an application for final registration under 80G(5)(iii) on or before 18.02.2023. However, the Assessee-Trust filed an application in Form 10AB for final approval on 27 March 2023. The CIT(E) thus rejected the application of final approval on the ground that it is barred by limitation. The Assessee accordingly filed an appeal before the Hon'ble Tribunal.

Held

On appeal, the Hon'ble ITAT discussed the new provisions for trust registration as introduced by the Finance Act 2020. To interpret the new provisions, the Hon'ble ITAT referred the budget speech of the FM, the use of which has been approved by the Hon'ble SC in case of ***K P Varghese vs. ITO [1981] 131 ITR 597 (SC)***.

The budget speech clearly provide that the amending provisions were introduced to simplify the procedure of registration of Charitable Trusts/Institutions and thus cannot be interpreted in a way that causes prejudice to the Trust/institutions.

The Hon'ble ITAT further noted that the amending provisions have differentiated between the Trust which were newly formed and the trust which were already doing charitable activities.

In the 2nd category, there are again two possibilities, **one** the trust was already doing charitable activities and was already having Registration u/s 12AA or 80G(5) of the Act. **Secondly**, those trust/institutions which were already doing charitable activities but had never applied for registration u/s. 80G(5) of the Act. Since it is not mandatory for every trust to get registered, such 2nd category trusts may first apply for provisional registration and then for final registration. These trusts will fall within sub clause (iii) of the Proviso to Section 80G(5) of the Act since they have obtained Provisional registration.

The ITAT held that on a harmonious interpretation, the time limit for applying for regular registration for existing trusts is within six months of expiry of Provisional registration. The Hon'ble ITAT also gave an example of an already formed trusts which was performing charitable activities from say year 2000 and was not registered under the Act. As per the interpretation given by the CIT(E), the aforesaid trust will never be able to apply for registration since they had commenced their activities in 2000 and 6 months from the date of commenced have already lapsed. Such interpretation leads to an absurd situation.

Accordingly, the Hon'ble ITAT held that the Assessee-Trust has applied for final registration within time and restores the application to verify eligibility as per the Act.

5 *Welspun Global Brands Ltd [ITA No. 2073/Mum/2022 dated 31 January 2024] [AY 2011-12]*

Section 144C – Passing of draft assessment order is mandatory even upon Assessee's specific waiver on filing DRP objections (No estoppel against the law) – considers the final order as incurable illegality

Facts of the case

The assessee company had made certain international transactions due to which the case was referred to the TPO for computation of arm's length price. The TPO recommended additions of ₹ 10.02 cr. Subsequently, the AO issued show cause to as to why the above adjustment of ₹ 10.02 cr. should not be made.

The assessee specifically submitted that it does not wish to file objections before the DRP but shall be filing an appeal before the CIT(A). Considering the response, the AO without passing the draft order u/s 144C of the Act, went on to pass the final assessment order u/s 143(3) r.w.s. 92CA(4) of the Act making TP adjustment of ₹ 10.02 cr and and addition u/s 14A of ₹ 6.17 cr.

The assessee appealed before the CIT(A) which partly allowed Assessee's appeal by deleting all disallowance except adjustment/ addition of ₹ 40 lakhs. Consequently, both the Assessee and Department filed appeal before the Hon'ble ITAT. During the ITAT proceedings, the assessee filed additional legal ground that not following the mandatory procedure u/s 144C makes the final order invalid.

Held

Having regard to the additional legal ground raised, the Hon'ble ITAT framed the following three questions:

1) Whether the passing of the draft assessment order as prescribed under section 144C(1) of the Act is mandatory or not?

2) Whether the Assessee can be estopped from challenging the assessment order which was passed on the basis of the admission by the Assessee itself?

3) Whether on the waiver/admission/ undertaking of the Assessee for not challenging the draft order before the Ld. DRP u/s 144C of the Act, the AO is competent to pass the assessment order under section 92CA(4) of the Act without passing a draft assessment order as prescribed u/s 144C of the Act may be?

With respect to the first question above, the ITAT followed the decision of the Hon'ble Bombay High Court in case of ***SHL India Pvt. Ltd vs. DCIT (2021) 128 taxmann.com 426(Bom)*** and ***PCIT vs. Andrew Telecommunications Pvt Ltd (2018) 96 taxmann.com 613 (Bom)*** and held that the provisions of section 144C of the Act clearly mandates that the AO is required to pass a draft assessment order in the first instance. Therefore, failure to follow the procedure as prescribed under section 144C(1) of the Act, would be a jurisdictional error and not merely procedural error or irregularity. Hence, the final assessment order passed u/s 92CA is without jurisdiction and illegal.

With respect to question 2 & 3, the ITAT followed the decision of the Hon'ble Bombay HC in case of ***PCIT vs. Lion Bridge technology Pvt. Ltd (2018) 100 taxmann.com 413 (Bom)*** and ***Kolkata ITAT in case of Linc Pen & Plastics Ltd vs. DCIT (2023) 148 taxman.com 273 (Kol-Trib)*** and held that mere consent of parties does not bestow jurisdiction, if the order is beyond jurisdiction. The Hon'ble ITAT also observed that there cannot be any estoppel on the issue of law pertaining

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to jurisdiction and waiver/undertaking of party cannot bestow the jurisdiction which otherwise do not exist.

The Hon'ble ITAT also discussed the maxim *'Nullus commodum capere potest de injuria sua Propria'* which provides that a person who by manipulation of a process, frustrates the legal rights of others, should not be permitted to take advantage of his wrong or manipulations. The Hon'ble ITAT also observed that allowing claim of the assessee at this stage of assessment would amount to unjust enrichment. However, it followed the mandate of the law laid down by the Hon'ble Bombay HC. Thus, ITAT held that the final assessment order passed u/s 143(3) r.w.s. 92CA(4) of the Act without passing the draft assessment order as prescribed u/s 144C(1) of the Act, is without jurisdiction and void-ab-initio.

6 *Tarun Tolaram Kapoor vs. ACIT (ITA No. 3395/Mum/2023 dt. 14.02.2024) (AY 08-09)*

Sec. 147 – *Reason to believe vs. Reason to suspect* – Reason to believe must – Indication that income is escaping necessary for reopening – No such evidence available to prove that income has escaped the assessment – Reopening void-ab-initio

Facts:

Case of the assessee was re-opened u/s 147 of the Act by issuance of notice u/s 148 of the Act and thereafter the AO noticed that the assessee had shown 4 properties and had calculated the deemed rent as per the Municipal Ratable Value by which the assessee has claimed loss of ₹ 17,54,864/-. Such view taken by the assessee was not acceptable by the AO and instead case was reopened and Ld. AO computed the fair rent on the basis of annual income yielding capacity of the properties and thus disallowed ₹ 14,08,400/- out of the loss claimed by assessee at ₹ 17,54,864/-. CIT(A) also confirmed the addition made by AO. Being aggrieved by the same, appeal is filed before Hon. ITAT.

Held

Hon. ITAT held that the fundamental requirement of law as stipulated u/s 147 of the Act is that before reopening an assessment the AO has to record the reasons wherein he has to spell out the "Reasons to believe, escapement of income". It is well settled that "Reasons to believe" postulate foundation based on information and belief based on reason. After a foundation based on information is made, there still must be some reason which should warrant the holding of a belief that income chargeable to tax has escaped assessment. In addition, one should bear in mind the fine distinction between "Reason to Suspect" and "Reason to believe". Information adverse may trigger "Reason to Suspect" which is not sufficient to reopen an assessment because as per section 147 of the Act, AO should have "Reasons to believe", escapement of income" and not Reasons to suspect escapement of income. When AO receives adverse information against an assessee, he should make preliminary inquiry and collect material, which would make him form a belief, that there is in fact an escapement of income. A perusal of the contents of page no. 14 PB, when compared with the facts stated in that of the reason recorded by AO, reveals that the facts stated therein at page 14 PB has been copied as such in the "reasons recorded" by AO for reopening of the assessment. Thus, there is neither any material to suggest that the income of the assessee has escaped assessment, nor information based on which AO has formed his reason to believe escapement of income; and moreover, recorded reasons does not reveal the essential element of AO's belief (of escapement of income). Hence, in absence

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of material information, reassessment was considered as void-ab-intio.

7

Vaaan Infra Private Limited vs. Principal Commissioner of Income Tax [ITA No. 1102/Del/2022 dt. 24.01.2024 (Delhi)(Trib.) (AY: 2015-16)

Sec. 263 – When the assessee submits all documents pertaining to share premium transaction, the order cannot be considered as erroneous just based on valuation basis-section 263 cannot be invoked

Facts

The assessee company was assessed u/s. 143(3) whereby some addition was made on account of section 36(1)(va) of the Act on account of delayed payment of ESI/PF. The assessment was records were called for examination by PCIT because one of the reasons for which case was selected for scrutiny was large share premium received during the year. During the year, assessee had issued 1,91,665 shares at ₹ 120/- each (including a premium of ₹ 110/-). It was further observed by PCIT that on perusal of assessment records, it was found that, no valuation report was filed on how the assessee had arrived at the fair market value. The Ld. PCIT observed that the valuation as per Rule 11UA (2) of the Rules had to be based upon the latest preceding balance sheet of the entry which had to be approved at the Annual General Meeting (AGM) of the Company and observed that the assessee submitted the balance sheets as on 31/03/2015 and also the balance sheet audited during March 2014. As the balance sheet as on 31.03.2015 could not have been an audited balance sheet, the only balance sheet available would be as on 31.03.2014 and the balance sheet produced by the assessee as on 02.03.2015 and the same cannot be used for the purposes of valuation under Rule 11UA of the Act. In view of the same, PCIT cancelled the order u/s. 143(3) and directed the AO to conduct fresh assessment as per provisions of law. Against this revision order u/s. 263, the assessee filed an appeal before the Hon'ble ITAT.

Held

The Hon'ble ITAT, mentioned that after perusing all the documents available on record it was seen that a notice u/s. 142(1) of the Act was issued where specific questions were asked related to the large share premium received during the year. The assessee had also produced documents with respect to share capital money received to support credit worthiness of shareholder, ledger accounts, bank statements, return of income of last three years of shareholders were also submitted. It was after making a detailed enquiry the additions were not made on large share premium received.The assessee also produced the Valuation Report in order to determine the fair value. It was held by the Hon'ble ITAT that, the said observations of the Ld. PCIT was not supported by any of the provisions of law. On the contrary, the Rule 11UA of the Rules did not mention the pre-condition of approval of the balance sheet by the Annual General Meeting. Therefore, the above finding of the Ld. PCIT was found to be perverse. Further it was held that assessee had submitted all documents which were required for assessing the large share premium received and therefore the order of AO cannot be considered as erroneous. The PCIT had committed an error in exercising the power conferred u/s. 263 of the Act and accordingly the order passed u/s. 263 was set aside.

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INTERNATIONAL TAXATION
Case Law Update

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A. HIGH COURT

1 ***CIT. vs. Mitsubishi Corporation India (P.) Ltd. [(2024) 159 taxmann. com 539 (Delhi)]***

The Hon'ble HC held that (i) where period in issue was assessment year 2006-07, amendment brought about in section 40(a) by virtue of Finance Act, 2014 would have no relevance, therefore, equal treatment or non-discrimination clause in articles 24(3) and 26(3) of India-Japan/India-USA DTAAs would apply with regard to payment for purchases made by assessee from its group companies and, thus, Hon'ble Tribunal had rightly deleted disallowance made by AO on account of non-deduction of tax at source (TAS) under section 40(a)(i) (ii) Where assessee had made purchases from its Thailand and Singapore based AEs without deducting TAS, since the AEs did not have a PE in India, payments made to them were not chargeable to tax in India and, thus, Hon'ble Tribunal had rightly deleted disallowance made by AO on account of non-deduction of tax at source (TAS) under section 40(a)(i)

Facts

i. The assessee, an Indian Company had entered into certain purchase transactions with its seven group companies, i.e., MC (Japan), Metal One (Japan), Tubular (USA), Petro (Japan), Metini (Japan), MC Metal (Thailand) and Metal One (Singapore). It had made payments to these Associated Enterprises (AEs) on account of purchases made without deducting tax at source [TAS].

ii. The AO concluded that since MC (Japan) had a Liaison Officer (LO) in India, on account of similarity of business models, the assessee's Thailand and Singapore based group companies, amongst other companies, also had PE in India. Therefore, concluded that payments made by the assessee to its AEs were chargeable to tax in India and hence, disallowed same under section 40(a)(i) on the ground that TAS had not been deducted.

iii. The DRP upheld the addition made by the Assessing Officer.

iv. On revenue's appeal to the Tribunal, there was a difference of opinion between the two learned judges and the matter was referred to Learned third Judge.

