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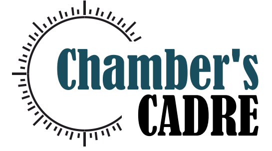

THE CHAMBER'S JOURNAL

Your Monthly Companion on Tax & Allied Subjects

Vol. XI | No. 12 | September 2023

GST and INCOME TAX

Divergence & Analysis

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Editorial

Dear Readers,

23rd August, 2023 will be recorded in the history of India a Red Letter Day, as on that day at 6.15.p.m Chandrayan-3, the most ambitious creation of India's extra-ordinary, brilliant scientists, had a soft landing with utmost ease and smoothness at the southern hemisphere of the MOON. India became the fourth country whose space craft landed on the moon and the first country in the world to land its Chandrayan-3 on the southern hemisphere, whereas the earlier space craft of other countries had landed on the northern hemisphere of the moon, which is considered relatively easy. The landing date was chosen while keeping in mind, the availability of sunlight in the region.

Chandrayan-3 is an ISRO mission with the primary objective of putting a lander and rover in the highlands near the South pole of the moon and demonstrating end to end loading and roving capabilities. It would also make a number of scientific measurements on the surface and from the orbit.

The sun rose over the landing site on 23rd August, 2023 and has set after two weeks. During this time the solar powered VIKRAM lander and PRAGYAN rover has used a range of instruments to make thermal, seismic and mineralogical measurements. This includes a spectrometer analysis of the mineral composition of the LUNAR surface.

While India has outshone rest of the world in the economic stability and growth, despite formidable challenges; the overwhelming success of CHANDRAYAN-3 is an incredible achievement in the arena of scientific exploration. The entire world has conveyed in high praise for the scientists of ISRO for delivering such a wonder.

There are number of positive takes as a result of smooth and successful landing of CHANDRAYAN-3.

That India has acquired special abilities for keeping the highly exorbitant cost of such missions at a much lower financial outlay, as compared to the westerns and other nations.

— That intellectual capital of the country, if given proper opportunities, is there to deliver benefits as never before.

— That addition to providing spectacular leadership in the area of Business management I.T and scientific advances by alumniey of top Technical and management institutions of India; the manpower groomed and moulded by the second rung institutions and universities of India are capable of throwing equally brilliant people.

— That the womanpower (Nari Shakti) is becoming a predominant force in the major business & scientific activities of the nation.

— That the country is having a sufficient depth of talent to undertake many more difficult missions.

— That the contribution of the private sector enterprises in the successful launch of Chandrayan-3 is formidable, paving way for a wider participation of both private and public sectors, to have a spectacular outcome.

— That the success of the mission, having enhanced the confidence of the world in the capabilities of India as a country, is bound to encourage and enhance the capital inflow and participation of the global players.

— That it has substantially augmented interest in the pursuit of pure science related activities in the minds of youth, which would further enhance the flow of students in the area of learnings in pure science and technology.

— That it has portrayed India, a nation with huge potential in Science and Technology and would result in heavy demand of talent pool to manage strategic projects globally from India.

While penning this piece, I got the news that Vikram lander exceeded its mission objectives. It successfully underwent a hop experiment. On command, it fired engines, elevated itself by about 40 cm as expected and landed safely at a distance of 30-40 cm. away.

Three Cheers and Hats off to ISRO! The stupendous success of MISSION CHANDRAYAN 3 has elevated the status of India, in an unprecedented manner, in the field of space science, making all the countries big or small, look to India with awe and exulted pride, may be with some hidden jealousy! We all owe a great deal of gratitude and perennial debt to the brilliant, persuasive, hardworking ,determined and dutiful scientists and their dedicated teams for this monumental achievement .

Recognizing this stellar achievement, Prime Minister has declared August 23rd as "National Space Day" in India.

As the deadline for filing of tax audits is fast approaching , the professionals must be burning the midnight oil to complete the tax audits coupled with audit of charitable trusts well in time .The Audit Report to be issued in Form 10B and 10BB for charitable trusts were amended vide notification of 21-02-2023 There may not be readiness of the management of charitable trusts to furnish all the details as the amended reports are quite detailed and therefore the professionals may face some challenge this year. The previous issue of the Journal was on Tax Audit and revised reporting for the charitable trusts. I am sure the readers would have found the issue useful.

The subject of the current issue of the Journal is "GST and Income Tax - Divergence and Analysis". Compliments to the Journal Committee especially to its members Rajkamal Shah , Janak Vaghani and Simachal Mohanty for conceptualising and designing this issue of the Journal on a very interesting subject which I am sure would be very useful to the readers. I express my sincere gratitude and appreciation to the authors of the articles for sparing their valuable time and sharing their expert knowledge.

I wish, you all , the very best for the busy audit / tax audit season and for the festivals of Ganesh Chaturthi and Paryushan!

VIPUL K. CHOKSI
Editor

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From the President

Dear Members

The overhaul of India's criminal justice system is long overdue, aiming to replace outdated colonial-era laws. The introduction of new bills to replace key legal frameworks like IPC, CrPC, and the Indian Evidence Act is a positive stride. However, the lack of transparency and public involvement is concerning. This transformation is vast, impacting all citizens, necessitating open dialogues. The new bills need more public participation. Notably, the renaming of offenses shouldn't disguise their nature. The proposal of capital punishment for mob actions is a novel but delicate concept. Ambiguous and antiquated laws on criminal defamation require clarity. While speeding up justice is important, practical feasibility is paramount. Current forensic capacity might hinder the envisioned progress. Let's deliberate comprehensively, avoiding haste in these significant changes.

The Indian Education Ministry has come up with a fresh plan for schools that aims to give students more choices and make learning easier. They want students to be good at three languages: their mother tongue, English, and one more language from India, all by the time they are 15 years old. They also want to have two important exams every year, which will help students understand and learn better instead of just remembering things. In grades 11 and 12, students will study two languages, like Hindi, Tamil, or others. They're changing how they teach subjects like science, social studies, and arts to help students understand the real world better. And over the next ten years, they're planning to make the stages of school simpler, so it's easier for students to learn different things. This plan is like a roadmap to make learning more interesting and useful for all students. This plan is like building a strong economy based on knowledge. But for this plan to work well, they need well-trained teachers. Teachers are important because they help students learn and grow. The concept of a 'Knowledge Economy' is important too, where teachers and students work together to build knowledge. The new plan for education is designed to encourage creativity and treat all subjects equally. This change is good, but it will really depend on how well they can put these ideas into practice. The plan also focuses on teachers, who play a big role in making sure students learn well. The plan aims to make teachers ready to help students learn and succeed.

Isro's big success with Chandrayaan-3 landing on the Moon's south pole is a huge deal for India's science. On August 23, 2023, something amazing happened – not just for Isro but

for our whole country. India has been really good at exploring space, like finding water on the Moon in 2008 with Chandrayaan-1. Now, with Chandrayaan-3's successful landing, we're showing the world how smart we are in space stuff. This makes us one of the top four space countries, like the US, China, and Russia. Chandrayaan-3's achievement proves that we can do amazing things even without a lot of money. Isro, the space people, have been working super hard. They've made us really good at things like satellites and remote sensing, which means looking at things from far away. They're also getting ready to send Indian people to space with the Gaganyaan mission. This big win makes us think more great things will come from our scientists and space companies. To keep doing well, Isro and the private companies need to work together. This is happening through something called IN-SPACe. Many private companies want to be part of this space journey too. Isro's success isn't just a win for them – it's making more people interested in science. Let's cheer for Isro and all the cool things they're doing for India and science!

Neeraj Chopra makes India proud with a golden victory at the World Athletics Championships. His amazing javelin throw not only clinched the gold but also etched his name in history as the first Indian to achieve this feat. A moment of inspiration and pride for our nation, showing that with dedication and passion, we can conquer the world in sports.

Our Chamber has been working really hard to help our members and the public update and understand Tax Audit better. Chamber organized different events to share information. There was a program for students led by CA Devangi Patel who has taken us to clause-by clause of form 3CD, where a respected past president Shri. Pradeep Kapasi gave his Key note address. Our Direct Tax Committee arranged a webinar about Tax Audit problems with expert CA N. C. Hegde and CA Vyomessh Pathak. The Study Circle and Study Group Committee held a special online meeting to discuss Tax Audit issues in a FAQ format. Experienced CA Mahendra Sanghvi and CA V. Ramnath guided this meeting. Our Journal Committee also released a monthly magazine that talked about every part of Tax Audit reports. All these things are making Tax Audit easier to understand for everyone – our members and the public.

Using AI in legal drafting has its advantages and challenges. AI can make things complex and miss certain contexts due to its automatic nature. But remember, it can improve efficiency and accuracy in regular tasks, saving costs. However, we also need to think about AI lacking human judgment and causing ethical concerns. Deciding on AI integration means considering these pros and cons for specific tasks. In a recent webinar by the IT Connect committee, led by Shri. Suhas Baliga, we looked into whether AI suits legal drafting, discussed the work's nature, and talked about the risks with relying too much on language models.

Our Indirect Tax Committee organized a valuable webinar led by Adv. K Vaitheeswaran. This webinar discussed a crucial judgment from the Andhra Pradesh High Court about the time limit for claiming Input Tax Credit under Section 16(4) of the CGST Act. The event had many members attending, showing their interest in staying informed about important changes in indirect taxation.

Friends, Non-compliance of requirements under the Companies Act, 2013 can have a negative impact on a company's operations as well as on director's reputation apart from

other consequences. Considering that the due dates of filing of Annual Return under the Companies Act, 2013 is fast approaching, our Vibrant Student Committee organized an intensive workshop spread over 3 days, uniquely designed for students and young professionals, E-Certificate Course on Key Compliances Under The Companies Act, 2013. The Workshop addressed key compliances under the Companies Act, 2013, important forms, practical difficulties and common errors that are faced while filing the Annual Returns under the Companies Act.

The Delhi Chapter arranged a Study Circle Meeting focusing on "Recent Development In Pillar-II – STTR, Practical Issues & Implication on India". The event had Mr. Akhilesh Ranjan – Ex-Member CBDT as the Chairman and Keynote Speaker, who delved into the topic excellently. The panellists included Mr. Sanjeev Sharma – Chief Commissioner of Income Tax, New Delhi, and CA Jitendra Jain – Associate Partner PWC. The session was informative and interactive, provided valuable insights.

For many Tax Professionals, handling GST compliance and litigation can be challenging, especially when dealing with tax department officials or revenue authorities. To offer support in such scenarios, Indirect Tax Committee crafted a unique workshop titled "Workshop on Department Interactions & Litigation Under GST." This workshop is designed to provide practical guidance and legal insights for effectively engaging with these authorities. From scrutinizing returns to understanding GST audits, responding to various notices, and even tackling situations like inspections, searches, seizures, and arrests – this workshop covers it all. Participants can expect to gain valuable insights and strategies to confidently navigate these intricate situations. Join us to equip yourself with the knowledge and tactics needed to face GST-related challenges head-on.

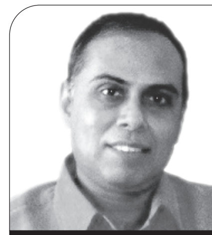
This month's Special Story explored a captivating topic - "GST AND INCOME TAX – DIVERGENCE AND ANALYSIS." The story comprehensively covered crucial aspects of this subject. It examined situations where GST and Income Tax laws diverge. I want to commend our Journal Committee for compiling this enlightening story. I extend my sincere gratitude to all the authors who have contributed to this insightful narrative. Your contributions greatly enhance our understanding of these intricate tax concepts.

As this month's journal arrives in your hands, the festive spirit of Ganesh Festival envelops us all. It's a joyous time of celebration and togetherness. On behalf of the Chamber of Tax Consultants, I extend my warmest wishes to each and every one of you for a Happy Ganesh Festival. May the blessings of Lord Ganesha bring happiness, prosperity, and success into your lives. Enjoy the festivities and the spirit of unity that this auspicious occasion brings.