Decision

i. The Hon'ble HC noted that the assessee insofar as the following entities were concerned, i.e., MC (Japan); Metal One Corporation (Japan); Tubular (USA);

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Petro (Japan) and Miteni (Japan), had assailed the disallowance ordered by the AO, not on the ground that the payments made were not chargeable to tax in India, but on the basis that equal treatment was not accorded, as envisaged in Articles 24(3) and 26(3) of DTAAs entered into by India with Japan and USA.

ii. It further noted that before 01.04.2005, payments specified in Clause (i) of Section 40(a) made outside India or to a non-resident could not be deducted while computing the income chargeable to tax under the head "profits and gains from business and profession" unless TAS was deducted or after the deduction the amount was made over, i.e., paid. Inter alia, the payments specified in Clause (i) of Section 40(a) concern interest, royalty, fees for technical services or other sums chargeable under the Act. The rigour of the said provision, as it obtained prior to 01.04.2005, did not apply to the aforementioned specified payments made to residents. FA 2004 brought about an amendment in Section 40(a), whereby the resident was also brought within its sway, albeit with respect to payments specified in Clause (ia) viz. "any interest, commission or brokerage, fees for professional services or fees for technical services payable to a resident, or amounts payable to a contractor or sub-contractor, being resident, for carrying out any work (including supply of labour for carrying out any work)".

iii. Thus, although parity had been brought about with regard to the power of the AO to deny deduction where TAS was not deducted against payments made outside India or to non-residents and residents, it was limited to certain payments. As evident upon perusal of Clause (ia) of Section 40(a), it did not bring payments made towards purchases to resident-vendors within its net. This disparity was removed by FA 2014, albeit w.e.f. from 01.04.2015, when the ambit of disallowance was enlarged by bringing any sum payable to a resident within the four corners of Clause (ia) of Section 40(a). Since the period in issue is AY 2006-07, the amendment brought about in Section 40(a) by virtue of FA 2014 would have no relevance. Therefore, the equal treatment or the non-discrimination Clause obtaining in Articles 24(3) and 26(3) of the India-Japan/India-USA DTAAs would apply with regard to the payment for purchases made by the assessee concerning the following five companies: MC (Japan); Metal One Corporation (Japan); Tubular (USA); Petro (Japan) and Miteni (Japan).

iv. The argument advanced on behalf of the revenue that since provisions of Article 9 of the respective DTAAs apply, the equal treatment/non-discrimination clause incorporated in Article 24(3)/26(3) would have no application, was untenable since Article 9 captures transactions that an assessee may enter with an AE, which may result in a transfer pricing adjustment. In the instant case, the transfer pricing adjustment impacted the payments received by the assessee against services rendered by it to its group companies. This aspect was concededly not the subject matter of the disallowance ordered under Section 40(a) of the Act. The disallowance under the said provision was confined to payments made by the assessee against purchases required to conform to the equal treatment clause or the non-discrimination Clause contained in Article 24(3)/26(3).

v. As regards the transactions entered into by the respondent/assessee with the remaining two entities, i.e., MC Metal (Thailand) and Metal One (Singapore), the assessee did not press the argument of equal treatment as the DTAAs entered into by India with Thailand and Singapore do not contain an equal treatment/non-discrimination clause. In this behalf, the assessee has rightly contended that since the two companies referred to above, i.e., MC Metal Thailand and Metal One Singapore, did not have a PE in India, the payments made to them were not chargeable to tax in India. The AO, via convoluted logic, had concluded that since MC (Japan) had a LO in India, on account of the similarity of business models these two companies, amongst other companies, also had PE in India. On the other hand, the Tribunal has returned a finding that MC Metal Thailand and Metal One Singapore did not have a PE in India. Given this position, as correctly argued on behalf of the assessee, it was not obliged to deduct TAS from payments made to MC Metal (Thailand) and Metal One (Singapore). Chargeability to tax is the paramount condition for triggering the obligation to deduct TAS as evident from the plain language of sub-section (1) of Section 195. Reliance was placed on the judgment rendered by the Supreme Court in GE India Technology.

vi. The reliance of the Revenue on the judgment rendered by the Supreme Court in Transmission Corporation of AP Ltd. v. CIT was misplaced, as that was a case involving a composite transaction where the trading receipt was embedded with a component of income. It was neither the stand of the revenue nor was any finding of fact arrived at by the AO that the transactions entered into between the assessee and its seven group companies were "composite transactions". In other words, the suggestion that an element of taxable income was embedded in the transactions executed between the assessee and its seven group companies did not emerge from the record. In this regard reliance was placed on the judgement of the Hon'ble SC in G.E. India Technology.

vii. Accordingly, all the issues were denied in favour of the assessee.

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2 ***PCIT v. Karam Chand Thapar & Bros Coal Sales Ltd. [(2024) 159 taxmann.com 644 (HC - Calcutta)]***

The Hon'ble HC held that where assessee had already charged a guarantee commission at 0.5% from associated enterprises upward adjustment made on account of corporate guarantee commission could not be sustained, since average rate of corporate guarantee commission had been accepted in several decisions of the Tribunal at 0.5%.

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3 ***PCIT vs. John Deere India (P.) Ltd. [(2024) 159 taxmann.com 681 (HC - Bombay)]***

The Hon'ble HC upheld the order of the Hon'ble Tribunal holding that (i) Where assessee was rendering ITES services to AE, a company which outsourced services to be rendered by it and thereby followed a different business model, could not be accepted as comparable (ii) A company in whose case extraordinary event of amalgamation took place during relevant year, could not be accepted as comparable (iii) Where assessee was rendering ITES services to AE, a company engaged in providing KPO services, could not be accepted as comparable.

B. TRIBUNAL

4 ***Anjali Puri vs. DCIT [(2024) 159 taxmann.com 603 (Delhi Tribunal)]***

Where assessee, a tax resident of Netherlands, was residing and exercising employment in Ireland under complete control of BA PLC, Ireland for impugned assessment year and services were rendered in Ireland, the Hon'ble Tribunal held that the salary received by him in India (when he was in India for less than 183 days) and paid by BA PLC, India which was reimbursed by BA PLC, Ireland, could not be taxed in India by virtue of Article 4(1) of the India-Netherland DTAA.

Facts

i. The assessee, an individual and tax resident of Netherlands employed with British Airways PLC, a company incorporated under the laws of United Kingdom, was deputed on a long term-term assignment from April 01, 2019 to British Airways PLC, Ireland branch ("BA PLC, Ireland").

ii. During the year, the assessee rendered services outside India (i.e. in Ireland). Further, in the relevant F.Y., the total stay of the assessee in India was less than 60 days. Accordingly, by virtue of section 6(1), the assessee qualified as Non-Resident in India for the impugned Assessment Year.

iii. While on the deputation, for administrative convenience and on behalf of BA PLC, Ireland, the assessee received salary in India in respect of the services rendered outside India i.e., in Ireland to BA PLC, Ireland. Further, to ensure withholding compliance laid down under section 192 of the Act, BA PLC, India deducted tax at source on the salary paid in India and deposited with the government. The Company was reimbursed in full by the BA PLC, Ireland.

iv. The assessee filed the Income Tax Return for the impugned year, as a Non-Resident Indian and in accordance with the section 90 of the Act read with Article 15(1) of the India-Ireland Double Taxation Avoidance Agreement ("DTAA"), claimed the income to be exempt from tax in India.

v. The AO issued the draft Assessment Order under section 144C(1) holding that services were rendered in India and an addition on account of salary received was made to the income of the Assessee.

vi. The DRP affirmed the addition proposed by the AO.

vii. Aggrieved, the assessee filed an appeal before the Hon'ble Tribunal.

Decision

i. The Hon'ble Tribunal noted that during the course of assessment proceedings, the assessee had provided relevant documents to substantiate the claims made *viz* Letter of Assignment, Certificate/letter by the BA PLC, India in relation to salary received by her ; Certificate/letter by the BA PLC, Ireland in relation to reimbursement of salary paid by BA PLC, India to the assessee ;Tax residency certificate; Income Tax Return filed in Ireland ;Income Tax Return filed in Ireland ; Income Tax Return filed in India along with Income Tax computation, Ireland employment permit and relevant extract of the passport.

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ii. It was thus clear that despite the above submissions and evidence on record, the AO had erred in incorrectly holding that the assessee was based in India and that the salary was taxable in India, where in fact the salary was earned from BA PLC, Ireland and the services were rendered outside India.

iii. The DRP after perusing the documents submitted by the assessee had erroneously noted that there was a failure on the part of assessee to provide agreement between Irish and Indian entity without appreciating the certificate/letter of reimbursement issued by BA PLC, Ireland which substantiated the assessee's submission that during the impugned Assessment Year, the assessee was employed with BA PLC. Ireland and was paid salary in India merely for administrative convenience.

iv. Salary income of the Assessee was not exigible in India under Article 15 of the DTAA. The Assessing Officer was not correct in not granting relief under Article 15 of the DTAA and disregarding that income is accrued where employment is exercised. As per the Article 15 of the DTAA between India and Netherlands, the income earned by the person is exempt from tax if following conditions are satisfied: (1) If the person has not stayed for more than 183 days in India, and (2) If the employment is exercised outside India.

v. In the present case, both the conditions prescribed in the article 15 were satisfied. The first condition had not been disputed by the Assessing Officer, whereas the second condition had been justified by various evidences furnished by the assessee. Further, the AO himself had accepted that the services were rendered outside India.

vi. The Hon'ble Tribunal concluded that the assessee was residing and exercising employment in Ireland under the complete control of BA PLC, Ireland for the impugned Assessment Year that the salary was also borne by BA PLC, Ireland. Thus, the salary of the assessee derived from BA PLC, India on behalf of BA PLC, Ireland was exempt from tax in India.

vii. It further held that the salary income earned by the assessee for services rendered in Ireland could not be said to be deemed to accrue or arise in India under section 9 of the Act. Thus even in view of section 9(1)(ii), salary payment can be said to be earned in India only if the corresponding services are rendered in India. Thus, if the services are rendered outside India, for which salary has been paid, then the income cannot be said to accrue or arise in India.

viii. Further, it held that the contention of AO that the assessee had rendered services from India was incorrect in light of the tax residency certificate for Ireland. Thus, in light of above facts and legal position, since the employment was not exercised in India, such income could not be held to be taxable in India and hence, the addition made by the AO on this issue was directed to be deleted.

5 ***TCI-GO Vacation India (P.) Ltd. vs. ACIT [(2024) 159 taxmann.com 710 (Delhi Tribunal)]***

The Hon'ble Tribunal held that since working capital adjustment took into account impact of outstanding receivables , no further adjustment was required - since margin of assessee was higher than working capital adjusted margin of comparables.

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INDIRECT TAXES
GST – Recent Judgments and Advance Rulings

CA Naresh Sheth CA Jinesh Shah

A. WRIT PETITON

1 ***Eicher Motors Limited vs. Superintendent of GST and Central Excise - Madras High Court [W.P. Nos. 16866 & 22013 of 2023 dated 23.01.2024]***

Facts and Issues involved

Petitioner is a renowned manufacturer of mid-sized motorcycles, led by the iconic brand Royal Enfield, with its manufacturing unit in Tamil Nadu.

On the date of introduction of GST i.e., 01.07.2017, the petitioner had accumulated CENVAT credit of approximately 34 crores ready to be transitioned into the GST regime. However, due to technical glitches in the GST Common Portal during the initial stages of implementation of GST, the credit in entirety sought to be transitioned was not made available forthwith as Input Tax Credit (ITC) on furnishing of Form GST TRAN-1 on 16.10.2017.

Since the credit was not reflected in the petitioner's Electronic Credit Ledger, petitioner was unable to file GSTR-3B for the month of July 2017 within the due date. Such non-filing of Form GSTR-3B for July 2017 had a domino effect and the petitioner was unable to file the GSTR-3B for subsequent months from August 2017 to December 2017, since Section 39(10) of CGST Act disables an assessee from filing returns for the subsequent period if the returns for the previous tax period are not furnished.

Though the petitioner was disabled from filing the returns, the petitioner had ensured that the tax dues are fully paid within the due dates without any delay and accordingly, the petitioner had discharged GST liability for the period from July 2017 to December 2017 by depositing the tax amounts in the Electronic Cash Ledger (ECL) under the appropriate heads as CGST, SGST, IGST into the Government account within the due date for each month.

The credit was finally reflected in the petitioner's Electronic Credit Ledger when the petitioner filed revised TRAN-1 on 27.12.2017. This enabled the petitioner to file the return for July 2017. Accordingly, the petitioner filed all the returns from the month of July 2017 to December 2017 on 24.01.2018.

GST Authorities issued a recovery notice demanding interest for alleged belated

payment of GST from July 2017 to December 2017.

The petitioner filed a writ petition challenging the said recovery notice.

Petitioner's submission

The petitioner submitted that the moment cash has been deposited in the ECL through Form PMT-06, tax is said to have been paid since it gets credited to the Government's Account then cannot be withdrawn by the petitioner at his own free will i.e. the petitioner then, loses access to the said money.

It was also submitted that debit to the ECL is only a journal entry and the same cannot negate the fact that the tax already stands paid at the time of depositing the cash in the Government's Account (which gets reflected in ECL).

Respondent's submission

GST Authorities contended that deposit of tax in ECL would not amount to payment of tax and would be tantamount to failure to remit GST in time, for which interest liability is attracted.

They submitted that a deposit of cash made in the petitioner's ECL cannot be considered as tax paid to the Government unless the said amount is debited while filing the monthly GSTR-3B returns.

Discussions by and observations of High Court

On a combined reading of Section 39(1), 39(7) and explanation to Section 49(11), the instance of payment of tax would not occur later than the last date of filing GSTR-3B. Thus, it is immaterial whether GSTR-3B is filed within the due date or not for remittance of tax to the account of Government. Therefore, it is not correct to state that the instance of payment of tax to Government would occur only upon the filing of GSTR-3B return and thereafter by debiting the electronic credit ledger or ECL.