With best wishes,

HARESH KENIA
President

Chargeable Event – Supply vs. Taxable Income



CA Rajkamal Shah   CA Janak Vaghani

Overview

A businessmen conceiving idea of business first looks at profitability and sustainability. Profitability is directly impacted by the taxes. This article attempts to highlight both the taxes, direct tax and indirect tax by focusing on the chargeability of both the taxes, one on the transaction and the other is on profit earned during the year. It also discusses the time within which the taxes are payable. Though not exhaustive, the contents of the article can serve as guidelines when one tax department questions the liability to pay tax based on the tax paid under the other law.

Preamble

This article aims to bring out certain similarities or otherwise between the relevant provisions of each individual Act, i.e. CGST Act, 2017/SGST Act/UGST Act/IGST, 2017 (all of them referred here as GST Acts) and Income Tax Act, 1961 though it cannot be over emphasized that chargeability of tax and all other taxation, parameters, such as framework, criterion etc., are governed by the provisions of respective laws. However, attempt is made to examine the impact of the transaction under one law to avoid unintended legal consequence in the other law. It is also possible to optimise the tax impact and to avoid adverse unintended consequence. This has now become possible as the plethora of indirect taxes like excise duty, value added tax, service tax, entertainment tax, luxury tax, so and so forth have been subsumed under GST. Needless to say that, after introduction of "One Nation - One Tax" it is easier to understand impact of direct tax on indirect tax or *vice a versa* (certain other tax or duty levied excepted). We, in this article shall deal with the prime and most important subject of the taxation i.e., the chargeable event under GST and income tax. However, this has to be considered as general guidelines and one has to go to the relevant provision of the respective law to understand the implication on a particular transaction.

The Goods and Service Tax Act (herein after referred to as "GST Act") provide for levy and collection of tax on supply of goods or service or both. There are four Acts which provides for levy of GST, namely The Central Goods and Service Tax Act, 2017 and The State or UT Goods and Service Tax Act, 2017 provides for levy of tax on the intra State supply of goods or service or both. Whereas The Integrated Goods and Service Tax Act, 2017 provides for levy and collection of tax on inter State supply of goods or service or both including export and imports. Since

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provisions of all acts are on similar lines, we have considered the provisions of The Central Goods and Service Tax Act, 2017.

The difference between two taxes are explained by the Supreme Court in ***Morriroku U.T. Indians Pvt. Ltd. vs. State of U.P. reported in (2008) 15 VST 559 (SC)***. Wherein it has been held that in income tax, the tax is exigible on real income which means the actual income received or which accrues to the assessee whereas in case of Sales Tax, tax is exigible on real price received or receivable by the dealer in respect of a sale.

However, in view of amendments to the income tax act from time to time the concept of real income is diluted to a large extent to levy tax on notional and/or deemed income.

I. Chargeability of Tax

Under Income Tax (ITA)

1. Section 4 of ITA, the charging section seeks to levy tax on total income, in accordance with and subject to the provisions of the act. It is important to note that all incomes are not taxable and section 10 of ITA provides f exclusions of certain income from levy of tax.

2. Scope of total income is defined in S. 5 of ITA based on the status of a person who is resident of India, or a resident of India but not ordinary resident of India, or a non-resident. The residential status of a person depends on his stay in India in span of a particular year or number of years together as defined u/s. 6 of ITA. The income u/s. 5 of ITA includes the income accrued or arise in India or deemed to have accrued or arise or received in India from external source or from a business or profession set up in India. The term, 'deemed to be received' is defined u/s. 7 of ITA. Income deemed to accrue or arise in India is based on the income from business connection in India under the provisions of Section 9 and 9A of ITA.

3. Section 14 of the Act classify the total income in the five broad heads of income viz. (i) income from salary, (ii) income from house property, (iii) income from business or profession, (iv) income from capital gain and (v) income from other sources. It is to be noted that income classifiable under one head can not be classified under any other head.

4. Each of the heads of income have different provisions of allowances, *ad hoc* deductions etc. These provisions also contains the dis allowances or restrictions on deductions of any expenditure incurred to earn the income.

Thus, one has to compute income under the relevant heads of income and aggregate thereof is gross total income and after deduction provided in Chapter VI-A, total income is derived. It may be added that income from some of heads are subjected to special rate of tax specified under the ITA.

Under GST

Section 9 of the GST Act provides for the levy of GST on all intra-State supplies of goods or services or both, except on the supply of alcoholic liquor for human consumption and petroleum products. The value of supply determined under section 15 and rules made thereunder. For levy of tax. The sale of liquor for human consumption and petroleum products is subject to VAT under the respective State Acts.

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Essentially under the GST Act, taxable event is supply of goods or service or both. Section 7 of the GST Act defines the scope of supply which includes all forms of supply of goods or services or both such as sale, transfer, barter, exchange, license, rental, lease or disposal made or agreed to be made for a consideration by a person in the course or furtherance of business. Accordingly, the ingredients of supply are as under;-

i) there should be a Supply,

ii) of Goods or service or both,

iii) for a consideration,

iv) by a person and,

v) in the course or furtherance of business.

As per section 7(1)(b) of the GST Act, import of services for a consideration whether or not in the course or furtherance of business is included in the scope of supply.

At the same time para 4 of the schedule I treats import of services without consideration by a person from a related person or from any of his other establishments outside India in the course or furtherance of business as supply.

Combined reading of the of the above provisions reveal that as per section 7 the import of service is considered as supply for a consideration even it is not in the course or furtherance of business. However, the import of service without consideration is treated as supply when provided by as related person or the establishment from outside India.

II. Taxation of Subsidy

Under Income Tax

As per section 2(14)(xviii) of the ITA, any assistance in form of a subsidy or grant or cash incentive or duty drawback or wavier or concession or reimbursement (by whatever name called) by the Central government or State Government or any authority, body or agency in cash or kind is liable to tax.

However, as per section 43(1) if any amount of subsidy or grant or reimbursement for the purpose of acquisition of an asset, the same shall be taken into account for determination cost of asset. Accordingly, such amount of subsidy shall not be included in the income.

Under GST

Under the GST Act, the amount of subsidy, grant etc., received by any person is not taxable supply either of goods or services. However, as per section 2(31) of the GST Act, any amount received by way of subsidy from the State or Central Government shall be excluded from the amount of consideration of the goods or services supplied for which it is received.

Section 15(2)(e) of the GST Act provides that subsidies directly linked to the price other than subsidies from the State or Central Government shall be included in the valuation of supply of goods or services.

III. Deemed Chargeable Events

1. Income from House Property -Unsold Inventory of a Building Part Thereof

Under ITA where any building or land appurtenant is held as stock-in-trade (by a builder or developer) but not let for a period of two years from the end of financial year in which completion certificate is obtained from the competent authority is treated as deemed income at annual value (Section 23).

No such provision exists under the GST Act for levy of tax on unsold inventory of building or part thereof.

2. Unexplained Cash Credit

U/s. 68 of ITA any some found credited in the books of the assessee for which no satisfactory explanation about its nature and source provided, is deemed to be income of the assessee.

Under the GST Act no tax is payable on mere unexplained cash credit in the books of accounts unless it is related and linked to supply of goods or services. However, section 35(6) of the GST Act provides that where the registered person fails to explain account for the goods or services or both, the proper officer shall determine the amount of tax payable on the goods or services or both that are not accounted for, as if such goods or services or both had been supplied by such person and the provisions of section 73 or section 74, as the case may be, shall, mutatis mutandis apply for determination of such tax.

3. Unexplained Investment

U/s. 69 of ITA any investment which are not recorded in the books of accounts is found for which no satisfactory explanation is provided by the assessee is deemed to be income of the assessee. No such provisions exist under the under the GST Act for levy of tax on such investment.

4. Unexplained Money, etc.

U/s. 69A of ITA any money, bullion, jewellery or other valuable article which are not recorded in the books of accounts is found for which no satisfactory explanation is provided by the assessee is deemed to be income of the assessee. No such provisions exist under the under the GST Act for levy of tax on such unexplained money etc.

5. Supply Without Consideration

Section 7(1)(c) of the GST Act deems following certain activities specified in Schedule I made or agreed to be made without a consideration are treated as supply;-

1. Permanent transfer or disposal of business assets where input tax credit has been availed on such assets.

2. Supply of goods or services or both between related persons or between distinct persons as specified in section 25, when made in the course or furtherance of business:

   Provided that gifts not exceeding fifty thousand rupees in value in a financial year by an employer to an employee shall not be treated as supply of goods or services or both.

3. Supply of goods—

   (a) by a principal to his agent where the agent undertakes to supply such goods on behalf of the principal; or

   (b) by an agent to his principal where the agent undertakes to receive such goods on behalf of the principal.

4. Import of services by a person from a related person or from any of his other establishments outside India, in the course or furtherance of business.

Income tax being a central tax, the concept of distinct person is alien to it. The entire income of all units is taxable at registered office as single entity.

6. Treatment of Supply to Agent

Depending on the contract of agency an agent steps into the shoes of principal when he acts as per the instructions of the principal such as commission agent, consignment agent. Such agents do not have authority to decide the

price of the goods and the risk and reward remains with the principal. Such agent get commission as agreed mutually. Under the income tax, tax is payable on the amount of commission received by the agent from the principal.

The goods supplied to such agent is not a supply under income tax but supply under the GST law as per para 2 of the Schedule I of the GST Act. Hence,under the GST tax is payable by the principal on transfer of goods to the agent. The agent is also liable to pay tax on the receipt of commission.

It may be noted that supply of goods by an agent to his principal or vice a versa is treated as supply under the GST Act. However, the supply of service by the principal to agent when made without consideration is not treated as deemed supply as such not subject to GST. The CBIC *vide* circular No. 57/31/2018 dated 04/09/2018 has clarified the scope of principal agent relationship in the context of Schedule I of the GST Act.

However, when an agent has power to conclude the contract, e.g., to decide the customer, the price and other terms and conditions is a sale under income tax and supply under GST.

7. Goods sent for Job Work

Section 142(3) of the GST Act provides that where inputs sent to job work are not returned or sold from the place of job work within a specified period of one year of their being sent out, it shall be deemed that such inputs had been supplied by the principal to the job worker on the day when the said inputs were sent out. Further, section 143(4) of the GST Act provides that where the capital goods, other than moulds and dies, jigs and fixtures, or tools, sent for job work are not returned or sold from the place of job worker within period of three years of their being sent out, it shall be deemed that such capital goods are supplied by the principal to the job worker on the day when said capital goods are sent out.

IV. Principal of Mutuality

No one make profit out of himself. This is a well-accepted principle under income tax. This applies to any mutual organization where the receiver and payer have complete identity, for eg., a members' club, a co-operative housing society where the members contribute the funds and the same is used for the members benefits only. Such associations are not liable to income tax. However, any income arise from an external source like a guest in a members' club or interest income from bank account in a co-operative housing society is not exempt from income tax. See the latest judgement of Hon'ble Supreme Court in ***Secundrabad Club etc., vs. CIT (2023) 153 taxmann.com 441 (SC)***.

In order to consider any transaction or activity as a supply of goods or service it is necessary that it should be by and between two different persons. In ***State of West Bengal & Ors. vs. Calcutta Club Limited, Civil Appeal No. 4184 of 2009 [reported in 2019-TIOL-449-SC-ST-LB]***, the SC held that the supply/ sale of goods or rendering of services by incorporated/unincorporated associations or clubs to their members are not liable to sales tax/service tax by application of the principle of mutuality even after the 46th Amendment to the Constitution of India.