The assessee have been maintaining the electronic cash and credit ledgers, only for the purpose of accounting, while the entire tax to be paid to the Government is directly deposited through Form GST PMT-06 not later than the last date for filing the Form GSTR-3B.

Therefore, once the tax has been deposited by a taxpayer through GST PMT-06, the tax liability of the said taxpayer will be discharged to the extent of the deposit made i.e. the tax liability of the taxpayer will be discharged from the date when the amount gets credited to the account of the Government.

Interest provisions will only trigger when the deposit itself is made later than the due date of filing return i.e. no interest can be demanded by the GST Authorities if the taxpayer has deposited the tax with the Government before the due date of filing GSTR-3B (i.e. 20th of every subsequent month) but has merely failed to file the said return (due to which the debit in the ECL is delayed which is purely for the purpose of accounting).

Decision of High Court

Writ petition was allowed.

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2 *Fairdeal Metals Limited vs. Asst. Commissioner of Revenue - [Writ Petition No. WPA/170/2024 DATED 01.02.2024 HIGH COURT CALCUTTA]*

Facts and Issues involved

The specific case of the petitioner is that there is no allegation against the petitioner, but the entire allegation has been made against the supplier from whom the petitioner procured the goods.

Navaraj Trading Company i.e., the supplier of the petitioner was registered recently under the GST Act with effect from 09.10.2023 in the State of Assam. The supplier has shown the nature of occupancy over the place of business as 'rented' and in support of its claim rent agreement and the trade license was supplied. Neither electricity bill nor municipal khata copy nor any such document was available to show the legal occupancy of the owner over the place of business.

The authority mentioned that there was a need for physical examination of the goods and other verification of the documents produced before the proper officer. The proper officer, after perusal of the documents, opined that M/S. Navaraj Trading Company was involved in receiving and passing on fictitious/bogus ITC to other parties. The said company has been set up solely for the purpose of circulating bogus ITC.

Penalty was calculated and the petitioner was directed to show cause within four days as to why the proposed tax and penalty should not be payable failing which further proceeding would be initiated.

Petitioner's submission

The petitioner submitted that it was not required to know the antecedents of the supplier Company. As the supplier company was a registered taxable person in the State of Assam, the petitioner did not have any information or did not have any mechanism to verify the details of the supplier company.

In support of the aforesaid submission the petitioner has relied upon the decision dated 04.02.2022 passed by the Hon'ble Division Bench of the High Court of Punjab and Haryana in the matter of ***M/s. Shiv Enterprises vs. State of Punjab & Ors.*** wherein the court after observing that the petitioner was not responsible for contravention of any of the provisions of the Act and the contravention so alleged was against the supplier who was shown to have indulged in outward supply without having any inward supply, the court was pleased to set aside and quash the impugned notice.

It has been submitted that the facts of the case in ***M/s. Shiv Enterprises (supra)*** is similar to the facts of the instant case and similar relief ought to be allowed by the Court.

Discussions by and observations of High Court

Assuming there was an intention to evade tax on the part of the supplier, but later on by way of payment of tax, the allegation of intention to evade tax falls flat. After registration has been issued and tax has been paid by the supplier company, the allegation made against the supplier company does not stand.

The petitioner, being in no way connected with any of the allegations that has been

levelled against the supplier company, cannot be made liable to pay penalty as has been assessed.

Decision of High Court

In view of the above, the order of detention and the subsequent order imposing penalty are liable to be set aside and quashed.

3 ***Falguni Steels vs. State of U.P. and Other Allhabad High Court [Writ Tax 146 of 2023 dated 25.01.2024]***

Facts and Issues involved

The petitioner is an authorized dealer of the Steel Authority of India Ltd. (hereinafter referred to as 'SAIL'). On February 17, 2019, the petitioner purchased a consignment of TMT Bar. Thereafter, the petitioner obtained the service of a private road carrier for the transportation of its goods. The tax invoices contained the number of the said vehicle.

The petitioner alleges that during the relevant time, the e-Way Bill portal of the Department was marred by glitches and technical shortcomings due to which E-way could not be generated. The said e-Way Bills were generated on February 20, 2019, and February 21, 2019.

The petitioner states that the said e-Way Bills were presented before the Respondent No. 2 at the time of the interception of the goods. However, the said e-way Bills were not taken into consideration by Respondent No. 2.

Show Cause Notice was issued to the petitioner on February 21, 2019, alleging that the movement of the goods was in contravention to the provisions of the UPGST Act, 2017.

The petitioner, thereinafter, deposited the amount of INR 2,59,724 towards tax and penalty.

Aggrieved from the order dated February 21, 2019, passed by Respondent No. 2 and the order dated October 20, 2019, passed by Respondent No. 3, the petitioner has preferred the instant writ petition before this Court.

Discussions by and observations of High Court

Even otherwise, a combined reading of Sections 68, 129, and 130 of the UPGST Act, 2017 shows that goods can be detained and tax and penalty can be demanded only when the goods are liable for confiscation, which can be only when the same are transported in contravention of the provisions of the UPGST Act, 2017/CGST Act, 2017 and the rules framed thereunder along with the intention to evade the payment of tax.

In the instant case, there cannot be any intention to evade the payment of tax as the CGST and the SGST were already charged by SAIL and payments were also made. Additionally, the vehicle number was mentioned in the invoices and during the physical verification of the goods and no discrepancy was found.

Before the order imposing penalty was passed, the petitioner in the instant case had generated both the e-Way Bills which the Respondent No. 2 failed to consider.

This failure on the part of Respondent No. 2 was not corrected by the Respondent No. 3.

In ***Axpress Logistics Pvt Ltd. vs. Union of India and Others reported in 2018 SCC OnLine All 6089,*** this Court quashed the

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penalty order issued under Sections 129(1) and 129(3) of the UPGST Act, 2017, since the petitioner therein had produced e-Way Bill before the detention and seizure of the goods and vehicle.

In given case, both the e-Way Bills were produced by the petitioner before the order imposing penalty was passed. Explanation given by the petitioner with regard to the delay in generation of the e-Way Bill due to the barrier imposed by the local administration on the occasion of 'Maghi Purnima, Kumbh Mela 2019' has also not been taken into consideration by the authorities below.

Finally, the authorities have failed to indicate any specific reason that would indicate an intention for evasion of tax. Having already determined that the authorities in the instant case transcended their jurisdiction while passing the impugned orders, issuance of the writ of certiorari is necessitated in the instant case.

Ruling of High Court

The order dated February 21, 2019 passed by the Respondent No. 2 and the order dated October 20, 2019 passed by the Respondent No. 3 are quashed and set aside. Court also directs the Respondent No. 2 to refund the amount of tax and penalty deposited by the petitioner.

4 *Aryan Timber Store vs. Sales Tax Officer (W.P.(C) 628/2024 dated 18.01.2024) – NEW DELHI HIGH COURT*

Facts and Issues involved

Petitioner discontinued his business w.e.f. 31.03.2019 and applied for cancellation on 06.05.2019.

GST Authority (Respondent) vide SCN dated 15.07.2021 issue notice to show cause as why the registration be not cancelled retrospectively for not filing the returns for a continuous period of six months.

GST authorities vide order dated 09.07.2022 cancelled the registration retrospectively with effect from 01.07.2017. There is no material on record to show as to why the registration is sought to be cancelled retrospectively.

Further, SCN did not put the petitioner notice that GST registration is liable to be cancelled retrospectively. Accordingly, the petitioner had no opportunity to object to the retrospective cancellation of registration.

Petitioner filed the present writ petition praying for quashing the of the order dated 09.07.2022.

Discussions by and observations of High Court

Section 29(2) of the CGST Act, 2017 provides that the proper officer may cancel the GST registration of a person from such date including any retrospective date, as he may deem fit if the circumstances set out in the said sub-section are satisfied.

Registration cannot be cancelled with retrospective effect mechanically. It can be cancelled only if the proper officer deems it fit to do so. Such satisfaction cannot be subjective, but it must be based on some objective criteria.

Merely, because a taxpayer has not filed the returns for some period does not mean that the taxpayer's registration is required to be cancelled with retrospective date also covering the period when the returns were filed, and the taxpayer was compliant.

Once the registration stood cancelled on 06.05.2019, there was no cause for the petitioner to file any returns. Accordingly, the cancellation of the registration on the grounds that petitioner has failed to file returns is not sustainable.

Further, one of the consequences for cancelling a taxpayer's registration with retrospective effect is that the taxpayer's customers are denied the input tax credit availed in respect of the supplies made by the taxpayer during such period. The proper officer is also required to consider this aspect while passing any order for cancellation of GST registration with retrospective effect.

Decision of High Court

The order of cancellation is modified to the extent that registration cancellation shall operate with effect from 06.02.2019, i.e., the date when petitioner first applied for cancellation of registration.

5 ***Prahitha Constructions Private Limited vs. Union of India And Ors [Writ Petition No: 5493 of 2020 dated February 09, 2024] – Telangana High Court***

Facts and Issues involved

Petitioner is engaged in the business of conceptualizing, planning, constructing, and developing commercial real-estate projects.

The petitioner i.e., the developer of land entered into a Joint Development Agreement for development of land with M/s. Jitvan Land Limited and M/s. Janina Marine Properties Private Limited (landowners).

Petitioner has sought the following relief in the impugned writ petition:

- Transfer of development rights of land by the landowners to the petitioner by way of a joint development agreement (JDA) should be treated as sale of land, and hence the execution of the said agreement should not be subjected to levy of GST under Entry 5 of Schedule III of GST Act; and
- Notification No. 4/2018-Central Tax (Rate) dated 30.09.2019 imposing GST on transfer of development rights of land by the landowners under a JDA be declared ultra vires the Constitution of India.

Discussions and observations of Telangana High Court

Mere execution of JDA by itself would not mean that the right, title and ownership of the property or a portion of that property stands transferred in the name of the petitioner/developer. The landowner has a bundle of rights attached to his immovable property. One of the rights is getting the property developed. By virtue of the JDA, the petitioner would have the permission/license to enter into the subject property of the landowners for the purpose of undertaking and execution of the development activities on the said property.

There is also a condition of cancelling the contract agreement and under such situation the entire rights over the said property would continue to remain with the landowners. This again would show that the right and title of the said property even as on date stands vested with the landowners and not with the petitioner.

The contention of petitioner that the JDA eventually results in sale of land to the petitioner is incorrect and misleading. It is only by way of separate conveyance

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deed, that too after completion of the developmental activity land is transferred and not solely by virtue of JDA. The execution of JDA between 2 parties by itself would not amount to transfer of ownership of properties.

The transfer of development rights is a service under GST Law which the landowner is offering to the developer and that too for a consideration. The transfer of development rights is service and not outright sale of an immovable property.

The transfer of ownership from the landowner goes directly to the purchaser of the constructed property and not in favor of the petitioner. Transferring of development rights does not result in transfer of ownership rights.

The contention of petitioner that Article 265 of the constitution of India prohibits imposition of tax otherwise that by authority of law is not tenable. The court assailed these arguments on following grounds:

- GST is levied under Article 246 A of the constitution which empowers Government to make the law with respect to GST.
- Section 9(1) of CGST Act empowers Government to levy the tax.
- Section 15 of CGST Act prescribes the valuation.
- The Government, after the recommendations of council, had fixed the GST rates as notified in Notification No. 11/2017-CT(R) dated 28.06.2017.

Decision of High Court

Taking into consideration the provisions of Article 246A of the constitution of India and also considering the extraordinary powers which has been conferred upon the GST council and upon whose recommendation the Government has issued the notification clarifying the aspect of transfer of development rights being attracted to GST/ TGST, the challenge to the notification issued by the Government of India can be safely held to be devoid of merits.

Court was of the considered opinion that the grounds and contentions raised by the petitioner in respect of the reliefs sought for is not sustainable and the writ petition sans merit and therefore deserves to be and is accordingly, dismissed.

> "So long as the millions live in hunger and ignorance, I hold every person a traitor who, having been educated at their expense, pays not the least heed to them!"
>
> — *Swami Vivekananda*

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INDIRECT TAXES

Service Tax – Case Law Update

CA Rajiv Luthia CA Keval Shah

1 *Principal Commissioner of CGST and Central Excise vs. SBI Life Insurance Company Ltd. [2024] 159 taxmann.com 168 (Mumbai - CESTAT)*

Backgrounds and facts of the case

- The Respondent M/s SBI Life Insurance Company Ltd., has been engaged in providing different type of insurance services, apart from providing services like renting of immoveable property etc. The Department, on verification of data obtained from Income-tax Return and Service Tax Returns of the aforesaid period had observed that against ₹ 10,382 Crores of turnover shown as services rendered by it in its Form-26(AS) against which appropriate TDS was deducted, it had discharged Service Tax only on the turnover of ₹ 7,254 Crores and therefore, additional Service Tax liability to the tune of ₹ 387 Crores @12.36% was not discharged by the Respondent.
- Adjudication was carried out by the Commissioner who dropped the demand relying on Chartered Accountants Certificate and also various other documents produced by the Assessee. Being aggrieved by the Order of the Commissioner, Department filed an appeal before Hon'ble CESTAT assailing the legality of the said order.