Section 7 of the act is amended with retrospective effect from 01/07/2017 by Finance Act, 2021 and inserted clause (aa) in section 7(1) to treat activities or transaction by a person other than an individual to its members or constituents or vice versa for cash or deferred payment or for other valuable consideration as supply. Further, by way of

Explanation it is clarified that the person and its members or constituents shall be deemed to be two separate persons and the supply of activities or transactions inter se shall be deemed to take place from one such person to another. Thus, by this amendment the transactions or activities by and between the association of persons or club, whether incorporated or not by it members, with its members are included in supply when it is made for a consideration so as to levy GST on such transactions.

V. Point of Taxation

Under income Tax

Total income of an assessee in assessment year (which consist of a part or full accounting period i.e. April to March) is a normal point of taxation. Tax is required to be paid in advance in four installments, 15th June, 15th Sept, 15th Dec and 15th March at a percentage based on the estimate income for the accounting period.

Section 145 of ITA provides option for payment of tax in respect of profits and gains from the business as well as income from other source to maintain the books of account on consistent basis either on cash or mercantile basis. Accordingly, the income computed on the basis of regularly employed accounting system is subject to tax in the relevant assessment year.

2. Special provisions for point of taxation under ITA under certain cases as shown below:—

   i) Non-resident person leaving India –Taxable at the time of departure.

   ii) Profits of non-residents from occasional shipping business – On or before departure from any port in India.

   iii) Receipt of arrears of salary – taxable in the previous year of receipt subject to the relief provided under section 89.

   iv) Capital gain arising in case of individual or HUF transferring a capital asset being land or building or both under a development agreement to develop a real estate project on such land or building or both in consideration of a share being land or building or both in such project with or without payment of part of consideration in cash arise on the date of issue of completion certificate by a Competent Authority [Section 45(5A)].

   v) On conversion of the capital asset into stock-in-trade the capital gain shall be chargeable to tax as his income to the previous year in which such stock-in-trade is sold or otherwise transferred by him.

   vi) The amount of compensation including additional compensation for compulsory acquisition of the land is taxable in the year of receipt [section 45(5)].

Under GST

Under the GST Act sections 12 and 13 provides for time of supply when tax is payable either on receipt of money or issue of invoice, whichever is earlier. However, by Notification No. 66/2017 dated 15.11.2017 no tax is payable at the time of receipt of advance against supply of goods.

1. In case of continuous supply of goods, where successive statements of accounts or successive payments are involved, the invoice shall be issued before or at the

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time of each such statement is issued or, as the case may be, each such payment is received. (S. 31(4)).

2. In case of continuous supply of services, S. 31(5) —

   a) where the due date of payment is ascertainable from the contract, the invoice shall be issued on or before the due date of payment;

   b) where the due date of payment is not ascertainable from the contract, the invoice shall be issued before or at the time when the supplier of service receives the payment;

   c) where the payment is linked to the completion of an event, the invoice shall be issued on or before the date of completion of that event.

3. In case of supply of goods for sale on approval, the invoice shall be issued before or at the time of supply or six months from the date of removal, whichever is earlier. [S. 31(7)].

4. In case of supply of development rights or FSI as well as construction services, as per notification No. 6/2019 dated 29/03/2019, in respect of—

   (a) supply of development rights or FSI (including additional FSI) where the consideration paid in the form of construction service of commercial or residential apartments in the project;

   (b) the monetary consideration paid for supply of development rights or FSI (including additional FSI) relatable to construction of residential apartments in project;

   (c) the upfront amount (called as premium, salami, cost, price, development charges or by any other name) paid for long term lease of land relatable to construction of residential apartments in the project; and

   (d) the supply of construction service against consideration in the form of development rights or FSI (including additional FSI),—

   tax is payable in a tax period not later than the tax period in which the date of issuance of the completion certificate for the project, where required, by the competent authority, or the date of its first occupation, whichever is earlier.

5. In respect of receipt of interest, late fee or penalty for delay in payment, to the extent it relates to the addition in value, for any supply of goods or services, the tax is payable at the time of receipt. (S. 12 and 13).

6. In case of supply of vouchers by a supplier, the time of supply shall be—

   (a) the date of issue of voucher, if the supply is identifiable at that point; or

   (b) the date of redemption of voucher, in all other cases. (S. 12 and 13).

VI. Non Taxable Events

Under Income Tax

Section 10 of ITA provides certain receipts excluded from total and not liable to tax.

Under GST

Section 7(2) of the GST Act read with Schedule III provides following activities be treated neither supply of goods or services as such not liable to GST;-

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1. Services by an employee to the employer in the course of or in relation to his employment.

   The amount received by the employee from the employer is subject to tax under the head income from salary as provided under ITA.

2. Services by any court or Tribunal established under any law for the time being in force. Also the same is not taxable under ITA.

3. a) the functions performed by the Members of Parliament, Members of State Legislature, Members of Panchayats, Members of Municipalities and Members of other local authorities;

   b) the duties performed by any person who holds any post in pursuance of the provisions of the Constitution in that capacity; or

   c) the duties performed by any person as a Chairperson or a Member or a Director in a body established by the Central Government or a State Government or local authority and who is not deemed as an employee before the commencement of this clause.

   Under ITA, it is taxable under the respective heads subject to exemption provided in section 10 for allowances.

4. Services of funeral, burial, crematorium or mortuary including transportation of the deceased.

5. Sale of land and, subject to clause (b) of paragraph 5 of Schedule II, sale of building.

   Sale of land except agricultural land is taxable under ITA either as capital gain or income from business, as the case may be.

   Sale of completed building or part thereof is taxable under ITA under respective head of income.

6. Actionable claims, other than lottery, betting and gambling.

7. Supply of goods from a place in the non-taxable territory to another place in the non-taxable territory without such goods entering into India.

8. (a) Supply of warehoused goods to any person before clearance for home consumption.

   (b) Supply of goods by the consignee to any other person, by endorsement of documents of title to the goods, after the goods have been dispatched from the port of origin located outside India but before clearance for home consumption.

Income from all activities mentioned at 5 to 8 above are subject to income tax under their respective heads of income except covered by section 10 of the Act.

VII. Conclusion

Although we have tried to draw a line between convergence and divergence between indirect & direct tax law in respect of chargeability and point of taxation as far as possible in respect of a transaction, it can never be sacrosanct for a simple reason that the taxability of a particular transaction is to be viewed from the provisions of the relevant tax law.

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Valuation Provisions - Interplay between GST & Income Tax Legislation

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Overview

"Both income tax and GST are generally applicable on the real income or the transaction value. The value adopted by the assessee and recorded in his books of accounts is normally accepted for the levy of income tax and GST. It is only in the few specific circumstances where the statute creates exceptions and seeks to bring in the concept of notional income or open market value that the principles of valuation become relevant."

1. Valuation is the act of estimating or determining the value of something, i.e., the act of appraisal. It is an art which has been an essential facet of taxation laws since time immemorial. As held by the Hon'ble Supreme Court in *A.R. Krishnamurthy*[1], 'valuation is not an exact science. *Mathematical certainty is not demanded, nor indeed is it possible*.' This decision of the Hon'ble Supreme Court is discussed in detail later in this article.

2. The Hon'ble Supreme Court in *Moriroku*[2] undertakes a detailed analysis of the concept of valuation under tax law and elucidates on the theory of valuation in the context of different taxing statutes. In the *Moriroku (supra)* matter, the Hon'ble Supreme Court was dealing with the question whether Section 4 of the Central Excise Act, 1944 r.w. Rule 6 of the Central Excise Valuation (Determination of Price of Excisable Goods) Rules, 2000 could be read into Section 3 of the U.P. Trade Tax Act, 1948. In other words, the question was whether the value adopted under Excise law could be incorporated into the value for sales tax purposes. Rule 6 of the Valuation Rules, in certain circumstances, provided that the value of the goods for the purposes of excise duty would be an aggregate of the transaction value and the money value of additional consideration flowing directly or indirectly from the buyer to the assessee in relation to sale of the goods being valued. The Rule specifically provided that the value of any tools, dies and moulds provided

1. *A.R. Krishnamurthy & Anr. vs. C.I.T., Madras (1989 AIR 1055).*
2. *Moriroku Ut India (P) Ltd vs. State of U.P. & Ors. [(2008) 3 S.C.R. 678].*

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by the buyer to the assessee would be includible in the value of the goods for the purposes of excise duty. In cases, where the costs of the tools, dies and moulds are amortized by the assessee over a period of time, the amortized costs were includible in the excise value. In that matter, the Sales Tax Department sought to load the amortised cost of the moulds supplied by the buyer to the assessee to the sale price of auto components sold by the assessee. In this context, the Hon'ble Supreme Court has lucidly explained the concept of valuation. A few pertinent portions of the said judgment are extracted below:

13. Valuation is a matter of principle. Under Section 4 of the 1944 Act, the basis of valuation is the transaction value for each removal. Section 4 lays down the method for arriving at the assessable value for levying excise duty. It refers to taxing the value. Therefore, Section 3 of the 1944 Act is the charging section which creates the liability to pay excise duty whereas Section 4 deals with assessment or quantification of liability ad valorem. Under Section 4, duty of excise is chargeable with reference to the value of excisable goods and "value" is defined by Section 4. The price charged by the manufacturer on sale by him represents the measure of that value, therefore, in the judgment of this Court in the case of Union of India and Ors. vs. Bombay Tyre International Ltd. reported in AIR 1984 SC 420 it has been held that under the excise law, prices and sale are related concepts. In that judgment, it has been further observed that "price" under the excise law has a definite connotation. That, the "value" of an excisable article has to be computed with reference to the price charged by the manufacturer, the computation being made in terms of Section 4. Therefore, Section 4 of the 1944 Act requires the Department to find out the real value of the excisable article. As stated above, excise law is a tax on value. This is the most important distinction between the excise law and the sales tax law.

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16. Before analyzing Section 3 of the 1948 Act, it is important to keep in mind that in Income-tax cases, tax is exigible on "real income" which means the actual income received by or which accrues to the assessee. In case of sales-tax, tax is exigible on real price received or receivable by the dealer in respect of a sale. A dealer is entitled to frame his price-structure in a manner conducive to the type of his business or with a view to withstand the competition. In a given case, cost may be more than the price. The dealer may base his price-structure to give an incentive to his clients, agents, distributors etc., particularly if he is a manufacturer. In such cases, his price- structure has to be scrutinized by the Department under the sales-tax law to find out the real sale-price receivable by him. There may be cases where he is required to give a discount on account of defect in quality or delay. The important

thing to be noted is that "price" is the amount of consideration which a seller charges the buyer for parting with the title to the goods. It comprises of the amount which the dealer himself has to pay for the purchase of the goods, the expenditure, which he is to incur for transporting the goods from the place of purchase to the place of sale, the duties, if any, levied on the particular goods bought by him, the octroi duty, which he may have had to pay and his own margin of profit after meeting handling charges including interest on the capital invested. The cost price of the goods actually paid by him under various heads of accounts would no doubt constitute the consideration for which he would part with his title to the goods. The entire amount of consideration, including the sales tax component, which the purchaser pays, would constitute the price of goods. To this extent, there is no difficulty.

...

Therefore, sales-tax or trade-tax under the 1948 Act is leviable on sale, whether actual or deemed, and for every sale there has to be a consideration. On the other hand, excise duty is a levy on a taxable event of "manufacture" and it is calculated on the "value" of manufactured goods. Excise duty is not concerned with ownership or sale. The liability under the excise law is event-based and irrespective of whether the goods are sold or captively consumed. Under the excise law, the liability is there even when the manufacturer is not the owner of raw material or finished goods (as in the case of job workers). Excise duty, therefore, is independent of ownership (see: Ujagar Prints & Ors. vs. Union of India & Ors. [(1989) 3 SCC 488]. Therefore, for sales-tax purposes, what has to be taken into account is the consideration for transfer of property in goods from the seller to the buyer. For this purpose, tax is to be levied on the agreed consideration for transfer of property in the goods and in such a case cost of manufacture is irrelevant. As compared to the sales-tax law, the scheme of levy of excise duty is totally different. For excise duty purposes, transfer of property in goods or ownership is irrelevant. As stated, excise duty is a duty on manufacture. The provisions relating to measure (Section 4 of 1944 Act read with Excise Valuation Rules, 2000) aim at taking into consideration all items of costs of manufacture and all expenses which lead to value addition to be taken into account and for that purpose Rule 6 makes a deeming provision by providing for notional additions. Such deeming fictions and notional additions in excise law are totally irrelevant for sales-tax purposes."

3. Hence, no hard-and-fast rules can be applied for the purposes of valuation. Valuation would be dependent on solely on the nature of the tax being levied and the purpose/intent of the levy itself.

4. Under the earlier indirect tax regime, Excise duty was a tax on the manufacture with the duty being levied on the 'value' of the goods at the time of removal of the goods from the factory. Prior to 2000, the method of valuation was directly linked to the 'normal price' for an ordinary sale in the course of wholesale trade. Post 2000, where the manufactured goods were sold and the buyer was not a related person and the price of the sale was the sole consideration, the value was deemed to be the transaction value itself. References to 'normal price' and 'wholesale trade' were deleted[3]. In all other cases, the 'value' was determined in terms of the specific Valuation Rules which had been prescribed. These Rules sought to determine the 'true value' of the goods at the time of their removal.

5. Sales tax, on the other hand, mostly accepted and followed the contract between the parties. In other words, sales tax was generally levied on the price charged by the seller from the buyer. There were no provisions which sought to determine the so called 'true value' of the goods. The price charged by the seller was accepted irrespective of the open market value of the goods.

6. Under Customs law, prior to 1988, the duty was based on the 'real value'. Under the Sea Customs Act, 1878, real value was defined as the wholesale price for which like goods are capable of being sold at the time and place of importation. Similarly, under the Customs Act, 1962 prior to 1988, valuation was based on the concept of 'normal price'. 'Normal price' was the price at which such or like goods were sold or offered for sale, in cases where the buyer and seller were not related. It is only after India became a signatory to the General Agreement on Tariffs and Trade ('GATT') that the Customs duty came to be levied on the transaction value.

7. Goods and Services Tax Law has, more or less, adopted the transaction value principle as under Sales Tax, Excise and Customs law. In cases where the supplier and the recipient are not related and the price is the sole consideration, the value of the supply is taken to be the transaction value. However, most crucially, even in cases where the supplier and recipient are related, if full input tax credit is available on the transaction, the transaction value adopted by the parties is accepted by the GST law for the levy of tax[4]. This is a unique and beneficial provision which never existed earlier in the previous indirect tax regimes. If the transaction value is not determinable by the application of the above principles, the law resorts to valuation vide the open market value route or the cost of acquisition/production/provision of the supply.

8. In the context of Income Tax, the Courts have consistently taken a view that

3. *Commissioner of C. Ex., Cus. & S.T., Calicut vs. Cera Boards and Doors [2020 (373) E.L.T. 794 (S.C.)].*
4. 2nd Proviso to Rule 28 of the CGST Rules, 2017.

the tax can only be levied on the real income of an assessee, i.e., only on income that is actually received or has actually accrued. The Hon'ble Supreme Court in *Shoorji Vallabhdas*[5] held as under:

> *"Income tax is a levy on income. No doubt, the Income-tax Act takes into account two points of time at which the liability to tax is attracted, viz., the accrual of the income or its receipt; but the substance of the matter is the income, if income does not result at all, there cannot be a tax, even though in book-keeping, an entry is made about a "hypothetical income" which does not materialize. Where income has, in fact, been received and is subsequently given up in such circumstances that it remains the income of the recipient, even though given up, the tax may be payable. Where, however, the income can be said not to have resulted at all, there's obviously neither accrual nor receipt of. Income, even though an entry to that, effect might, in certain circumstances, have been made in the books of, account."*

9. Hence, the Income-tax Act, 1961 primarily seeks to levy tax on the real income of the assessee. It is only in a few specific circumstances that the tax is levied on 'notional income', i.e., on income that does not or may not accrue to or is received by the assessee. In *A. Raman & Co.*[6], the Hon'ble Supreme Court held that '*the law does not oblige a trader to make the maximum profit that he can out of his trading transactions. Income which accrues to a trader is taxable in his hands: income which he could have, but has not earned, is not made taxable as income accrued to him.*' In that matter, it was the stand of the Income Tax Department was that the income which could have been earned by the assessee was not earned and that a part of the said income which could have been earned by the assessee was instead earned by Hindu undivided family of which the appellant was a part. It was contended by the Department that if by resorting to a "subterfuge or device or contrivance", income which would normally have been earned by the assessee is divided between the assessee and another person, the Department would be entitled to bring the entire income to tax as if it had been earned by the assessee. This was clearly negatived by the Hon'ble Supreme Court, as extracted above, on the basis that income tax was a tax on 'real income'.

10. Under Section 80A(6) of the Income-tax Act, 1961, when any goods or services are transferred by an undertaking or unit or enterprise or eligible business to any other business carried on by the assessee (and vice versa), the statue requires that such a transfer to be valued at the open market value or the arm's length price. If the value adopted by the assessee in its books is not in accordance with the market value of

5. *CIT vs. Shoorji Vallabhdas & Co. [1962 46 ITR 144 (SC)].*
6. *CIT vs. A. Raman & Co. (1968 AIR 49).*

such a transfer, then it is liable to be rejected. The intention of this Section is to prevent the transfer of any profits or losses from an exempted unit to a non-exempted unit and vice versa. In such a scenario, the real income is rejected, and a notional income is adopted for the purposes of taxation. For a similar transaction under GST, as long as input tax credit is available, the transaction value of the transfer is required to be accepted for the levy of GST.

11. Section 50C is a special provision relating to the transfer of land or building or both. In cases where the consideration actually charged by an assessee for the transfer of land and building or both is lower than the value adopted for stamp duty purposes by the Stamp authorities, the value adopted for stamp duty purposes is deemed to be the value of the transaction. Under GST the sale of land and post-occupation/completion buildings is completely exempt from the levy of GST. Even for cases covered by clause (b) of paragraph 5 of Schedule II of the CGST Act, it is the transaction value (i.e., the consideration that is agreed upon the sale agreement) that is liable for GST. There is no relation to the stamp duty valuation in the context of GST.

12. In the matter of *B.C. Srinivasa Shetty*[7], the issue before the Hon'ble Supreme Court pertained to the levy of capital gains tax on the transfer of self-generated goodwill. It was held that when the cost of acquisition of an asset could simply not be conceived, the transfer of such an asset would not be income under the head 'Capital Gains'. It was to overcome this that Section 55 was amended in 1988 to deem the cost of acquisition of self-generated goodwill as nil.

13. In *A.R. Krishnamurthy (supra)*, the assessee purchased on an outright basis a piece and parcel of land alongwith all the rights that flow with the ownership of such a piece of land. Subsequently, the assessee entered into a mining lease and transferred only the right to mine the land for consideration. It was argued by the assessee that since he had purchased a bundle of rights for a lumpsum consideration, the cost of acquisition of the mining rights was not available/ascertinable and that hence no capital gains tax was payable by him. The Income Tax Officer had assessed the fair market value of the entire parcel of land. Since the value for the transfer of the mining rights was known, the Officer determined the value of the mining rights as being 5/8th of the fair market sale price of the entire land. On that basis, the same ratio of 5/8 was applied to the cost of acquisition of the entire parcel of land. Hence, the Officer valued the cost of acquisition of the mining rights as being 5/8th the purchase price of the land. Holding that valuation is not an exact science where certainty is required or demanded, the Hon'ble Supreme Court upheld the approach of the Income Tax Officer.

14. Section 50D of the Income-tax Act, 1961 operates in a similar context. Section 50D deems the fair market value of a capital asset to be the value of

7. *CIT vs. B. C. Srinivasa Setty (1981 AIR 972).*

the transfer of the said capital asset in cases where the consideration accruing/received by the assessee cannot be determined. The intention of the Parliament was to cover cases of business re-structuring/re-organization/ amalgamation, etc., acquisition & transfer of intangible rights such as goodwill, trademarks, copyrights etc. For e.g., where a trademark is transferred from a company to a sister concern for no money consideration, the consideration for the transfer of the said mark is not readily ascertainable as the assessee may have done it for the ease of improving business. In such a circumstance, the fair market value of the trademark is deemed to be the value of the transfer of the capital asset. Under GST, where the price is not the whole consideration for the supply, then valuation principles enshrined in Rule 27 of the CGST Rules would apply. Like under Income Tax, the open market value of the supply is deemed to be value on which GST is levied.

15. Section 56(2)(x) of the Income-tax Act pertains to the taxation of gifts. In essence, in cases of gifts of money or immovable property or any other property, the fair market value of the property is deemed to be the income of the recipient. Hence, irrespective of the fact that the transaction is that of a gift, a notional income is deemed to have been received by the recipient. For GST purposes, the transaction value is adopted. If the price charged is nil, the supply is not taxable. If the price is not nil, the price charged is what is liable to tax. Even in case of gifts between related persons, as long input tax credit is available, the price charged is accepted as the value of the gift.

16. Another common application of Section 56(2) is in relation to the transfer of shares at values lower than its face value or fair market value. In such cases, the fair market value of the shares is deemed to be income received by the recipient of the shares. Since the supply of shares is fully exempt under GST, the same issue (as in Income Tax) would not arise under the GST law.

17. Under Section 22, tax on notional income is levied where the owner has more than one property for self-occupation. In such cases, the income from other houses is deemed to be the sum for which the property might reasonably be expected to be let. Even if the house is occupied rent-free by a tenant, the said property is assessable on notional income. Under GST, the levy would only be on the actual rental receipts received by the owner. In cases the house is let out rent-free or is not let out at all, the owner would not be liable for any GST.

18. In conclusion, both income tax and GST are generally applicable on the real income or the transaction value. In other words, the value adopted by the assessee and recorded in his books of accounts is normally accepted for the levy of income tax and GST. It is only in the few specific circumstances where the statute seeks to bring in the concept of notional income or open market value that the principles of valuation become relevant.

Navigating the Divergence and Convergence: A Comparative Analysis of Tax Provisions under the Income-tax Act and GST Laws

CA Ruchi Bhat

Overview

It is imperative for business enterprises to adhere to multiple legal frameworks, especially tax regulations. In India, direct and indirect taxes levied through Income Tax and Goods and Services Tax (GST) are pivotal tax regulations. These two taxes often exhibit divergent perspectives on various aspects of same business transactions. This article highlights key differences which encompasses capital and revenue expenditure treatment, input tax credit, depreciation, and more. This divergence may affect valuation and revenue recognition, impacting cash flows and tax liabilities. To thrive in this complex landscape, businesses must integrate these divergent areas into their financial planning, cost analysis, and negotiations with external parties to ensure compliance and efficiency.

Introduction

In today's business environment, a company needs to comply with multiple laws and regulations including the tax regulations. In India, two prominent taxes come into play: **Income Tax and Goods and Services Tax (GST)**, commonly referred to as direct and indirect taxes respectively. The inherent nature of levy of these taxes has given rise to some divergent point of view for the same set of business transactions. The present article attempts to highlight some of such divergent concepts between the provisions of the Income Tax Act, 1961 ('IT Act') and the GST law. We have summarised this divergence in broadly following categories –

I. Capital Expenditure

1. Interplay of Depreciation and Input Tax Credit (ITC) under GST
2. Treatment of Government subsidies

II. Revenue Expenditure

1. Implications on ITC vis-à-vis deduction of expenses
2. Treatment of deferred revenue expenses
3. Treatment of Provisions
4. Valuation for Income tax vs. Indirect tax laws
5. Preliminary Expenses
6. Corporate Social Responsibility related expenses
7. Prior period expenses
8. Free gifts and samples

III. Revenue

1. High seas and Out and Out sale
2. Free of cost supplies, Gifts, branch transfers

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3. Advance receipts

I. Capital Expenditure

Every business must accurately record their income and expenses each year, as per applicable accounting principles and taxation laws. The distinction between capital and revenue expenses is extremely important as to determine how businesses recognize and treat their expenditures/ income. However, determining whether an expense/ income should be accounted under the capital or revenue category can pose challenges for taxpayers, given the divergent perspectives of Income Tax and GST regulations.