Arguments on behalf of Department

- The Ld. Commissioner placed reliance mainly on the certificate issued by the Chartered Accountant and had passed the erroneous order without verification of its content and without verification of any other document to ascertain corroborative evidence.

Arguments on behalf of Assessee

- The Authorized Representative argued that the entire demand was raised on the basis of difference between Income-tax Return and Service Tax-3 Returns, which in view of the following judgments, cannot form the sole basis of the demand for which the order of the Commissioner needs no interference by this Tribunal:
    - o ***M/s Umesh Tilak Yadav vs. Commissioner of Central Excise, Nagpur reported in 2023 (11) TMI 473-CESTAT Mumbai,***
    - o ***M/s Maheshwari Transport vs. Commissioner of Central Excise & Service Tax, Raigad reported in 2023 (9) TMI 77-CESTAT Mumbai,***

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- o ***M/s Sharma Fabricators & Erectors Pvt. Ltd. vs. Commissioner of Central Excise, Allahabad reported in 2017 (7) TMI 168- CESTAT Allahabad,***
- o ***M/s Kush Constructions vs. CGST Nacin, ZTI, Kanpur reported in 2019 (5) TMI 1248-CESTAT Allahabad,***

Decision of the Hon'ble Bench

- At the outset it is to be noted that certificate issued by the Chartered Accountant is alone a valid piece of evidence without corroboration in view of several decisions of Tribunals including the one with Final Order No. A/11206/2023 dated 8-6-2023 in the case of ***Rajashree Polyfil vs. Commissioner of Central Excise & Service Tax, Surat-II***.
- Be that as it may, it is worth mentioning here that apart from examining the certificate issued by Chartered Accountant, Learned Commissioner had also examined other relevant documents from the case records and observed glaring discrepancies ranging from taking of figures of Income-tax Return of the preceding year 2012-13 and comparing the same with Service Tax-3 Return of the subsequent year 2013-14 and making demand on the basis of Service Tax-3 returns of six months while taking figures of Income-tax Return for the entire Financial Year.
- The Ld. Commissioner has categorically pointed out, which is also noted in the Review order of the Committee of the Chief Commissioner's, that three different percentage of Service Taxes ranging from 1.545% and 3.09% to 12.36% were leviable against the services rendered by the Respondent for different insurance categories but Show-cause notice contains a calculation of demand on the basis of its calculations @12.36%. It is, therefore, cannot be said that other relevant documents or corroborative piece of evidence were not examined by the Learned Commissioner before passing of his order.
- Further the basis of demand is purely taken from the difference between the value shown in the Service Tax Returns and income shown in the Income-tax Return. In view of irregularity in the Show cause and the non-sustainability of demand purely on the basis of difference between ST-3 return and Income-tax returns of any other period, without any further examination to establish that the difference is on account of consideration received towards discharge of services, the Ld. Commissioner has rightly dropped the Show Cause Notice.
- Accordingly, the Appeal filed by the Department was dismissed.

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2 ***Adv. Pooja Patil vs. Deputy Commissioner, CGST and CX Division VI [2024] 159 taxmann. com 188 (Bombay HC)***

Backgrounds and facts of the case

- The Petitioner in the present case is a practicing Advocate. The Petitioner contended that on 5th October 2023, an email was received by the Petitioner to attend a hearing on 17th October, 2023, on which date, the Petitioner appeared through her Chartered Accountant. On 18th October 2023, the Petitioner addressed a letter to the Designated Officer attaching an email dated 5th October, 2023 which merely referred

to the show-cause notice dated 24th December, 2020, which was never received by the Petitioner.

- It was recorded that even the Chartered Accountant who represented the Petitioner was not furnished a copy of the show-cause notice, as also the website referred only to the personal hearing letter. It was pointed out that neither Service Tax nor GST were applicable and/or payable by advocates, hence any attempt to pass an order would be without jurisdiction. The Petitioner therefore filed a Writ Petition before the Hon'ble High Court Bombay.

Arguments by the Petitioner

- The Counsel appearing for the Petitioner submitted that the impugned order would be required to be set aside on two primary grounds. Firstly, that the show-cause notice on the basis of which the impugned order has been passed was neither issued nor received by the Petitioner. It is next submitted that the impugned order is in the teeth of the Respondents own notification(s) dated 20th June, 2012 being Notification No. 25-30/2012-Service Tax, which categorically exempted individual advocates from the purview of taxable services and levy of any service tax.

- It was further submitted that once the Order-in-Original itself was without jurisdiction and in the teeth of the Notification(s) which were binding on the Designated Officer, he could not have passed the impugned order.

- The Counsel also referred to an order dated 16th October, 2023, passed by Co-ordinate Bench of Hon'ble High Court in Writ Petition (L) No. 25269 of 2023 (***Ish Kiran Jain vs. The Assistant Commissioner & Ors***), which was also a case of an advocate approaching this Court in similar circumstances wherein the Court had interfered.

Arguments by the Revenue

- The Ld. Counsel for the Respondents would not dispute the purport of the Notification No. 25/2012-Service Tax dated 20th June, 2022 and Notification No. 30/2012-Service Tax dated 20th June, 2022 that the same exempts services provided by individual advocate from levy of the service tax.

Decision by Hon'ble High Court

- At the outset, the Court observed that it appears that the Petitioner was not granted an opportunity of an appropriate hearing before the impugned Order-in-Original was passed against the Petitioner. Hence, there is substance in the contention as urged on behalf of the Petitioner that in passing the impugned order, there is a breach of the principles of natural justice.

- Notification No. 25/2012 dated 20th June, 2012, also clearly provides that the service provided by an individual advocate, partnership firm of advocates, by way of legal services being exempted from levy of service tax. If the aforesaid position is to be the correct position, certainly the Designated Officer has acted without jurisdiction having acted contrary to the binding notifications.

- The Court was of the considered opinion, that no useful purpose would be achieved in present proceeding remanding to the Designated Officer.

- The High Court deemed it fit in the interest of justice to quash and set aside the impugned order, for the reasons that the Designated Officer has acted without jurisdiction.

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3 *M/s Dabur Research Foundation vs. Commissioner of CCE & ST, Ghaziabad 2024 (2) TMI 516 – CESTAT Allahabad*

Backgrounds and facts of the case

- Appellant is a non-profit making organization registered as a company incorporated u/s 25 of the Companies Act, 1956. The Appellant provides comprehensive range of services for pharmacological, biological and analytical testing of drugs and chemicals. The Appellant entered into an Asset Licensing Agreement dated 19.05.2009 with M/s. Fresenius Kabi Oncology Limited. (FKOL).

- The Appellant had received ₹ 3,92,00,000/- from FKOL towards license fee under the abovementioned agreement. On the said payments received by the Appellant from FKOL,(being towards deemed sale), the Appellant had already paid Sales Tax (VAT), as applicable under the Uttar Pradesh Value Added Tax Act and assessed accordingly.

- The Appellant's records were audited by the audit party of the Central Excise Commissionerate, Ghaziabad, wherein during the course of audit, the department observed vide DAR No. 177/2010-11 dated 15.02.2011, that the Appellant had received payments against the service- 'Supply of Tangible Goods' under the agreement entered into with FKOL.

- The Department issued a Show Cause Notice proposing demand of ₹ 44,41,360/- and the Appellant contested and filed its reply. The Adjudicating Authority vide the Order-In-Original dated 30 March, 2013 confirmed the allegation and demands made in the SCN. Being aggrieved, The Appellant filed an appeal before the learned Commissioner (Appeals). Learned Commissioner (Appeals) in the impugned Order-In-Appeal, recalculated the demand to ₹ 39,86,350/-. Hence the present appeal before the Tribunal.

Arguments by the Appellants

- It is urged that the taxable service with reference to 'supply of tangible goods' has been defined u/s 65(105)(zzzz) of the Finance Act, 1994. Further, the scope of service was clarified by the Government vide D.O.F. No. 334/1/2008-TRU dated 29.02.2008.

- Appellant has discharged VAT on the transaction and the VAT authorities already concluded the assessment proceedings in respect of the same transaction, considering the transaction as the transfer of right to use goods. Therefore, in terms of the above referred Circular, the same transaction is not taxable under the Service tax. Further reliance is placed on the decision of this Tribunal in the matter of ***M/s. Rockwell Automation India (P) Ltd. vs. CCE, Ghaziabad passed vide Final Order No. 70660-70662/2019 dated 25.03.2019***.

- The 46th amendment, Article 366(29A)(d) of the Constitution of India defines tax on sale or purchase of goods includes a tax on the transfer of right to use any goods for any purpose for cash, deferred payment or other valuable consideration.

- The aforementioned constitutional provisions have been the subject matter of interpretation by various courts. The Hon'ble Supreme Court in the case of ***Bharat Sanchar Nigam Ltd vs. UOI***

[2006 (2) STR 161.(SC)] has discussed the different aspects involved in such transaction and came to the conclusion that to constitute a transaction for "transfer of right to use the goods" the transaction must have the following attributes:

a. There must be goods available for delivery.

b. There must be consensus ad idem as to the identity of the goods.

c. The transferee should have a legal right to use the goods -consequently all the legal consequences of such use including any permission or licenses required therefore should be available to the transferee.

d. For the period during which the transferee has such right, it has to be to the exclusion of the transferor, this is the necessary concomitant of the plain language of the statute- viz a "transfer of the right to use" and not merely a license to use the goods;

e. Having transferred the right to use the goods during the period for which it is to be transferred, the owner cannot again transfer the same rights to others.

- The above finding establishes that the goods were exclusively given for use to the customer of the Appellant, and they were free to use the goods. The agreement provides that even if the Appellant transfers' title of the goods, the right of the Customer will be protected It is further urged that the above clause establishes that during the subsistence of the Agreement, the right of the customer cannot be again assigned by the Appellant to anyone else. Therefore, the finding and the conclusions are incorrect factually.

- The Appellant transferred the Right to use the goods to the customer and the title of the goods was not transferred. The transfer of the Right to use the goods amounted to 'deemed sale' whereas transfer of title amounts to sale. Even after the transfer of right to use the goods, the Appellant continued to be the owner of the goods, therefore, the customer of the Appellant cannot get an absolute right to use the goods in any manner or for any purpose. The transfer of right to use goods, always provides the manner and purpose for which the goods maybe used.

- Further, with the transfer of right to use goods, the transferee does not acquire the title of the goods, therefore, such transferee may not be allowed to assign or sublicense the goods to others. in the present case, the customer was having right to use the goods for the purpose of doing research as contemplated under the Agreement.

Decision by Hon'ble Allahabad CESTAT

- In the instant case the custody of the assets was given to FKOL, as they were granted Exclusive Licence to use the goods, but they had no possession and effective control of the goods and neither were free to make use of the said assets in the manner and purpose other than as specified in the said agreement. Nor FKOL were free to allow/assign or licence the goods for use by others. Further, FKOL was not free to remove these assets from the premises of the Appellant. Further observed as per Clause 2.7 of the agreement, that during the terms of the agreement the Appellant can sell its right or interest on the said

assets. This agreement only allows FKOL to use the laboratory infrastructure developed by the Appellant for a specific purpose of oncological research, without transferring the possession or control. Thus, while FKOL had access to infrastructure in question, the Appellant did not lose control over the said infrastructure, which is evident from the written terms of the contract between the parties.

- The exclusive possession with right to use the goods was given by the Appellant to M/s. FKOL, who were free to use the goods. We further find from the Clause 2.7 of the agreement, which provides that even if the Appellant decides to sell or transfer its right, title or interest in the goods during the term or the extended term for right to use granted, the Appellant shall take prior consent from FKOL and further ensure that right to use of FKOL under the agreement are not disturbed/preserved and their interest is not prejudicially effected. Thus, evidently, the Appellant had granted exclusive right to use without disturbance or encumbrance to their clients – FKOL and accordingly, we hold that they have rightly paid the Sales Tax/VAT on transfer of right to use the goods, to their customers, which is a transaction of deemed sale. Accordingly, we hold that service tax is not attracted.

4 *M/S RISHU ENTERPRISE vs. Commissioner of CGST & Excise, Dibrugarh 2024 (2) TMI 566 – CESTAT KOLKATA*

Backgrounds and facts of the case

- Appellant is a proprietorship concern and had been engaged in providing services such as, supply/renting of passenger vehicles and load carrier vehicles to the Indian Army. The appellant had also supplied fresh eggs, fish, chicken and fruits to the Indian Army for consumption of its personnel. During the period October, 2014 to March, 2017, the appellant has provided services exclusively to the Indian Army and during the period April, 2017 to June, 2017, they rendered services to the District Health Society, Sonitpur and to Patanjali Ayurveda Limited in addition to rendering the services undertaken to the Indian Army.
- On the basis of the information received from the Income Tax Department, it came to know that the appellant is providing taxable services. Therefore, an enquiry was initiated against the appellant. Further, a show-cause notice dated 30th December, 2020 came to be issued to the appellant for the period October, 2014 to June, 2017.