What is the meaning of capital goods/ assets?

As per **Section 2(19)** of Central Goods and Services Tax Act, 2017 ('CGST Act'), "capital goods" means the goods the value of which is capitalised in the books of accounts. While the definition is drastically different from the one from pre-GST regime but is in line with Accounting Standards and Companies Act, 2013, however the definition under IT Act is different.

As per **Section 2(14)** of the IT Act, "capital asset" includes property of any kind held by an assessee, whether or not connected with his business or profession. In this context, it is important to highlight that the IT Act defines a capital asset to include personal assets as well viz, gold, residential property etc. On the other hand, under the GST Act, capital goods refer to items capitalised in the books of accounts. Consequently, personal assets not capitalized in the books of accounts are not categorized as a capital asset according to the GST Act's definition.

However, while this may seem like a divergence in both the laws there are some finer nuances as discussed under to be considered:

1. Interplay of Depreciation and Input Tax Credit ("ITC")

Section 32 of the IT Act, which pertains to depreciation, states that for tangible assets like buildings, machinery, plant, or furniture, the eligibility criteria require these assets to be owned, either fully or partially, by the taxpayer and used for business or professional purposes. Accordingly, referring back to the classification of a property as a capital asset, it's important to note that an entity can only seek depreciation benefits for assets engaged in the advancement of business activities. Depreciation is not allowed on the personal assets.

According to the rules outlined in the GST Law, a taxpayer is allowed 100% ITC during the year of purchase of a movable capital asset. However, in case of immovable assets (excluding plant and machinery) that are capitalised in the books of accounts such as buildings wherein no such ITC is available. Further, under the GST Law, if a capital asset for which ITC was claimed gets sold within 5 years of use, the taxpayer is required to reverse ITC for the period during which the asset was not in use. This reversal is calculated at a rate of **twenty percent per year (equivalent to five percent per quarter or any part thereof)**. It is important to note that this rate remains consistent for assets like plant and machinery, as well as furniture, and the like.

Further, it is important to note that the cost base for an asset, for the purpose of IT Act, depends on whether the taxpayer claimed ITC on such assets. If ITC was claimed for an asset's purchase under GST, the GST paid during the purchase won't be included in the asset's cost base for the purpose of depreciation under IT Act.

Further, it is also pertinent to note that in case where ITC is reversed in a later year where the asset is sold off before 5 years, since the

said GST is inherently capital in nature, the same cannot be treated as tax deductible expense for income-tax purpose. One can explore if the same can be added to the block of assets for income-tax purpose in the year in which ITC is reversed so as to reduce the effective cost for the taxpayer through income-tax break on tax depreciation on such GST portion.

For immovable property, the GST paid would be part of the asset's cost base and will be eligible for depreciation under IT Act, if permissible, unlike GST laws, where ITC on building becomes a cost.

Further, while the ITC reversal rate is the same across asset class under the GST Law, the rate of depreciation of various classes of assets under IT Act is tabulated below:

Asset	Rate of Depreciation as per IT Act1
Building	5%/ 10%
Furniture & Fixtures	10%
Plant and Machinery	15%[2]
Intangible Assets	25%
Computers	40%

Conclusively, the IT Act allows deduction in the form of depreciation of cost of capital assets used for business purposes over the life of the asset at the rates mentioned above. Whereas full ITC under GST is eligible to the taxpayer in the year of purchase. The eligibility to avail full ITC in the year of purchase is divergent with the laws applicable in pre-GST regime wherein CENVAT Credit Rules, 2004 ("CCR") allowed credit in two years whereas State VAT laws followed divergent timelines for allowing the credit depending upon the state involved.

Case Study - What would be the impact on the cost element of immovable assets where ITC is not allowed?

Let us consider an example where a new manufacturing facility is being set-up by a company with significant capital expenditure which includes purchase of land, construction of factory building and roads, purchase of Plant & Machinery, electrical fittings and other ancillary expenses. In such a case, typically, it is always complex exercise to determine treatment of many common expenses, such as salary of the employees engaged in this overall capital expenditure, the common infrastructure cost such as electricity, water, security, housekeeping, cost in relation to building plinth for installation of Plant & Machinery, cost in relation to levelling of land or beautification of land adjacent to building etc. Question arises if these expenses should be capitalized in one of the assets or some of these expenses can be treated as revenue expenses.

To the extent expenses are capitalized as a part of immovable property (excluding plant and machinery), ITC on such expenses would not be available and hence, such GST becomes a cost. Whereas, for income-tax purposes, such GST can become part of the cost base and be eligible for depreciation resulting into effective benefit of tax break at applicable corporate tax rate say, 25.17%. Thus, it reduces overall cost for the company to some extent. Hence, it is important to plan such capitalization appropriately in line with correct accounting and tax principles, to minimize the cash flow impact for the company.

1. Full rate of depreciation is allowed in the year of purchase if the asset is used for more than 180 days
2. Additional 20% depreciation may also be allowed in the year of purchase for certain taxpayers

2. *Treatment of Government subsidies*

As per industrial promotion schemes introduced by various state Governments, the incentive is generally correlated to the output GST liability of the applicant during the incentive period. In other words, the incentive is partially in form of refund of the GST. Income-tax treatment of such subsidy has been debatable issue due to divergent court rulings. However, the controversy was settled when section 2(24)(xviii) was introduced in IT Act, which clarified that any government grant in form of assistance will be treated as income. Exception was carved out in relation to grants directly related to depreciable fixed assets, which can be reduced from the block of fixed asset as per explanation 10 to section 43(1) of the IT Act. Thus, depending on the purpose/ objective of the scheme of incentive, income-tax treatment of government grant is decided.

However, given that the purpose/objective of the scheme is very wide, it is often difficult to determine exact classification of such grant as to whether it is related to acquisition of depreciable assets or the same is provided to support overall manufacturing operations. More so because in most of these incentive schemes the computation is linked with sales and VAT/ GST payable on the same whereas the intent was to provide incentive for capex. Similar interpretational issues also exist in the recently implemented Production Linked Incentive Scheme ('PLI') introduced by Central Government. Hence, the taxpayers need to carefully study and determine the treatment of such incentives under PLI for income-tax purpose.

II. Revenue Expenditure

1. *Implications on ITC vis-à-vis deduction of expenses*

Section 17(5) of CGST Act provides for negative list of goods and services in respect of which ITC is not allowed. The supplies under Section 17(5) include rent-a-cab, canteen, catering etc. subject to exceptions whereas the IT Act allows a deduction of all the expenses (along with GST thereon, if ITC is not claimed) which are incurred for the purpose of business or profession and appropriate taxes have been deducted thereon. This again creates a cash flow impact for the company in terms of getting ITC for 100% of the GST vis-à-vis a 25.17% tax break on the deduction under IT Act.

2. *Treatment of deferred revenue expenses*

As per the Hon'ble Supreme Court decision in case of Taparia Tools Limited vs JCIT (2015) 55 taxmann.com 361, deduction of expenses shall be allowed in the incurrence for a revenue expenditure which otherwise is deductible. However, the same may be deferred at the option of the taxpayer over the period of ensuing years if there exists continuing benefit of such expenditure. While this decision was in the context of upfront interest paid to debenture holders, similar principle can be adopted for other expenses where the benefit is spread across several years. Thus, depending on specific facts, the taxpayer has a choice to either claim such expenditure in the year of incurrence or defer the same over useful period. Deferral of expense would be useful in case where entity is under losses or under set-up period and there is no immediate incentive of claiming upfront deduction.

However, no such choice is available under GST laws. As per section 16(4) of the CGST Act, ITC on the expense can be availed until 30 November following the end of the financial year to which such invoice pertains or date of annual return whichever is earlier subject to fulfilment of other specified conditions.

3. *Treatment of Provisions*

As per the provisions of the IT Act, the provision created can fall into two categories. One involves the creation of a provision based on a scientific approach, where the expense is precisely ascertained. The other is forming a provision on an *adhoc* basis, contemplating the possibility of a future expense. In instances where a provision is scientifically determined, it is considered as an allowable expense under the IT Act. Conversely, if a provision is established on an adhoc basis, it is disallowed under the IT Act.

Reference is drawn on the ruling of the Hon'ble Supreme Court in the case of Rotork Controls India Private Limited vs. Commissioner of Income-tax, Chennai (Civil Appeal Nos. 3506-3524 of 2009) wherein it is held that scientific basis of provision is accepted as one of the critical but acceptable factors for ascertaining income tax deductibility of the provision.

Whereas under the GST Law, ITC is available on fulfilment of conditions specified under section 16 of the CGST Act, 2017 majorly being:

- Possession of tax invoice or debit note,
- Receipt of goods or services or both,
- Tax should have been paid to the government and return should have been filed
- ITC can be claimed within the specified timelines

Having said the above, one of the commonalities in case of IT Act and GST in so far as "provision" is concerned is that TDS becomes deductible on creation of provision and GST under reverse charge mechanism ("RCM") also becomes payable, wherever applicable.

However, where ITC under GST laws is specifically not allowed e.g. items falling under section 17(5), it is important to factor such GST cost in the amount of provision created in the books of accounts, so that the same can be claimed as deductible expenditure for income-tax purpose in the same year in which provision is accrued.

4. *Valuation for Income tax vs. Indirect tax laws*

In matters where valuation of transactions involving related parties is concerned, distinct valuation regulations are outlined within Income Tax laws and Indirect Tax laws. A notable contrast exists between these sets of valuation rules. When it comes to the valuation for import of goods, the customs authorities often allege an undervaluation of goods. On the contrary, the income tax authorities allege an overvaluation of the same goods.

It is imperative to note that test of arm's length principle is applicable for all the transactions with related parties whereas in case of GST, the arm's length principle could typically come in play in case the recipient is not eligible for full ITC. Further, there is no exception under IT Act as is in the case of GST wherein cost plus ten per cent would be considered as valuation of the goods or services.

Case study – impact of the valuation rules for import of goods

Let us consider a case where ABC India, an Indian company, incurs substantial royalty or knowhow expenses towards its overseas Parent company. This payment is for the usage of the intellectual property using which ABC India is manufacturing a particular product. Further, ABC India imports raw material from the Parent entity for producing the said goods.

For accounting purposes as well as under the IT Act, the royalty or knowhow expenses are typically considered as revenue in nature and are claimed as a deduction by ABC

India. However, as a part of transfer pricing proceedings, the tax authorities would evaluate whether these payments are excessive and if found so, would try to arrive at a lower arm's length price which would increase the taxable profit of the company.

On the contrary, the Customs authorities typically may argue that such royalty is a condition of such import of goods and hence, the same should be added to the value of imported goods for payment of customs duty. Additionally, such royalty payment would also attract GST under reverse charge mechanism.

Considering the above, there is a very divergent view taken on valuation from the income tax and the indirect tax perspective, which could result into additional cost for the company, it is important to maintain appropriate documents to justify as to why such royalty is paid at arm's length basis and does not have direct linkage with import of goods.