Arguments by the Appellants

- The appellant submits that during the period October, 2014 to March, 2017, they provided supply/renting of passenger vehicles and load carrier vehicles to the Indian Army. The appellant had also supplied fresh eggs, fish, chicken and fruits to the Indian Army for consumption of its personnel. During the period October, 2014 to March, 2017, on all the payments made by the Indian Army, the Income Tax was deducted, which was reflected in Form 26AS as for supply of fish, chicken etc. to Indian Army, no service tax is payable as it is an activity of trading. With regard to supply/renting of passenger vehicles and load carrier vehicles to the Indian Army, it is his submission that the said service is exempted from payment of service tax

in terms of Notification No. 30/2012-ST dated 20.06.2012 under negative list regime as the appellant has not issued any consignment notes. He submits that the service involved herein is transport agency service. For the period April, 2017 to June, 2017, the appellant contended that the total amount of ₹ 2,75,876/- has been received by the appellant, which is exempted from payment of service tax being less than ₹ 10.00 lakhs threshold limit to demand service tax. Therefore, on that amount, the appellant is not liable to pay service tax.

- It was further submitted that the proceedings were initiated against the appellant in year 2015 itself and for the period October, 2014 to June, 2017, a show-cause notice came to issue on 30th December, 2020,which is barred by limitation as there is no suppression on the part of the appellant. He further submitted that the whole of the demand has been raised against the appellant on the basis of Form 26AS issued by the Income Tax Department, the demand cannot be raised on the basis of Form 26AS as held by this Tribunal in the cases of ***Pijush Sharma vs. Commissioner of CGST & Excise, Patna vide Final Order No. 77332/2023 dated 17th October, 2023*** and ***M/s Lord Krishna Real Infra Private Limited vs. Commissioner of Customs, Central Excise & Service Tax, Noida vide Final Order No. 70126/2019 dated 27.12.2018***, wherein it has been held that the demand raised is not sustainable against the appellant.

Arguments by the Revenue

- As per agreement filed by the appellant in appeal papers, the appellant was engaged in supply of vehicle for use of passengers, which is not exempted service under negative list regime. Therefore, the appellant is liable to pay service tax. As the appellant did not provide the details and did not join the investigation, therefore, the Department has no other alternative to demand the service tax on the appellant on the basis of Form 26AS. As the appellant did not join the investigation, therefore, extended period of limitation is rightly invoked.

Decision by Hon'ble Kolkata CESTAT

- It is evident from the facts of the case that the whole of the demand has been raised against the appellant on the basis of Form 26AS issued by the Income Tax Department. It is also evident from the fact that the appellant has also provided the copies of Balance Sheet, Form 26As, Income Tax Return etc. during the investigation itself. Further, the appellant also joined the adjudication proceedings through virtual hearing, but in the show-cause notice, the demand has been raised based only on the basis of Form 26AS issued to them. Therefore, the issue arises whether the demand can be raised on the basis of Form 26AS supplied by the Income Tax Department or not?
- We hold that merely on the basis of Form 26AS issued by the Income Tax Department, the demand of Service Tax is not sustainable against the appellant.
- The appellant had contested on limitation also. We find that initially, the investigation started against the appellant in April, 2015 when they came to know that the appellant is not paying service tax on taxable services and no efforts were made by the Department to issue the show-cause notice in time or to further investigate

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the matter, no efforts were made by the Department to find out for what purposes these amounts have been paid by the service recipient.

- In that circumstances, we hold that as the investigation is faulty and the show-cause notice has been issued by invoking extended period of limitation, the demand is not sustainable on limitation itself. In view of the aforesaid observations, we set aside the impugned order and allow the appeal with consequential relief, if any.

STATEMENT AS PER PRESS AND REGISTRATION OF BOOKS ACT

Form IV
(*See* Rule 8)

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I, Kishor Vanjara, hereby, declare that the particulars given above are true to the best of my knowledge and belief.

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Kishor Vanjara
Signature of the Publisher

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CORPORATE LAWS

Case Law Update

CS Makarand Joshi

Companies Act – Case 1

In *The Matter of Smile Energy (P.) Ltd. (Struck Off), vs. Registrar of Companies, National Company Law Appellate Tribunal, Principal Bench, New Delhi*, Order dated 3rd March 2023.

Facts of The Case

1. M/s. Smile Energy Private Limited ('SEPL'/'company'/Appellant') made an appeal to the National Company Law Appellate Tribunal against an order passed by the National Company Law Tribunal, Cuttack dt: March 3, 2021, upholding the order of struck off passed by Registrar of Companies, Odisha. The appellant here is acting through its shareholder director. The company was incorporated under the Companies Act, 1956, on April 24, 2007. The company's primary objective was to engage in the generation, production, sale, distribution, and other aspects related to electronic power across various sources, including thermal, hydraulic, atomic, wind, solar, and other energy plants.

2. On February 2, 2009, the Government of Orissa had allocated the 3 MW SHEP Lower Indra project to SEPL. Subsequently, on February 16, 2009, the company entered into a Memorandum of Understanding ('MoU') with the Government of Odisha to establish a Small Hydro Electric Project (3 MW) on River Indra near Village Dargaon in Nuapada District, Odisha.

3. Later, on November 30, 2013, the company had signed a further MoU for an enhanced capacity project of 4 MW in the same area.

4. Thereafter on July 1, 2014, the Office of Chief Engineer cum Chief Electrical Inspector (Generation), Government of Odisha, issued Techno Economic Clearance for the proposed project, with an estimated cost of Rs. 24.00 Crores.

5. The company was instructed to obtain all necessary approvals and clearances within twelve months. Subsequently, the company issued letters to relevant authorities, requesting information, and seeking land allotment for the project.

6. Further on October 8, 2017, SEPL issued a letter to the Chief General Manager of Grid Corporation of Orissa ('GRIDCO'), seeking to enter into a Power Purchase Agreement for the project. Further correspondence was made to identify the nearest substation and requested for allotment of land for project implementation.

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7. The company held its Annual General Meetings for the financial year ending on March 31, 2017, 2018, and 2019. Balance sheets and Director's reports were approved, showing losses for each respective financial year.

8. Further Registrar of Companies Cuttack Odisha who was respondent in the present matter ('ROC/Respondent') had issued a Gazette Notification on October 24, 2019, officially striking off SEPL from the ROC under Section 248(5) of the Companies Act, 2013. This action indicated that the company was no longer recognized as a legal entity.

9. The Appellant discovered this status change by checking the Ministry of Corporate Affairs Portal, where the company's status was listed as 'Strike Off'. Despite this administrative action, the company asserted that it remained a going concern and had consistently met all statutory requirements.

10. Despite being struck off the register, company continued its operations and maintained audited financial statements in compliance with statutory requirements.

11. Notably, the company continued its engagements with the Government of Odisha. The Engineer-in-Chief, Government of Odisha issued letter dated 03.01.2020 to the EIC(P&D), West Resources, Odisha, requesting him to allot 10.3 Acres of land in Badamaheswar Village for the construction of different components of the project. Additionally, the government requested an extension of the company's Bank Guarantee, which was duly extended until August 8, 2023.

12. Displeased with the striking off notice, the company approached the National Company Law Tribunal ('NCLT'/'Tribunal') under Section 252 of the Companies Act, 2013. This section allows for the revival of a struck-off company.

13. The Tribunal heard arguments from both the Registrar and the company and eventually passed an order maintaining the **Struck Off** status of the company. This prompted the company to file an appeal against it. Therefore, the matter was now heard by the National Company Law Appellate Tribunal ('NCLAT').

Contention by the Learned (Ld.) Counsel for the appellant

1. **The company was a going concern and the mere inability to update annual reports by the company cannot mean that the company was not carrying out activities**.

    - It was submitted by the Ld. Counsel for the appellant that the company was a going concern, which had been awarded a MoU by the Government of Odisha. As per the terms of the MoU, the company was to set up a 4 MW Small Hydro Electric Project in Nuapada, Odisha. Though the company had received all the required sanctions, the Government of Odisha was yet to allot the land for the project. Therefore, the company was not a shell company, but a going concern, awaiting the allotment of land from the Government.

- It was further submitted that Section 248(1) of the Companies Act, 2013, enjoins the **ROC to serve notices on all the Directors of the company.** This was not complied with. Further, the counsel cited that NCLAT *had repeatedly held that when notices are not served on the Directors of the company which is sought to be struck off, the striking off must be set aside, held in the case of "**Calcutta Rubber Factory vs. Registrar of Companies, [2019] SCC Online NCLAT 851/[2020] 113 taxmann.com 410/157 SCL 671 (NCL - AT)**".*
- The counsel further submitted that the mere lack of income or lack of profits cannot mean that the company was a shell company. The finding of the NCLT was completely erroneous in this regard, as the company was conducting its business through issuing various letters to the relevant authorities to be able to begin construction and necessary activities on the Hydro Electric Project.
- Counsel for the appellant further submitted that the company and its shareholders were ready and willing to invest crores of rupees in the construction of the dam, which was important for the development of Nuapada District, and for the national development.
- Further the Ld. Counsel for the appellant mentioned that the company would help to produce renewable electricity connected to the national grid in an environmentally friendly manner. Therefore, it was in the interests of society that the company was allowed to function and conduct business.
- Further, the Ld. Counsel brought to the notice of the NCLAT that the **Company herein had not received any notice under section 248(1) of the Act**. Such a notice was mandatory for the company to be struck off from the ROC, therefore, the striking off was bad in law for the failure to follow due process.
- Further, the **company was unable to upload its annual reports with the ROC due to the suspension of the director identification number of its shareholder director between 2016 and 2019**. This was only later investigated by the appellant, and the appellant approached the Hon'ble High Court to defreeze the DIN. Therefore, the inability to update the annual reports could not be said to amount to a reasonable cause to believe that the Company was not carrying out any business.

2. Findings of NCLT were ex facie erroneous

- The Ld. Counsel for the appellant further contended that the NCLT failed to peruse and examine various documents which proved that the company had been conducting business.
- The finding of the NCLT that the company was merely a shell company was ex-facie erroneous,

as the company had been awaiting allotment of land for the construction of the project awarded to it by the Government of Odisha. The company repeatedly renewed Bank Guarantees for the project awarded to it, as had a long-term loan of ₹ 29,96,000/-. Therefore, the company's assets and liabilities were also required to be analyzed by the NCLT, which had not been done before. Therefore, the Ld. counsel believed the order of the NCLT ought to be set aside by this Tribunal.

Contention by the Learned (Ld.) Counsel for the respondent

1. **<u>The company was a going concern and the mere inability to update annual reports by the company cannot mean that the company was not carrying out activities</u>.**

   - The Ld. Counsel for the respondent contented that the company was incorporated on September 29, 2007, but due to failure in filing of its statutory returns for a continuous period of more than two years, the name of the company was considered for striking off by the Respondent in a Suo motu action under the provisions of Section 248(1)(c) of the Act and also in pursuance of the circulars issued by the Ministry of Corporate Affairs, Govt. of India, New Delhi from time to time.

   - The basis of striking off the name of the company was the continuous non-filing of the statutory returns i.e. financial statements and Annual Returns since the financial year ending March 31, 2017 onwards (which was required to be filed under the Act) and it was believed that the company was not carrying on any business or operation for a period of two immediately preceding financial years as the company had not made any application within such period for obtaining the status of a dormant company under section 455, prior to its struck off.

   - It was further submitted by the Ld. Counsel that the respondent issued Notice STK-1 *i.e.* a show cause notice under Section 248(1)(*c*) of the Act, to the Appellant company enquiring whether the said company was carrying on any business or was in operation, but no reply to the said show cause notice was received by the Respondent's office.

   - Subsequently, the Respondent's office published a notice in the *Official Gazette* and Newspaper for the information of the general public regarding striking off the name of the company in Form No. STK-5/5A.

   - The said notice was issued as public notice not only to the company and the directors of the company but also to all stakeholders concerned so as to receive their objections, if any, to the said intention of the Registrar to remove the name of the company from the Register.

- Finally, after the expiry of the time mentioned in the said notice, the name of the company was struck off from the Register maintained by the Respondent and the name of the company was published in Form STK-7 in the *Official Gazette* dated July 22, 2017 and on the publication of such notice in the *official Gazette* the company stood struck off on and from October 24, 2019. Further, the instant appeal was liable to be dismissed with costs because the appellant had not been able to prove that the appellant company was a going concern and was having any business operations at the relevant time.

2. Findings of NCLT were ex-facie erroneous

No arguments are presented by the respondent with regard to the titled subject.

Judgement passed by NCLAT

1. After hearing the parties, NCLAT passed the order in the favour of the appellant citing following reasons:
   - The company had repeatedly renewed Bank Guarantees for the project awarded to it by the Government of Odisha, as it had a long-term loan of ₹ 29,96,000/- which showed that the appellant company was having substantial movable as well as immovable assets.
   - Therefore, it could not be said that the Appellant Company was not carrying on any business or operations.
   - Hence NCLAT struck off orders passed by NCLT Cuttack bench and ROC, Odisha.
2. Further, NCLAT passed the following orders:
   - The name of the Company be restored to the Register of Companies subject to the following compliances:
     (i) Appellant to pay costs of ₹ 3,00,000/- (Rupees Three Lakhs) to the Registrar of Companies, Odisha within eight (8) weeks from the passing of this Judgment.
     (ii) After restoration of the Company's name in the Register maintained by the Registrar of Companies, the Company shall file all their Annual Returns and Balance Sheets. The Company shall also pay requisite charges/fee as well as late fee/charges as applicable.
     (iii) In spite of present orders, the Registrar of Companies will be free to take any other steps punitive or otherwise under the Companies Act, 2013 for non-filing/late filing of statutory returns/documents against the Company and Directors.

SEBI – Case 1

Securities and Exchange Board of India's Order in The Matter of Alexander Stamps And Coin Ltd. (Formerly Rudraksh Cap Tech Limited)

Facts of The Order

1. Securities and Exchange Board of India ('SEBI') had conducted an investigation in the trading activities of certain entities in the scrip of Alexander Stamps and Coins Ltd ('ASCL'/'company').

2. The investigation period was divided into two slots as: period of March 18, 2016 to October 14, 2016 as period I (IP1) and period of May 24, 2017 to July 17, 2017 as period II (IP2).

3. During the investigation, SEBI observed that Mr. Anirudh Sethi, Director, and a designated person of ASCL ('**Noticee**') had executed contra trades during IP2.

4. Further SEBI highlighted that in terms of *Clause 10 of 'Minimum Standards for Code of Conduct to Regulate, Monitor and Report Trading by Insiders' (as applicable at the relevant time) specified under Schedule B of Prohibition of Insider Trading ('PIT Regulations')*, a designated person who was permitted to trade shall not execute a contra trade within a minimum period of six months.

5. At first, SEBI vide letter dated May 10, 2022 informed ASCL about contra trades executed by the Noticee during the period of December 06, 2016, to June 20, 2017, and the profits made to the tune of ₹ 1,18,14,031.39. Further details of contra trades executed by Noticee along with calculation of profit of ₹ 1,18,14,031.39 was also provided by SEBI to ASCL.

6. ASCL was also advised to disgorge the said profit earned by the Noticee and remit the said amount to SEBI IPEF in terms of section 11(5) of the SEBI Act within a period of 30 days from the date of receipt of the letter.

7. Thereafter ASCL vide letter dated June 2, 2022 informed SEBI that it had advised Noticee to do the needful however in response Noticee provided ASCL with a copy of Noticee's letter to SEBI dated June 2, 2022 stating that he had also made losses by executing contra trades during a certain period and made profits by executing contra trades during another period and has therefore made net loss. Noticee also urged SEBI to view contra trades holistically and to drop instant proceedings.

8. Thereafter SEBI *vide* letter dated July 26, 2022 to ASCL once again explained details of contra trades executed by Noticee and asked ASCL to remit a profit of ₹ 1,18,14,031.39 to SEBI IPEF.

9. Thereafter Noticee *vide* letter dated August 20, 2022 responded to SEBI and stated that trading data relied upon by SEBI was incorrect. Noticee further provided his analysis of trading data to SEBI that lead to a loss of ₹ 14,28,011.81 on the execution of contra trades and requested SEBI to withdraw a letter dated August 12, 2022.

10. SEBI then perused the letter and trading data provided by the Noticee and it was observed that methodology of calculation of loss by the Noticee

was incorrect (as the loss calculated by the Noticee was by reducing the total purchase cost from the total sales price for the entire period and not individually from each contra trade) and that the Noticee had made a profit of ₹ 1,18,14,031.39 from the contra trades.

11. SEBI further alleged that Noticee had executed repeated and continuous contra trades over the period of 6 months, and it was not an isolated event. Hence SEBI was of the view that arguments provided by the Noticee against disgorgement of the profits did not stand.

12. In the light of above, Noticee was sent a show cause notice ('SCN') alleging violation of relevant regulation.

Charges Levied

1. Noticee was alleged to have violated clause 10 of the Code of Conduct as specified under Schedule B read with Regulation 9(1) of the PIT Regulations.

Contention by the Noticee

1. **Methodology of calculation of profits earned by Noticee via contra trade executed during IP2**

   - Noticee had admitted being a designated person under the provisions of the PIT Regulations and at no stage had he denied that he had indulged in contra trades or objected to the veracity of the trades.
   - However, Noticee contended strongly on the point that not only gross profits but losses as well should be considered for determining the disgorgement amount.
   - Further Noticee also in his contention cited the Hon'ble Securities Appellate Tribunal ('SAT') order, *National Stock Exchange & Ors vs. SEBI in which it was held that 'It is not necessary that in each and every case there should be a direction to disgorge profits merely because the provisions of the Act or Regulations have been violated. Disgorgement should be ordered only where persons have made gains or averted loss/losses as a result of their illegal/unethical acts".*
   - Further Noticee had stated that the FIFO method adopted by SEBI for calculating profit in this matter was erroneous while suggesting alternate methods like netting the profits from contra trades, weighted average method, and offsetting the losses from IP1 with gains from IP2. The Noticee had also submitted a calculation by an independent expert auditor indicating a loss of ₹ 5,75,823.

2. **Splitting of Investigation period into two parts**

   - Noticee contended that SCN had arbitrarily split the period of alleged contra trades into two periods and considered only the profits for determining the disgorgement amount.

Submissions by the SEBI

1. **Methodology of calculation of profits earned by Noticee via contra trade executed during IP2**

   - SEBI submitted that in the context of PIT Regulations, contra trades

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are those trades or transactions which involve buying or selling the shares of the company and then, within the time specified, trading or transacting in an opposite transaction involving selling or buying of the shares purchased or sold.

- SEBI further highlighted the objective of PIT Regulations which was to prohibit 'contra trades' per se so that the designated persons based on their functional role or by having access to UPSI do not make a profit from taking such contra positions.
- Further SEBI explained that usage of the words "*Should a contra trade be executed, inadvertently or otherwise, in violation of such a restriction...*" in clause 10, clearly indicated that the regulations envisage that a designated person, even though permitted to trade, must not take a contra position to his earlier trades within a period of 6 months.
- SEBI further mentioned that the regulations discourage the very act of trading by the designated persons exhibiting contra positions. This was the reason why only profits on a gross basis were considered and netting after considering the losses, if any, were disregarded for computation of the disgorgement amount.
- SEBI further mentioned that if the Noticee's argument for allowing netting was accepted, the same would go against the very fundamental principle of the PIT regulations which was – designated persons should minimize their trading in the scrip of the company and such trading, if any, by them should only be carried out in a regulated manner in accordance with the provisions of the regulations.
- SEBI was of the view that any alternate interpretation of the provision which entails netting or favourable treatment to the violators would be grossly against the intent of the regulations and therefore when determining contra trades executed over a period, what was required to be disgorged was not the net profit but the gross profit.
- Further SEBI submitted that each contra trade needs to be dealt with independently for computation of profit and therefore the question of netting the profit did not arise.
- Further, SEBI brought to the attention that clearly the code of conduct seeks to impose a restriction on even a single trade as opposed to usage of the language like contra trading, which had a pluralist connotation.
- Thus, each and every contra trade needs to be dealt with independently and profit made through each trade needs to be disgorged for credit to the IPEF.
- Further SEBI was of the view that the FIFO methodology ensured the independence of contra trades which captures the intent of the

provision. For this same reason, in respect of contra trade, FIFO was more suited for the calculation of unlawful gains in comparison to the average cost method.

- The FIFO method of calculating profit ensured that the opposite position taken by the Noticee for the first buy/sell trade, was squared off with the first buy/sell trade that was executed within six months.
- SEBI also highlighted that in relation to the non-applicability of the average cost method to contra trade(s), it needs to be emphasized that violations like price manipulation, pump and dump, insider trading, etc., which are more of event based violations (to which average cost method was more suited), were different from contra trade which was a time/duration based violation focusing on individual trade to which FIFO method was more suited. In cases where the shares bought and sold were not similar, FIFO method was best suited to identify the contra trades first and then derive the profits. Average cost method would be not suited in this scenario as it would only consolidate the shares bought and sold without identifying the contra trades first.
- Hence contra trade resulting into losses have not been considered and only the contra trades resulting into profits have been aggregated.
- Therefore, the contention of the Noticee could not be accepted by SEBI.

2. Splitting of Investigation period into two parts

- SEBI took note that an investigation in the scrip of ASCL was conducted for two investigation periods i.e. from March 18, 2016, to October 14, 2016 (IP1) and May 24, 2017, to July 17, 2017 (IP2).
- Based on BSE's report dated January 31, 2017, SEBI had initiated an investigation for the period stated in IP1 for the alleged price manipulation in the scrip of ASCL. While the investigation based on the first BSE Report was undergoing, SEBI had received another BSE Report dated March 20, 2018 (i.e. after 14 months from the initiation of the first investigation), whereas BSE had forwarded another letter pointing out to various disclosure violations for the period mentioned in IP2. While the investigation was being done for both the periods, it was noted that the Noticee had also executed contra trades for both the IPs.
- SEBI further mentioned that both the investigation periods are independent and based on two independent and different references received from BSE for different set of violations. The two investigation periods could have resulted in 2 separate investigations, and for the reason that both the references from BSE related to one person and one company, a common investigation report was prepared.

- In view of the above SEBI submitted that no arbitrary splitting of the investigation period had been done in the present case.
- Further, SEBI submitted that during, IP1, the Noticee had executed 56 contra trades and only made a loss of ₹ 2,16,47,323.77. Thus, no netting was done for IP1 as there was no profit made by the Noticee during IP1. Pursuant to this only a warning letter was issued to Noticee for contra trade violations during IP1.
- However, during the IP2, since the Noticee had made profits, various letters were issued to the ASCL/ Noticee to disgorge the profits made by the Noticee in accordance with the code of conduct and only on the failure of the Noticee to disgorge the profits, enforcement proceedings resulting into the issuance of the SCN was initiated against the Noticee.
- Further SEBI highlighted FAQ No. 43 from Comprehensive FAQs on PIT Regulations, 2015 dated March 31, 2023, with regards to Noticee's argument on splitting up of investigation period,
- FAQ reads as follows:

  43. Question Does contra trade restrictions apply on Share wise or Date wise.

  Example: A Designated Person purchased 100 Shares on November 1, 2020 and then again 100 Shares on December 1, 2020. Whether the person can sell the 100 Shares acquired in November 2020 in May 2021? Or it will be treated as contra trade?

  Answer Contra trade restrictions are applicable on date wise. Since shares are last bought on December 01, 2020, the person cannot trade for a period of 6 months from December 01, 2020.

- Hence SEBI made it clear that contra trade restrictions are applicable date wise as Noticee had continuously indulged in contra trades during IP1, IP2 along with an intervening period between two IPs.
- SEBI further mentioned that even considering the investigation period as one (without there being any gap between IP 1 and IP 2), as argued by the Noticee, the profit (calculated by applying the FIFO methodology without netting) was coming out to be ₹ 4,02,29,542.15, which was more than the amount mentioned in the SCN. However as a quasi-judicial authority, in the interest of natural justice, SEBI deemed it appropriate not to go beyond the ambit of SCN and accordingly, maintained the scope of these proceedings to the amount of ₹ 1,18,14,031.39, which was mentioned in the SCN.

Penalty

Shri Anirudh Sethi ('Noticee') to disgorge the amount of ₹ 1,18,14,031.39, which had been earned by him as profit from the contra trades as brought out in this Order.

Cases quoted by SEBI

Kiran Madhusadhan Seth vs. SEBI; Karvy Stock Broking Ltd. vs. SEBI and National Stock Exchange & Ors vs. SEBI

Cases quoted by Noticee

Snehlata R Tiwari v.s SEBI, Shripal Shares and Securities P. Ltd. vs. SEBI, DLF Limited vs. SEBI and NDTV Limited vs. SEBI

IBC – Case 1

In the matter of *Mr. Vishram Narayan Panchpor - Resolution Professional - Appellant vs. Committee of Creditors - Respondents at National Company Law Appellate Tribunal dated 11 January 2024*

Facts of the case

- M/s. Blue Frog Media Private Limited - the Corporate Debtor (CD) filed an application u/s 10 of the Insolvency and Bankruptcy Code, 2016 (IBC/Code) initiating its own Corporate Insolvency Resolution Process (CIRP) which was admitted by the National Company Law Tribunal (NCLT) on 19 May 2021.

- The Applicant was appointed as the Resolution Profession (RP) and invited the Expression of Interest (EoI) and received 3 EOI's. Out of which - 2 parties qualified the revised eligibility criteria and 1 was rejected as it did not met the eligibility criteria.

- A resolution plan was submitted by Mr. Mahesh Mathai, Ex-Director of the CD who resigned the company on 1 March 2018.

- The Committee of Creditors (CoC) on 8 November 2021 by 91.86% voting approved the resolution plan submitted by Mr. Mahesh Mathai - Successful Resolution Applicant (SRA) after some modifications in the resolution plan.

- RP filed an application with the NCLT under Section 30(6) IBC seeking approval of the resolution plan. However, the same was rejected by the NCLT as the SRA was not eligible u/s 29A of the IBC.

- Aggrieved by the order of NCLT - an appeal was filed by the RP at the National Company Law Tribunal (NCLAT)

Arguments of the Appellant

- It was claimed that NCLT committed an error in holding SRA as ineligible whereas promoters/ex-management were not ineligible to submit a resolution plan unless they are ineligible under any of the clauses as provided in section 29A of IBC.

- The SRA was not covered by any of the clauses under which ineligibility was attached to promoter/ex-management. Section 29A does not ipso facto render all promoters and directors ineligible. Ineligibility is attached if they are ineligible under any of the clauses specified in Section 29A.