5. *Preliminary Expenses*

Section 35D of the IT Act pertains to the provisions related to 'Amortization of Preliminary Expenses.' Under this section, businesses are allowed to claim deductions for preliminary expenses incurred in the process of setting up or expanding business. The deduction is allowed over a period of five years, starting from the year in which the business commences its operations. Further, any expenses which are incurred prior to the commencement of business but do not get covered under the provisions of section 35D are permanently disallowed under the IT Act.

For the purpose of GST, ITC would be allowed only to the person registered under CGST Act and respective SGST Act. Since, the preliminary expenses are incurred for incorporation or formation of the Company/ concern, it is natural that such person would not be registered under GST. Therefore, the ITC of such expenses would not be eligible under GST Law, which tantamount to credit loss. It is imperative to note that in the pre-GST regime, certain hon'ble courts in various cases had held that registration and eligibility of Cenvat credit are independent issues and thus Cenvat credit of service tax paid on input services prior to registration can be availed. To quote a few:

— ***mPortal India Wireless Solutions (P) Ltd. vs. CST [2011 (9) TMI 450 Karnataka High Court]***

— ***Commissioner of Service Tax Chennai vs. Verizon Data Services India Pvt. Ltd. [2013 (12) TMI 741 CESTAT Chennai]***

There may be certain expense incurred by the company before set-up i.e. before being ready to commence its operations does not fall within ambit of section 35D of the IT Act and the same cannot also be capitalized in any of the assets e.g., housekeeping or security expenses incurred while factory is being set-up, these expenses are typically disallowed for income-tax purpose. However, since these expenses are incurred after incorporation of the company, ITC on the should be available under GST laws. However, claiming any ITC for the period prior to GST registration would not be possible under GST even from compliance perspective.

6. *Corporate Social Responsibility (CSR) expenses*

The IT Act disallows CSR expenses under section 37(1) of the Act except where it fulfils the conditions under section 80G of the Act and is allowable as deduction under this section.

Under GST, credit eligibility on CSR related procurements has always been a contentious issue. Currently as per section 17(5)(h) ITC on goods disposed-off in the form of gifts

is ineligible. While there has always been confusion around applicability of section 17(5) to CSR expenses, considering the prevailing confusion, the Budget 2023 has proposed to put to rest the legal position by specifically introducing a provision to deny ITC on CSR expenses on all goods or services or both.

7. *Prior Period Items*

As per the provisions of the GST Law, ITC in respect of goods or services can be availed on or before 30th November following the end of the financial year in which the invoice or debit note is issued. Therefore, it is likely that ITC of invoice issued in FY 2022-23 is availed in FY 2023-24.

On the other hand, under the IT Act, business expenses are deductible in the same year to which they pertain. If the deduction is not claimed in the relevant financial year, it could be disallowed in the subsequent financial year, unless the expense is related to the current year.

8. *Treatment of Free Gifts and Samples*

ITC of the goods given as free gift or sample is specifically denied by Section 17(5) of CGST Act. However, the expenditure incurred for giving gifts and sample is eligible as deduction in terms of Section 37 of IT Act.

III. Revenue

GST is levied on "goods" and "services" whereas income tax is levied on "income". The definition of the term "goods" and "services" excludes shares, securities and activities covered under Schedule III such as sale of land and building. Resultantly, transaction in securities, land and building etc. would not be exigible to GST.

Whereas under the IT Act, income from shares & securities, land & building would be taxed under the head "Business or Profession" or "Capital Gains".

1. *High Seas and Out & Out Sale*

If the goods are procured by a person in India and are sold by him to a person located outside India without bringing the goods in India, the same are neither treated as supply of goods nor supply of service under the GST Law.

However, in accordance with section 5 of the IT Act, any income of resident which is received or accrued in India is taxable in India. Accordingly, any income generated by Indian company from its business operations in India is subject to taxation in India, irrespective of whether these sales occur within or beyond India's borders. Consequently, any income obtained from the sale of goods on the high seas is attributable to the taxpayer's annual income.

The aforementioned divergences are primarily because of the principle that indirect taxes are inherently levied on consumption whereas direct taxes are levied on source/ residence.

2. *Free of cost supply, Gift, Branch Transfers*

Under the GST law, transaction between related or distinct persons is treated as "supply" and liable to GST irrespective of whether or not the consideration is charged for such activity. If the goods or services are given free of cost to any unrelated person, then the same would not be liable to GST provided ITC on goods is not availed (as mentioned in Schedule I).

However, as per provisions of Section 56(2)(x) of the IT Act, any movable or immovable property received without any consideration is subject to tax under the head 'Income from other sources' where the threshold prescribed under this section is breached.

Transaction with Distinct Persons under same legal entity

As per Section 25 of CGST Act, two registrations of same legal entity would be treated as "distinct persons" for the purpose of GST Law. As per Schedule I of CGST Act, transaction in goods or services between distinct persons would be liable to GST even if the same is without consideration. Thus, there would be GST liability even on branch transfer. However, for the purpose of Income Tax Law, the entity as a whole is treated as 'one person'. Therefore, there are no implications on any branch transfer.

3. Advance receipts

ICDS IV – Revenue recognition prescribes that the revenue from sale of goods is recognized when the property in goods is transferred to the buyer along with all the risk and rewards associated therewith. In relation to revenue recognition for services, ICDS-IV prescribes that revenue from services shall be recognized on percentage completion method i.e. delivery of the services is important factor. However, as per the provisions of GST law, if advance is received prior to provision of service, then GST would be payable on such receipt.

Understanding the divergence through the example of treatment of advances

As per the provisions of GST Law, advance received for supply of services is liable to GST on receipt of such advance. The provisions relating to taxability of advance for supply of goods have been suspended w.e.f. 15 November 2017 vide Notification No. 66/2017-Central Tax. Therefore, presently GST is not payable on the advance received for supply of goods.

However, under the IT Act, income would be recognised only on actual provisioning of service. In other words, under income tax laws the receipt of advance would not be recognised as revenue till the service delivery is actually initiated as per provisions of ICDS IV – Revenue recognition.

Conclusion

There are many provisions where IT Act and GST laws are divergent. Some of these differences are due to inherent nature of the laws or the overall intent. However, these differences may lead to additional cost or cash flow impact for the taxpayers. Accordingly, one needs to be mindful of these areas, factor those in at the time of appropriately planning to transact and also include the same in the costing exercise of the taxpayers for internal management reporting as well as for negotiation with third parties.

"The extreme positive and the extreme negative are always similar. When the vibrations of light are too slow, we do not see them, nor do we see them when they are too rapid. So with sound; when very low in pitch, we do not hear it; when very high, we do not hear it either."

— *Swami Vivekananda*

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Business Expenditure – Similarity and Divergence between Income Tax & GST laws

CA Rohit Jain CA Arihant Tater

Overview

The article attempts to analyse the similarities and divergences in the provisions of the Income Tax and GST laws pertaining to business expenditure. On first flush, it may appear that both the taxing provisions are similar in nature. However, a deeper analysis would reflect that there are certain nuanced differences. The disallowances under both statutes are distinct and unrelated. The authors also highlight certain industry specific issues and point out that it has been recently observed that investigation by one wing of the Tax Department has also eventually invited scrutiny from the other Department.

In the modern economy, the power to levy taxes has been recognized as an essential attribute to sovereignty. The levy of tax by any sovereign nation is premised on three basic considerations – to raise revenue, carry out certain economic and social changes and discourage consumption of articles which the State regards as undesirable. Consistent with this objective, our direct and indirect tax laws have been framed by the legislature.

The Income Tax Act, 1961, which has been in vogue for more than sixty years, is a comprehensive direct tax levy on "income" earned by a person. The younger brother - GST, which was introduced in 2017, is a comprehensive indirect tax levy on the "supply" of goods and services.

Income Tax is levied on "income" and collected by the Central Government under Entry 82 of List I in the Seventh Schedule of the Constitution of India. The term "income" pre-supposes that it should be computed after providing deduction for all the expenditure incurred by the business for earning such income.

GST is levied concurrently by both the Central and State Governments under Article 246A of the Constitution of India. Recently, the Hon'ble Supreme Court (speaking through Chief Justice D Y Chandrachud) in the case of ***Union of India vs. Mohit Minerals [Civil Appeal No. 1390 of 2022 (SC)***] remarked that GST is a symbol of "co-operative federalism" as both the Union and the State legislatures have "equal, simultaneous and unique" powers to make laws on GST. The idea of GST was born out of the desire to have "one nation, one tax" and ensure that every rupee discharged as tax on procurement is correspondingly available as credit.

Common principle governing both levies

Section 37 of the Income Tax Act is the general provision which deals with grant of deduction qua items of business expenditure. Any expenditure which is incurred wholly and exclusively for the purposes of the business

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shall be allowed as deduction for computing business income.

On the other hand, section 16 of the Central Goods and Services Tax Act, 2017 ('CGST Act') deals with availment of input tax credit ('ITC') on goods and services used or intended to be used in the course or furtherance of business.

On first flush, on a comparison of section 37 vis-à-vis section 16, it may appear that the Income Tax and GST provisions are similar in nature – they allow seamless claim of expenditure/ITC which are in relation to business and disallow personal expenses. If the true intent of both the taxing provisions is gauged, a business should ordinarily be allowed deduction of all expenditures which are incurred in the course of business.

However, a deeper analysis would reflect that there are certain *nuanced* differences in both the provisions. The article attempts to analyse some of these divergences.

Allowability of expenditure under the Income Tax Act

The Income Tax Act provides detailed provisions to claim deduction of expenses incurred for earning business income. Sections 30 to 36 of the Act deals with specified deductions for computing profits and gains of business or profession and also prescribe certain conditions to avail such deductions.

Section 37 is a residuary section under the Income Tax Act extending the allowance to items of business expenditure which are not specifically covered under any of the preceding provisions. In terms of settled judicial precedents, the following conditions must be fulfilled for a particular item of expenditure to be allowed as deduction in computation of business income under section 37:

a. The expenditure should have been incurred in the accounting year;

b. The expenditure should be incurred exclusively and wholly for the purpose of business which was carried on by the assessee;

c. The expenditure should not be in the nature of personal expenses of the assessee;

d. The expenditure should not be in the nature of capital expenditure.

Once an assessee satisfies the above conditions, the claim of expenditure must be allowed. Courts have consistently held that the Tax Department "*cannot step into the shoes of the businessman*" to decide whether a particular expense is necessary or not. It is also not open for the Department to prescribe what expenditure an assessee should incur and in what circumstances he should incur that expenditure [Ref: ***Phaltan Sugar Works Ltd. vs. CIT reported in 1995 215 ITR 377 (Bom HC)***]

Allowability of ITC under the CGST Act

Under the erstwhile indirect tax regime, no set-off of central levies (such as excise duty, service tax) with state levies (such as VAT, entry tax) and *vice-versa* was permitted. Furthermore, no set-off was available in respect of certain specified levies such as CST, Entertainment Tax, Swachh Bharat Cess etc.

Therefore, one of the primary reasons for introduction of GST was to remove the cascading impact caused by multiplicity of indirect taxes and ensure seamless flow of credit across the chain. This underlying objective ought to be kept in mind at the time of analyzing the GST provisions.

Under section 16 of the CGST Act, the important conditions that must be fulfilled for availment of ITC are, *inter alia*:

a. The expenditure must be used or intended to be used in the course or furtherance of his business.

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b. The registered person must have received the goods or services;

c. The registered person must be in possession of valid tax invoice.

d. The expenditure should not be personal in nature.

It is a well settled position in law that that the right to input tax credit accrues consequent to the payment of tax, subject to the applicable provisions of law as on the date of accrual. Once the right to the credit so accrues, the same is in the nature of a vested right which is "indefeasible", as upheld in the landmark ruling of the Hon'ble Supreme Court in ***CCE vs. Dai Ichi Karkaria Ltd. [1999 (112) ELT 353 (SC)***].