- NCLT had referred to section 29A(c) which was not attracted. Reliance was placed on the judgment of the Hon'ble Supreme Court in ***Hari Babu Thota vs. Shree Aashraya Infra-Con Ltd*** – wherein it was submitted that the NCLT has misinterpreted Section 29A in holding that SRA was ineligible whereas none of the conditions under Section 29A were attracted and Section 29A per se does not make directors/promoters ineligible.

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- It was submitted that none of the Banks, nationalised or commercial banks were creditors of the CD, hence, there was no question of applicability of Section 29A(c).

Held

- A plain reading of Section 29A of IBC indicates that a person shall not be eligible to submit a plan if such person, or any other person acting jointly or in concert with such person is covered by any of the clauses mentioned from (a) to (g).
- Section 29A(c) is attracted when at the time of submission of the plan, the person has an account or an account of a CD under the management or control of such person or of whom such person was a promoter, was classified as Non-Performing Assets (NPAs).
- In this case as per the submission of the appellant, no bank is a creditor of the CD.
- Neither the case suggests nor is there any material indicating that the account of SRA or the CD is categorized as NPA as of the date of submission of the Resolution Plan. Therefore, there is no question regarding the applicability of Section 29A(c) of the IBC.
- Also, it is to be noted that in this case neither it was pleaded or alleged that any of the clauses (a) to (g) are attracted with respect to SRA.
- The Hon'ble Supreme Court had occasion to consider Section 29A of IBC in reference to promoters of the CD in *Hari Babu Thota*(supra). *In the said case, a plan proposed by the promoter was approved by the CoC and the application was filed by the resolution professional for approval of the plan which was dismissed on the ground that the promoters could not have presented the plan. In final appeal, the Hon'ble Supreme Court in the above case held that there was no per se disqualification u/s 29A. In the above case, MSME certificate was issued after commencement of the CIRP, hence, Section 240A was not relied by the NCLT.*
- The present case does not involve the invocation of any clauses of Section 29A to establish the ineligibility of SRA. Ineligibility is being asserted solely on the basis that SRA was a promoter of the CD until 2018 when he resigned. The interpretation adopted by NCLT was not in line with the true and correct understanding of Section 29A. Section 29A does not automatically render promoters and director's ineligible to submit a plan unless they fall under clauses (a) to (g). In the current scenario, none of the clauses (a) to (g) apply to SRA. ***Therefore, the mere fact that SRA was a promoter and director does not inherently disqualify him from submitting a Resolution Plan.***
- It was held that NCLT committed an error in holding that the SRA was ineligible to submit a Resolution Plan.
- The rejection of the Resolution Plan vide order IA No. 2828 of 2021 which was approved by CoC on 8 November 2021 is unsustainable. NCLT should endeavour to dispose of the application at an early date. The Appeal was disposed of accordingly.

OTHER LAWS
FEMA – Update and Analysis

CA Hardik Mehta CA Tanvi Vora

In this article, we have discussed recent amendments made in FEMA through Notifications, Circulars and Press Notes & Press Releases.

A. Update to FDI Policy

1. Amendments in the Foreign Direct Investment (FDI) policy on Space Sector

Recently the Indian Space Policy 2023 ('ISP') was notified as an overarching, composite and dynamic framework to implement the vision for unlocking India's potential in Space sector through enhanced private participation. As announced in the ISP 2023, the policy aims to:

- augment space capabilities;
- develop a flourishing commercial presence in space;
- use space as a driver of technology development and derived benefits in allied areas;
- pursue international relations and create an ecosystem for effective implementation of space applications among all stakeholders.

As per the existing FDI policy, FDI is permitted in establishment and operation of Satellites through Government approval route only.

Now, in line with the vision and strategy under the Indian Space Policy 2023, the Union Cabinet has eased the FDI policy on Space sector by prescribing liberalized FDI thresholds for various sub-sectors/activities.

The satellites sub-sector has been divided into three different activities with defined limits for foreign investment in each such sector.

Under the amended FDI policy, 100% FDI is allowed in space sector. The liberalized entry routes under the amended policy are aimed to attract potential investors to invest in Indian companies in space.

The entry route for the various activities under the amended policy are as follows:

- **Upto 74% under Automatic route**: Satellites-Manufacturing & Operation, Satellite Data Products and Ground Segment & User Segment. Beyond 74% these activities are under government route.
- **Upto 49% under Automatic route**: Launch Vehicles and associated systems or subsystems, Creation of Spaceports for launching and receiving Spacecraft. Beyond 49% these activities are under government route.

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- **Upto 100% under Automatic route**: Manufacturing of components and systems/ sub-systems for satellites, ground segment and user segment.

This increased private sector participation would help to generate employment, enable modern technology absorption and make the sector self-reliant. It is expected to integrate Indian companies into global value chains. With this, companies will be able to set up their manufacturing facilities within the country duly encouraging 'Make In India (MII)' and 'Atmanirbhar Bharat' initiatives of the Government.

(Press Information Bureau Ministry of Commerce & Industry (Release ID: 2007876) dated 21st February 2024)

Comments:

It has been informed that Department of Space consulted with internal stakeholders like Indian National Space Promotion and Authorisation Centre ('IN-SPACe'), Indian Space Research Organisation (ISRO) and NewSpace India Limited (NSIL) as well as several industrial stakeholders. NGEs have developed capabilities and expertise in the areas of satellites and launch vehicles. With increased investment, they would be able to achieve sophistication of products, global scale of operations and enhanced share of global space economy.

The proposed reforms seek to liberalize the FDI policy provisions in space sector by prescribing liberalized entry route and providing clarity for FDI in Satellites, Launch Vehicles and associated systems or subsystems, Creation of Spaceports for launching and receiving Spacecraft and manufacturing of space related components and systems.

The proposed amendment to the FDI policy in the space sector represents a significant milestone in India's journey towards space exploration and innovation. By liberalizing entry routes and providing clarity for FDI, the government aims to foster a conducive environment for investment, technology development, and job creation. The reforms are not only expected to bolster the domestic space industry but also position India as a key player in the global space arena and Indian companies are poised to seize new opportunities, driving the country's growth and leadership in the space sector.

Currently valued at $8 billion with a 2% share in the global space economy, India's space market could reach $40 billion by 2040 and claim a $100 billion share of the addressable opportunity in the global space economy. There is no doubt that the amendment is welcome and will boost the Indian economy further.

It should be noted that the amendment is currently approved by the Cabinet and is explained above as per the Press Release of the Central Government on Press Information Bureau. It would become effective only after notification in the Official Gazatte and would also be issued by the Department for Promotion of Industry and Internal Trade ('DPIIT') amending the FDI Policy. Accordingly, the fine print is awaited.

Best of The Rest

Rahul Hakani
Advocate

Niyati Mankad
Advocate

VENKATARAMAN KRISHNAMURTHY AND ANOTHER VS. LODHA CROWN BUILDMART PVT. LTD., ORDER DATED 22/02/2024 PASSED IN CIVIL APPEAL NO. 971 OF 2023 [SUPREME COURT]

Consumer Protection Act - it was not open to the NCDRC to apply its own standards and conclude that, though there was delay in handing over possession of the apartment, such delay was not unreasonable enough to warrant cancellation of the Agreement - It was not for the NCDRC to rewrite the terms and conditions of the contract between the parties and apply its own subjective criteria to determine the course of action to be adopted by either of them.

Facts

The case originated from a dispute between the appellants, Venkataraman Krishnamurthy and another, and the respondent, Lodha Crown Buildmart Pvt. Ltd., regarding the purchase of an apartment. The dispute arose when the respondent failed to deliver possession of the apartment within the agreed-upon time frame as per the terms of the agreement between the parties. Initially, the appellants entered into a written agreement with the respondent for the purchase of the apartment, which included specific terms and conditions regarding the delivery of possession. However, despite the contractual obligations, the respondent did not hand over possession within the stipulated period, leading to dissatisfaction and frustration on the part of the appellants. Subsequently, the appellants sought legal recourse to address the breach of contract by the respondent. They approached the National Consumer Disputes Redressal Commission (NCDRC) seeking relief for the non-performance of the contractual obligations by the respondent. The NCDRC, in its ruling, opined that the delay in possession was not unreasonable and dismissed the appellants' claim for cancellation of the agreement. The NCDRC though acknowledged a delay in possession but deemed it reasonable and allowed for the deduction of earnest money if the appellants sought a refund. It directed the respondent-company to provide physical possession of the apartment as per the agreement. Dissatisfied with the NCDRC's decision, the appellants appealed to the Supreme Court of India.

Issue Involved

Whether the NCDRC was right in holding that the appellants' termination of the agreement was not justified even though it acknowledged delay in handing over possession amounting to breach of the contract.

Held

The Supreme Court held that the appellants were within their rights to terminate the agreement due to the respondent's failure to

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deliver possession within the agreed-upon time frame. The NCDRC's decision to disregard the contractual terms was deemed improper. The court directed the respondent to refund the deposited amount to the appellants with interest as per the contract terms. The appeal was allowed, and each party was directed to bear their own costs. While deciding the case, the court held that the order of the Apex Court in the case of Ireo Grace Realtech Pvt. Ltd. v. Abhishek Khanna is not applicable to the present case as the facts are distinguishable.

HIGH COURT BAR ASSOCIATION, ALLAHABAD VS. STATE OF U.P. & ORS. – ORDER DT 29/02/2024 PASSED IN CRIMINAL APPEAL NO.3589 OF 2023 [SUPREME COURT]

Article 142 of Constitution of India - No automatic vacation of stay after 6 months - Asian Resurfacing of Road Agency Private Limited & Anr. V. Central Bureau of Investigation - Reversed

Facts

The case involves a reconsideration of the decision in ***Asian Resurfacing of Road Agency Private Limited & Anr. vs. Central Bureau of Investigation*** by a larger bench of the court. In Asian Resurfacing, it was decided that a High Court has jurisdiction to consider challenges to orders of framing charges under the Prevention of Corruption Act and to grant stays of trial proceedings. The court emphasized the need for expeditious disposal of trials, particularly in corruption cases, and outlined criteria for granting stays. However, subsequent developments raised questions about the automatic vacation of stays after six months and the imposition of day-to-day trial proceedings. The court now seeks to clarify whether it can order automatic vacation of interim orders of stays issued by High Courts and whether it can direct High Courts to decide pending cases with stay orders on a day-to-day basis within a fixed period under Article 142 of the Indian Constitution.

Issue Involved

(a) Whether this Court, in the exercise of its jurisdiction under Article 142 of the Constitution of India, can order automatic vacation of all interim orders of the High Courts of staying proceedings of Civil and Criminal cases on the expiry of a certain period?

(b) Whether this Court, in the exercise of its jurisdiction under Article 142 of the Constitution of India, can direct the High Courts to decide pending cases in which interim orders of stay of proceedings has been granted on a day-to-day basis and within a fixed period?

Held

The Apex Court after considering various legal provisions and submissions, summarized the main conclusions as follows in Para 37 and 38 of the judgment:

"37. Subject to what we have held earlier, we summarise our main conclusions as follows:

a. A direction that all the interim orders of stay of proceedings passed by every High Court automatically expire only by reason of lapse of time cannot be issued in the exercise of the jurisdiction of this Court under Article 142 of the Constitution of India;

b. Important parameters for the exercise of the jurisdiction under Article 142 of the Constitution of India which are relevant for deciding the reference are as follows:

(i) The jurisdiction can be exercised to do complete justice

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between the parties before the Court. It cannot be exercised to nullify the benefits derived by a large number of litigants based on judicial orders validly passed in their favour who are not parties to the proceedings before this Court;

(ii) Article 142 does not empower this Court to ignore the substantive rights of the litigants;

(iii) While exercising the jurisdiction under Article 142 of the Constitution of India, this Court can always issue procedural directions to the Courts for streamlining procedural aspects and ironing out the creases in the procedural laws to ensure expeditious and timely disposal of cases. However, while doing so, this Court cannot affect the substantive rights of those litigants who are not parties to the case before it. The right to be heard before an adverse order is passed is not a matter of procedure but a substantive right; and

(iv) The power of this Court under Article 142 cannot be exercised to defeat the principles of natural justice, which are an integral part of our jurisprudence.

c. Constitutional Courts, in the ordinary course, should refrain from fixing a time-bound schedule for the disposal of cases pending before any other Courts. Constitutional Courts may issue directions for the time-bound disposal of cases only in exceptional circumstances. The issue of prioritising the disposal of cases should be best left to the decision of the concerned Courts where the cases are pending; and

d. While dealing with the prayers for the grant of interim relief, the High Courts should take into consideration the guidelines incorporated in paragraphs 34 and 35 above.

38. We clarify that in the cases in which trials have been concluded as a result of the automatic vacation of stay based only on the decision in the case of Asian Resurfacing1, the orders of automatic vacation of stay shall remain valid."