Divergence in the negative list of disallowances under the respective statutes

A bare perusal of the statutory provisions would indicate that the negative list of disallowances under the Income Tax and GST law are distinct and separate - in scope as well as objective. Both statutes have drawn their respective negative list of disallowances.

Under the Income Tax Act, the objective behind the negative list of disallowances appears to be to (a) ensure compliance with TDS provisions, (b) curb tax evasion, and (c) identify unaccounted and cash transactions etc. The disallowances under the Income Tax are provided in section 40 & 40A of the Income Tax Act, *inter alia*:

- Disallowance on account of default in deduction of TDS/equalization levy on specified payments made to non-residents;
- Disallowances on account of default in deduction of TDS in respect of payments to residents [30% of the expense is disallowed];
- Income tax payments;
- Remuneration and interest on capital to partner beyond specified limit;
- Excessive on unreasonable payments to related parties;
- Cash payments exceeding INR 10,000.

On the other hand, the negative list of disallowances under GST is provided in section 17(5) of the CGST Act. These disallowances largely borrow inspiration from the erstwhile CENVAT regime as well as past litigation under erstwhile indirect tax regime. They also stem from the intent to disallow credits which do not have any link with a taxable outward supply. In case, for any reason, ITC is not eligible under section 17(5), the taxpayer must explore the option of claiming the said amount as deduction under Income Tax.

The key disallowances under section 17(5) are, *inter alia*:

- Motor vehicles except when they are used for specified taxable supplies;
- Food and beverages, outdoor catering, beauty treatment, health services, cosmetic and plastic surgery, travel benefits extended to employees on vacation;
- Goods and services received for construction of immovable property;
- Goods or services on which tax has been paid under composition scheme;
- Personal consumption;
- Goods lost/stolen/destroyed as well as gifts & free samples;
- Any tax paid u/s 74, 129 & 130 [*viz*. fraud, suppression cases]

Distinction between capital and revenue expenditure

Deduction under section 37 is available only in respect of revenue expenditure. Under the

Income Tax Act, capital expenditure is allowed as a deduction only when the statute expressly so provides.

On the other hand, the GST law does not make a specific distinction between revenue and capital expenditure inasmuch as credit on inputs, input services and capital goods can be availed in full in the year of purchase. This is also a welcome departure from the provisions of the erstwhile CENVAT regime where credit on capital goods was required to be availed in two instalments – 50% in the first year and the balance 50% in the subsequent year.

However, it must be noted that where depreciation under income tax has been claimed on the tax component of capital goods, ITC would not be available to the taxpayer. This is to ensure that double benefit is not taken by taxpayers.

Requirement of making payment to the supplier

Under the Income Tax Act, deduction is available in respect of those expenses which are incurred in the accounting year. Therefore, when the books of accounts are maintained on mercantile basis, expenditure would be allowed in the year when the expenditure is incurred irrespective of whether disbursement has been made or not. The claim of expenditure is not contingent on payment except in certain cases as specified in section 43B (*viz*. provident fund contributions, interest on loan, MSME payments etc.).

However, under the GST law, in order to claim credit, it is mandatory that: (a) the tax in respect of the supply has been paid to the Government and (b) the payment is made to the supplier within 180 days from the date of invoice. The GST law puts an onerous requirement on the recipient to pay the supplier within the specified time limit, failing which the corresponding ITC is liable to be reversed alongwith interest.

Requirement of one-to-one matching

At the time of introduction of GST, it was contemplated by the legislature that a robust matching system would be tech-enabled on the GST portal, which would provide the purchasers and the suppliers the ability to reconcile invoices. The matching requirement has also been introduced in the statute book by insertion of section 16(2)(aa) with effect from 1 January 2022.

Therefore, input tax credit will only be allowed if credit claimed by the recipient in its monthly GST return (Form GSTR 3B) matches with the corresponding disclosure by the supplier in its Form GSTR 1 and is auto-populated in the recipient's Form GSTR 2A.

While the vires of the matching provision is currently the subject matter of Writ Petition before various High Courts, the provision exists in the statute book today and the taxpayer is debarred from claiming credit without fulfilling the matching condition. It would be pertinent to mention that recently the Hon'ble Calcutta High Court in the case of ***Suncraft Energy Private Limited vs Asst. Commissioner, State Tax [MAT No. 1218 of 2023 (Cal HC)***] held that in cases of mismatch, ITC cannot be denied to the recipient without due investigation at the supplier's end.

Unlike the GST law, there is no such matching condition under the Income Tax Act. The claim of expenditure is largely on self-assessment basis. However, in case of scrutiny assessment, the onus of proving that the expenditure has been incurred lies on the assessee.

Expenditure prohibited by law

In terms of Explanation 1 & 3 to section 37 of the Income Tax Act, any expenditure which is an offence or is prohibited by law is specifically disallowed.

Recently, the Hon'ble Supreme Court passed a landmark judgment in the case of ***Apex Laboratories Pvt. Ltd. vs. DCIT [Civil Appeal No. 23207 of 2019 (SC)***]. The issue before the Supreme Court was with respect to deductibility of expenses incurred by the taxpayer for providing freebies (such as conference fees, gold coins, gifts etc.) to medical practitioners to promote sales of healthcare supplements. The Hon'ble Supreme Court emphatically upheld the disallowance on the ground that acceptance of freebies by medical practitioners is in violation of Indian Medical Council Regulations of 2002. If accepting freebies is prohibited by law for the recipient, giving freebies is also impliedly prohibited by law. The Hon'ble Supreme Court also held that one arm of the law cannot be utilised to defeat the other arm of law and doing so would be opposed to "public policy."

Under the GST law, there is no specific provision which disallows credit in respect of an expenditure which is prohibited by law. In the erstwhile regime, the High Court & Tribunal have held that when tax has been collected from the supplier by the Government, the corresponding input tax credit cannot be denied at the recipient's end.

However, recently the Directorate General of Goods and Services Tax Intelligence (DGGI) has issued GST show cause notices against the Insurance companies for illegally paying excess commission to agents. It has been alleged that the payment of excess commission is in violation of the regulations formulated by the Insurance Regulatory and Development Authority of India (IRDAI). The DGGI has sought to deny ITC in respect of such transactions and the matter is currently pending adjudication. The issue is likely to be strongly litigated by both the Insurance Company and the GST Department.

CSR expenditure & legislative overruling

Under both direct and indirect tax regime, Courts have consistently held that any CSR expenditure incurred by a Company is in furtherance of its statutory obligations under the Companies Act. The CSR expenditure has been incurred in the course of the business and must be allowed as deduction.

However, in order to override these rulings, the legislature has made amendments under the Income Tax Act and the CGST Act to specifically disallow CSR expenditure.

Explanation 2 to section 37 was inserted by Finance Act, 2014 to provide that any expenditure incurred in relation to CSR would not be deemed to be an expenditure incurred by the assessee for the purpose of business or profession. Recently, the Hon'ble Delhi High Court in the case of ***Principal Commissioner of Income Tax vs. Steel Authority of India Limited [2023/DHC/000307 in ITA No. 3 of 2023***] held that the amendment even though inserted through an Explanation would be prospective in nature and only apply with effect from 1 April 2015.

Recently, amendment has also been made in section 17(5) of the CGST Act [with effect from 1 October 2023] to disallow ITC on CSR expenditure. If the ratio of the judgment of the Hon'ble Delhi High Court is followed, the amendment must be interpreted as prospective in nature. Hence, ITC for CSR expenditure for the period prior to 1 October 2023 may be available to businesses, subject to fulfilment of other conditions.

As clearly evident, under both statutes, the legislature has sought to overrule the judgments and specifically disallow CSR expenditure.

Specific sectors not eligible for input tax credit under GST

Under GST, certain specific sectors such as the real estate and the restaurant sector are not eligible to avail input tax credit. The benefit of input tax credit has been denied in toto to these sectors in lieu of grant of concessional

rate of tax of 5% on the outward supply. Similarly, a non-resident taxable person is not eligible to claim ITC except on import of goods.

However, there is no such sector specific expense disallowance under the Income Tax Act.

There are also certain other **procedural bottlenecks** in GST which bar claim of ITC. Some of these scenarios are illustrated below:

a. Under GST, each state GST registration is considered to be a "distinct person". Credit pertaining to one state GST registration (say State X) cannot be claimed by another state GST registration (say State Y) even if the expenses have been incurred by the Company in the course of business.

b. Similarly, liability of one state registration (State X) cannot be discharged through ITC availed by another state registration (State Y) qua the same Company. There is also no mechanism for inter-state transfer of credit within the same company.

c. Unlike income tax, ITC would not be available if the expense has been incurred but goods/services are yet to be received.

d. A duty paying document (invoice/bill of entry) is sine qua non for availment of credit.

e. ITC is also not available if the place of supply of goods or services is different from the state where the entity is registered.

It is universally recognised that the greatest virtue of a value added tax system is that a full and free flow of credits ensures that only the value addition in each leg of a transaction is subjected to tax. At the time of introduction of GST, one of the avowed objectives of the Government was to ensure seamless flow of credits. GST was touted as a good and simple tax. However, on account of the numerous legislative amendments as well as procedural bottlenecks, the idea of a good and simple tax and seamless flow of credit appears to be a far-fetched dream.

Conclusion

As analysed hereinabove, the disallowances under the Income Tax and GST law are distinct in both nature and objective. It cannot therefore be assumed that an expenditure which is allowable as deduction under the Income Tax Act would also be eligible for ITC under GST and vice versa.

Similarly, the Department cannot also assume that an expenditure which is not allowable under Income Tax would also not be eligible as ITC under GST. A taxing statute needs to be interpreted strictly and there is no room for intendment.

At the time of assessment, the taxpayer is required to demonstrate compliance to both authorities separately and fulfil the procedural conditions specified in the statute.

Before parting, it would also be important to note that there has been wide facilitation and sharing of data between income tax and GST authorities. It has been recently observed that investigation by one wing of the Tax Department has eventually also invited scrutiny from the other Department. By way of illustration, reference may be drawn to recent investigation initiated against pharma companies qua payments made to medical practitioners, bogus purchase and fake invoicing investigation etc.

It is therefore the need of the hour that taxpayers revisit their tax position with a view to ensure compliance and alignment with both laws.

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Place of Supply vs. Cross Border Transactions under Income Tax

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Overview

In these rapidly evolving times of taxation we often find ourselves in the cusp of challenging provisions. Income tax law and GST have points of convergence as well as divergence. While, there are transactions which are supply that need not result in income, there are also transactions which are taxable under Income tax law which are not taxable supplies under GST. The position of GST and Income tax is examined in the concept of (i) Merchant trading/ High Sea Sales (ii) Intermediary Services (iii) Tool development (iv) Reimbursement of expenses (v) Corporate Guarantee. All these transactions have their specific rules and regulations for taxation and reporting purposes. It is likely that tax position taken under one law will resonate in the context of the other law and the journey of the assessee will be that of explanations and reconciliation.

Income tax law and GST have points of convergence as well as divergence. As a business a particular transaction could be looked at differently by both tax laws and there are cases where the tax administrator compares the reporting in both these laws to arrive at new tax liabilities. While, there are transactions which are supply that need not result in income and there are transactions which are taxable under Income tax law which need not be a taxable supply under GST, a number of cross-border transactions require examination for understanding how both laws look at the same transaction.

Cross-border transactions have their own challenges in Income Tax with reference to characterization of the transaction; source vs. residence debate; withholding obligations; existence or non-existence of Double Taxation Avoidance Agreements; transfer pricing; etc.

In GST issues arise on account goods vs. service debate; nature of service; place of supply; conditions for export and import; related party transactions etc.

Merchant Trading & High Sea Sales

Merchant Trade transaction is a transaction which involves shipment of goods from one foreign country to another foreign country without touching the India but involving an Indian trader. In other words, goods are bought and sold by a domestic company/firm and at no point of time, such goods enter the Indian territory. These transactions do not involve movement of goods, but would involve inflow and outflow of foreign currency in India.