CHANDERPATI V. SONI REALTORS PVT. LTD. – ORDER DT 01/03/2024 PASSED IN COMPANY APPEAL (AT) (INSOLVENCY) NO. 691 OF 2023 & I.A. NO.2302, 2303 OF 2023 AND ORS. [NCLAT, NEW DELHI]

Section 61 of the Insolvency and Bankruptcy Code, 2016 – r.w. Rules 22 and 31 of the Part III 'Institution of appeals-procedure' of the NCLAT Rules, 2016 - - the period of limitation for filing appeals is reckoned from the date of pronouncement of the order - Annexing a certified copy of the impugned order with the appeal memorandum is mandatory - - The tribunal may exempt parties from procedural requirements in the interest of substantial justice, but automatic exemption is not granted - Litigants must file appeals within 30 days, extendable up to 15 days with sufficient cause - Limitation ceases from the date of e-filing - To benefit from Section 12(2) of the Limitation Act, 1963, a certified copy must be applied for during the appeal filing period.

Facts

Soni Realtors Pvt. Ltd. was developing a residential township called 'Palm City' in Karnal, Haryana, which included 377 plots, a

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nursing home, nursery school, and commercial land. SE Investment Limited, now known as Paisalo Digital Ltd., filed for insolvency against Soni Realtors. The resolution plan submitted by Srijan Infra LLP was approved by the Adjudicating Authority, leading to various appeals being filed before the Tribunal. The main issue in these appeals revolved around the timing of the appeals and the requirement of filing a certified copy of the impugned order within the prescribed time limit. Contentions from both sides cited relevant case law and procedural rules regarding the timeliness and requirements for filing appeals. Counsel appearing on behalf of the RP has raised an objection regarding the maintainability of these appeals, inter alia, on the ground that since the impugned order was passed on 10.06.2022 and the period of 30 days prescribed for filing the appeal had expired on 10.07.2022 and a further period of 15 days had also expired on 25.07.2022 but these appeals have been filed without annexing the certified copy of the impugned order and the certified copies of the impugned order were applied much after the expiry of period of 45 days, therefore, these appeals are not maintainable and deserves to be dismissed.

Issue Involved

Whether the appeals were filed within the prescribed time limit and whether it is mandatory to attach the certified copy of the impugned order?

Held

The Tribunal after considering the various relevant provisions and case laws particularly, the cases of ***V. Nagarajan vs. SKS Ispat and Power Limited & Ors. [(2022) 2 SCC 244], Sanket Kumar Agarwal & Anr. vs. APG Logistics [2023 SCC Online SC 976], Jindal Power Limited. vs. Dushyan C. Dave, Liquidator of Shirpur Power Pvt. Ltd. & Ors. [Company Appeal (AT) (Ins) No. 11 of 2023] and Gaurav Agarwal vs. CA Devang P. Sampat, Liquidator of MAA Mahamaya Steels Pvt. Ltd. [Company Appeal (AT) (Ins) No. 916 of 2022].*** The Tribunal held that:

- the period of limitation for filing appeals is reckoned from the date of pronouncement of the order.
- Annexing a certified copy of the impugned order with the appeal memorandum is mandatory.
- The Tribunal may exempt parties from procedural requirements in the interest of substantial justice, but automatic exemption is not granted.
- Litigants must file appeals within 30 days, extendable up to 15 days with sufficient cause.
- Limitation ceases from the date of e-filing.
- To benefit from Section 12(2) of the Limitation Act, 1963, a certified copy must be applied for during the appeal filing period.
- The issue of limitation expiring if a certified copy is not applied for within 30 days has not been challenged in previous judgments.
- The court emphasized on the importance of procedural law as subservient to substantive law in enforcing rights and liabilities.

On the basis of the above, the Tribunal decided various applications and appeals before it. The Applications for exemption from filing certified copies and condonation of delay were considered. The Tribunal dismissed the Appeals that were filed without seeking exemption from filing certified copies. Further, the Tribunal held that the Applications for condonation of delay to be considered individually.

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THE CHAMBER NEWS

CA Neha Gada
Hon. Jt. Secretary

CA Vitang Shah
Hon. Jt. Secretary

Important events and happenings that took place online/ physical between **February 1, 2024 to February 29, 2023** are being reported as under:

I. ADMISSION OF NEW MEMBERS

The details of new members who were admitted in the Managing Council Meeting held on February 22, 2024 are as under:

Type of Membership	No. of Members
Life Member	04
Half Yearly Ordinary Member	02
Total	**06**

II. PAST PROGRAMMES

Sr. No.	*Date*	*Topics*	*Speakers*
ACCOUNTING & AUDITING			
1.	28.02.2024	Internal Audit Series, Part 2 - Auditing in ERP Environment	CA Vineet Jajodia Mr. Rajarshi Mandal
COMMERCIAL & ALLIED LAWS			
1.	The Commercial & Allied Laws Committee organised webinar on "Tax, Accounting and Secretarial implications arising post-acquisition under IBC". The session-wise detail of the webinar is as under:		
a.	02.02.2024	Broad overview of IBC Provisions including process and time-lines from the perspective of a resolution applicant (bidder) etc. • Drafting of plan	CA Pulkit Gupta

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Sr. No.	*Date*	*Topics*	*Speakers*
		• Flexibility in seeking reliefs in the resolution plan. • Key does and don'ts from tax and regulatory perspective • Key areas of concerns/litigation in the context of tax and regulatory laws • Grounds of which Form G can be challenged and who can challenge • Can RP be removed by NCLT and who can approach? • Grounds on which NCLT order approving plan can be challenged? Who can challenge? Implications on resolution applicant?	
b.	02.02.2024	Direct tax implications post-acquisition. • Carry forward and set off of loss, depreciation and MAT credit • Implication of assignment/ extinguishment of liabilities – loan, creditors, etc • Impact of corporate restructuring merger, demerger, capital reduction, etc. • Pending Proceedings, demands, refunds and rectification for prior year's. Initiation of new proceedings for prior year's • Effect of appeal pending before NCLAT	CA Gautam Doshi
c.	03.02.2024	Companies Act and Secretarial Compliances post-acquisition including, issues in relation to past non-compliance, accessing the online portal, change of directors, change of auditor, giving effect to merger/demerger, change in shareholding pattern, capital, issuance of fresh shares reduction, timelines involved etc.	CS Mamta Binani

Sr. No.	*Date*	*Topics*	*Speakers*
d.	03.02.2024	Accounting of acquisition • Treatment of recording of assets and liabilities • Treatment of reserves and surplus • Impact of treatment being prescribed in the resolution plan, • Accounting of business combination proposed in the resolution plan • Accounting for write off or extinguishment of liabilities, capital reduction, etc. • Effect of appeal pending before NCLAT	CA Himanshu Kishnadwala
e.		Indirect tax implications post-acquisition • Proceedings and demands for prior years • Registration issues • Issues Relating To Itc Credit etc. • Issues in relation to non-filing for past period • Online issues – including enabling filing of return, new place of business • Issues in relation to past proceedings and tax liability • Ability to file returns for past period – interest, penalty, fee, etc. • Effect of appeal pending before NCLAT	Harsh Shah, Advocate
2.	21.02.2024	Navigating the Legal Landscape – Recent Amendments under Companies Act, 2013 and LLPs and Adjudication under Companies Act 2013	CS Amita Desai

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Sr. No.	*Date*	*Topics*	*Speakers*
DIRECT TAXES			
1.	The Direct Taxes Committee oragnised "Workshop on GST Law" (*Jointly with GSTPAM, AIFTP (WZ), BCAS, CTC MCTC & WIRC of ICAI*) for the year 2023-24. The session-wise detail of the program is as under:		
a	06.02.2024	Provisions Related to Summons, Inspections, Search, Seizure, Bail, Prosecution	Nikita Badheka, Advocate
b.	09.02.2024	Important Circulars & Clarifications	CA (Dr.) Shailendra Saxena
c.		Issues in Intermediary Services	CA Pauloma Dalal
d.	13.02.2024	Departmental Audit, Assessment, Recovery	CA Pritam Mahure
e.	16.02.2024	Issues related to JDA, Redevelopment, Builders & Developers	CA Jayesh Gogri
f.	21.02.2024	Issues related to Liquidated Damages, Actionable Claims, Lottery, Gaming, etc	Ishaan Patkar, Advocate
g.	23.02.2024	Provisions related to Appeals, Interest & Penalty	CA Rajiv Luthia
h.	27.02.2024	Mega Brain Trust Session	CA Deepak Thakkar CA Ashit Shah Dinesh Tambde, Advocate Deepak Bapat, Advocate
2.	20.02.2024	Recent Important Decisions Under Direct Tax	Ravi Sawana, Advocate
3.	26.02.2024	Analysis of Recent Apex Court and other Important Decisions	Ajay Singh, Advocate
INDIRECT TAXES			
1.	29.02.2024	Issues in Reverse Charge Mechanism	*Group Leader:* CA Vasudev Mehta *Chairman:* CA Vinod Awtani
INTERNATIONAL TAXATION			
1.	15.02.2024	2024: Welcomes, transfer pricing in UAE	CA Umang Someshwar
2.	16.02.2024	Beneficial Ownership - Concept & Recent Trends with Indian & Foreign Case Laws | Case Studies	CA Anish Thacker

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Sr. No.	Date	Topics	Speakers
3.	21.02.2024	Overview of taxation in Singapore covering Tax residency, corporate taxation, FTC, Tax pooling mechanism, TP provisions, section 10L overview	Mr. Mukesh Kumar M Ms. Ankita Lath
IT CONNECT			
1.	08.02.2024	AI in CA and Legal Practice: Exploring ChatGPT and Other Tools	CA Mitesh Katira Paras S. Savla, Advocate
MEMBERSHIP & PR COMMITTEE			
1.	02.02.2024	Lecture Meeting on Impact of Union Budget (Vote on Account) on Capital Market *(Jointly with Matunga Gymkhana, Matunga CPE Study circle of WIRC, Investors' Grievances Forum, Forum of Free Enterprise & Interact Foundation*)	Mr. Mehraboon Irani CA Kanu Doshi
RESIDENTIAL & REFRESHER COURSE			
1.	The Residential & Refresher Course Committee organised "47th Residential Refresher Course on Direct Taxes" at Taj Hotel & Convention Centre, Agra. The session-wise detail of the programme is as under:		
a.	29.02.2024 to 03.03.2024	Paper for Discussion: • From Expense to Deduction A Comprehensive understanding of Business Deductions (Covering Business Loss, Revenue and Capital Expenditure, Accrual of Expenditure, Interest, Depreciation, Proviso to Section 37, Section 43B, ICDS provisions, etc.)	CA Ravikant Kamath
b.		Paper for Discussion: • Intricacies in Investigation Proceedings under Tax Laws • Search & Seizure • Survey • Enquiries • Other aspects • Related assessments, reassessments, and • Penalties & prosecutions	CA Pradip Kapasi

Sr. No.	*Date*	*Topics*	*Speakers*
c.		Paper for Discussion: • Case Studies in Direct Taxation	Devendra Jain, Advocate
d.		Paper for Presentation: • TeDiouS Provisions – TDS & TCS Decoded	CA Mahendra Sanghvi
e.		Brains' Trust	*Panellists*: S. Ganesh, Senior Advocate CA Gautam Doshi *Moderator:* Dharan Gandhi, Advocate
STUDENT			
1.	The Student Committee organised webinar on "Mediation Training in Commercial Disputes" (Jointly with Pravin Gandhi College of Law & Centre for Conflict Resolution). The session-wise detail of the webinar is as under:		
a.	17.02.2024	Key Note Address	Mr. Shaunak Thacker, Advocate, Solicitor & Arbitrator
b.		Module – 1: Mediation Principles Disputes Which Can be Mediated Styles of Mediation	Ms. Tanu Mehta, Legal Counsel,
		Module – 2: Understanding Disputes through Principles of Conflict Iceberg/ Conflict Wheel/Conflict Triangle	
		Module – 3: Dispute Resolution Approach in Mediation Position Vs Interest	
		Module – 4: Opening Statement /Introductions Communication Agreement Closure	

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Sr. No.	*Date*	*Topics*	*Speakers*
c.	18.02.2024	Module – 5: Mediation Formalities Appointment as a mediator' Time line for mediation	Parimal Shah, Advocate
d.		Module – 6: Problem solving Batna Watna Malata, Zopa Role of Mediator	Dr. Geetanjali Prabhu Shetty, Advocate
e.		Module – 7: Drafting of Mediation Settlement Agreement Legal formalities for Settlement Agreement Closing Statements in Mediation	Darshit Jain, Advocate
		Module – 8: Discussion on Mediation Act, 2023 Role of Mediation Council	
f.		Module – 9: Mediation – The Road Map Ahead Qualities and Skills of a Mediator Opportunities in the field of Mediation	Sanjay Asher, Advocate & Solicitor
STUDY CIRCLE & STUDY GROUP			
1.	19.02.2024	Critical issues on payments due to MSMEs under Section 43B(h) of the income tax Act	CA Naveen Khariwal
2.	22.02.2024	Recent Judgements under Income Tax Act	Kavita Jha, Advocate

"All power is within you; you can do anything and everything. Believe in that, do not believe that you are weak; do not believe that you are half-crazy lunatics, as most of us do nowadays. You can do any thing and everything, without even the guidance of any one. Stand up and express the divinity within you."

— *Swami Vivekananda*

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Residential Refresher Course Committee

47th Residential Refresher Course on Direct Taxes held from 29th February, 2024 to 3rd March, 2024 at Taj Hotel & Convention Centre, Agra

Devendra Jain, Advocate addressing the delegates

Brains' Trust Session

Group Photo

RRC Core Committee

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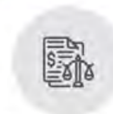
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