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In so far as Income tax is concerned, when a resident engages in merchant trading without the goods touching India, the income is still accruing or arising in India and liable to tax. When it came to GST many were clear that the transaction was outside the scope and ambit of Indian GST laws. However, some believed that it was taxable in India which led to debates and finally resulted in expansion in the list of items covered in the Schedule III to the CGST Act, 2017. Entry 7 declares that supply of goods from a place in the non-taxable territory to another in the non-taxable territory without certain goods entering into India is neither supply of goods nor supply of service.

High sea sale was a popular commercial terminology that was coined during the sales tax regime in the context of Article 286 of the Constitution of India and more specifically Section 5(2) of the Central Sales Tax Act, 1956. In a high sea sale, the importer does not clear the goods and identifies the buyer when the goods are in the course of import into India and transfers title to the goods before the goods cross the customs frontiers of India. The Customs law recognizes high sea sale and identifies the ultimate buyer as the importer liable to discharge applicable customs duties.

A from India may place a purchase order on B from Belgium and may transfer title to the goods before customs clearance to C in India and C may also do a further transfer in favour of D before customs clearance. Thus, A as well as C in India would derive income; A as well as C will have revenues reflected in their financial statements and D would be the importer filing the bill of entry.

When goods are imported into the country, IGST is levied under Section 3(7) of the Customs Tariff Act read with the proviso to Section 5(1) of the IGST Act, 2017. In terms of Section 3(8A) of the Customs Tariff Act, where goods that are deposited in the warehouse under the Customs Act are sold before clearance for home consumption, the value for levy of IGST would be the value determined under Section 3 or transaction value whichever is higher. In the instant case, the price paid by D to C would be the value for the purpose of levy of IGST in the hands of D. A as well as C would earn income on the transaction which would attract income tax in India but the transaction is excluded from the levy of GST by virtue of Entry 8, Schedule-III, CGST Act which declares such transaction *as neither supply of goods nor supply of services*.

While GST law is quite clear on non-taxability, comparison of GST returns with IT returns or GST returns with financial statements will throw-up queries and explanations will have to be given.

Finance Act, 2023 as amended Section 17 of the CGST Act whereby in the Explanation to Section 17(3) activities and transactions set out in para 8(a) of the Schedule-III have to be treated as an exempt supply. This amendment shall come into force from 01.10.2023 in terms of Notification No. 28/2023. In other words, even though the transaction is expressly declared as neither supply of goods nor supply of services, the amendment results in the transaction being treated as exempt supply which will impact the ITC that is availed.

Intermediary Services

An exporter in India may engage an agent or an intermediary in USA to procure orders or bring in sales and would be paid commission for the services rendered. The commission could be a percentage of sales. In the context

of income tax law, the general position would be that the income arising to the US resident would be in the nature of business profits and in terms of the Indo-US DTAA, the business profits cannot be taxed in India in the absence of a permanent establishment in India. Consequently, since no income accrues or arises in India, the Indian exporter would not be deducting tax at source when foreign payments are released.

In so far as GST is concerned, the place of supply in respect of intermediary services if the location of the supplier of services in terms of Section 13(8) of the IGST Act. Since the place of supply is outside India, the transaction will not amount to an import of service and would not attract IGST in the hands of the exporter under reverse charge mechanism.

Given the fact that it is a payment in foreign exchange, it would be specifically reported in the financial statements and queries would be raised in GST audit or assessment as to why IGST was not paid under reverse charge mechanism and explanation will have to be provided.

Permanent Establishment vs. Fixed Establishment

Where a permanent establishment can be determined to exist in India either by application by law or by the scope and ambit of the said term in the DTAA, profit attributable to the said permanent establishment will be taxed in India. A foreign entity which is considered to have a permanent establishment would thus be complying with various requirements of the income tax law in India.

The GST law brings in a new concept called as 'fixed establishment' which is defined as a place other than the registered place of business which is characterized by sufficient degree of permanence and suitable structure in terms of human and technical resources to supply services or to receive and use services for its own needs. Location of a supplier of services can be in India if a supply is made from a fixed establishment in India.

Interesting questions can arise in this context. Whether a PE created in India for a foreign entity would tantamount to an FE in India for the purpose of GST or whether a GST registration or FE in India can create a PE in India for a foreign entity?

The Supreme Court in the case of ***Formula One World Championship Ltd. (2017) 394 ITR 80*** has held that the Buddh International Circuit is a fixed place where the commercial/ economic activity of conducting F-1 championship was carried out, one could clearly discern that it was a virtual projection of the foreign enterprise namely Formula 1 (FOWC) on the soil of this Country. The fixed place of business that is the Buddh International Circuit was at the disposal of FOWC through which it conducted business. The taxable event has taken place in India and the non-resident FOWC is liable to pay tax in India on the income it has earned on this soil.

Now if the facts that let to this decision is reimagine for the purpose of testing whether fixed establishment is created for the purpose of GST. A fixed establishment requires sufficient degree of permanence and suitable structure in terms of human and technical resources to supply services and to receive and use services for its own needs.

In the ***Formula One*** case, Jaypee had entered into a race promotion agreement with FOWC whereby FOWC granted Jaypee the right

to host and promote F-1 Grand Prix of India event for a consideration of USD 40 Million. Under an artwork license agreement, FOWC permitted Jaypee to use certain IPR for a consideration of USD 1 million. Two possibilities emerge with attendant risks. If Jaypee, the Indian Company, were to take the position that FOWC has a fixed establishment in India on account of the existence of the permanent establishment under Income Tax Act then forward charge mechanism would become applicable and the responsibility to discharge GST would be on FOWC. On the other hand, if the transaction is considered as import of services by Jaypee and payments are released for various services, IGST would apply depending upon the nature of service and the place of supply being India.

Tool Development

An Indian Company is engaged by a US Company to develop tools and is remunerated in convertible foreign exchange. The tools belong to the US Company but are permitted to be retained by the Indian Company to be used in the manufacture of components which are to be supplied by the Indian Company to the US Company.

In GST law, export of goods means taking the goods out of India to a place outside India. While the components that are manufactured are exported, the tools do not leave the country. Even though the Indian company would receive convertible foreign exchange, the transaction involving the tools will not qualify as an export of goods. The question that would arise in GST is whether there is a supply of tools liable to GST or whether the transaction should be seen as tool development charges and in the nature of export of service or whether the tools can be considered as part and parcel of the export of component transaction.

The Karnataka High Court in the case of ***Ibex Engineering Pvt. Ltd. vs. State of Karnataka (2012) 49 VST 302*** held that delivery could be actual or symbolic and in this case delivery is symbolic as soon as it became the property of the foreign company and was held on behalf of the foreign company. Indian Company also acted under the instruction of the foreign buyer for further manufacture of goods for the benefit of the foreign buyer. As soon as payment was received and appropriated with reference to the moulds, sale had taken place. Transaction is not in the nature of export or inter-State sales and liable to Karnataka VAT.

The Mumbai High Court in the case of ***Tata Johnson Controls Automotive Ltd. (2017) 7 GSTL 271*** has held that the total amount of consideration for purchase of goods would include the price strictly so called and also other amounts which are payable by the purchaser or which represent the expenses required for completing the sale as a supplier would ordinarily include all of them in the price of which he would sell his goods. The payment of designing and tool costs is necessary concomitant of the final sale price of the seating system. The seller would not deliver the seating system without recovering the cost of the designing and moulds required for manufacture of seating system. The cost paid towards designing and tooling is part of the same series of the transaction of the sale of seating system. The sale cannot be segregated. The development charges for the mould is agreed to be charged and paid as part of the contract of supply of seating system. The development charges for designing and tool have inescapable bearing on the delivery of the seating system and therefore they will have to be held as part of the sale price of the seating system.

In the context of income tax, a question that can arise is whether the tools and moulds

developed for the US Company and located in India, can by itself create Permanent Establishment?

In the case of ***Poompuhar Shipping Corporation Ltd. vs. ITO (2014) 360 ITR 257 (Mad)***, the Madras High Court held that 'ship' is equipment of the business of a ship owner on a natural and ordinary meaning of the word.

The AAR in the case of ***Sea Bird Exploration FZ LLC (2018) 92 taxmann.com 328 (AAR)*** ruled that the applicant has a PE in India in the form of vessels and that by itself would constitute a fixed place PE since the vessel performs all the activities for the purposes of the contract and is at the disposal of the applicant.

It may be possible to demonstrate that the tool by itself does not create a permanent establishment in India on account of the fact that it is not a virtual projection of the foreign enterprise in India, and does not constitute a fixed base PE in India.

Reimbursement of Expenses

The general concept of reimbursement, as understood in Income Tax, is that 'Reimbursement' means payment for what has already been spent or incurred. It is not a reward or compensation for a service rendered. There should be a clear ascertainable relationship between the paying and the reimbursed parties. Reimbursement will be subject to tax only if the payment has been made in lieu of a supply of goods or services. It is upto the parties to demonstrate that the amount recovered is in the nature of reimbursement and does not constitute consideration.

In GST, there is an added complication where the transacting parties are related. When the transaction is between related parties, consideration is irrelevant and the transaction involving supply of goods or services is liable to GST sans consideration. Open market value of the supply of goods or services has to be determined for levy of GST. However, the GST law also recognizes a concept of pure agency whereby, if the conditions set out in Rule 33 of the CGST Rules, 2017 are met, the amount recovered as reimbursement will not form part of value for the purpose of GST.

While both the laws recognize the concept of consideration and the scenarios where reimbursement would not amount to consideration, the conditions for pure agency are strict with reference to GST.

Corporate Guarantee

Corporate Guarantee is a guarantee given by one business entity or by a corporate entity or a holding company or subsidiary company or joint venture company to another entity/company; which means one corporate entity stands as a guarantor for another corporate entity. It is generally given at the time of term loan or working capital loan, other special purpose loans being availed by other company. For e.g. If the subsidiary company fails to repay the debt, the holding company who stood as the guarantee will pay the debt on behalf of the subsidiary company.

Generally, when one entity provides a corporate guarantee to an institution or a bank in connection with financing or funding extended to another entity, there would be a fee or a commission which would represent the consideration for extending the services. However, when a holding company provides a corporate guarantee to its subsidiary, it is only engaging in a shareholder activity and is taking steps to protect its investments and there is no fee or commission.

In the context of income tax law, the Ahmedabad Bench of the ITAT in the case of ***Micro Inks Ltd. vs. ACIT, (TS-568-ITAT-2015)***, has held as under:

> *As evident from the OECD observation to the effect "In contrast, if for example a parent company raises funds on behalf of another group member which uses them to acquire a new company, the parent company would generally be regarded as providing a service to the group member", it is also to be clear that when the corporate guarantees are issued for the purpose of subsidiaries raising funds for acquisitions by such subsidiaries, these guarantees will be deemed to be services to the subsidiaries, and, as a corollary thereto, when corporate guarantees are issued for the subsidiaries to raise funds for their own needs, the corporate guarantees are to be treated as shareholder activity. The use of borrowed funds for own use is a reasonable presumption as it is a matter of course rather than exception. There has to be something on record to indicate or suggest that the funds raised by the subsidiary, with the help of the guarantee given by the assessee, are not for its own business purposes. As a plain look at the details of corporate guarantees would show, these guarantees were issued to various banks in respect of the credit facilities availed by the subsidiaries from these banks. The guarantees were prima facie in the nature of shareholder activity as it was to provide, or compensate for lack of, core strength for raising the finances from banks. No material, indicating to the contrary, is brought on record in this case. Going by the OECD Guidance also, it is not really possible to hold that the corporate guarantees issued by the assessee were in the nature of 'provision for service' and not a shareholder activity which are mutually exclusive in nature. In the light of these discussions, we are of the considered view, and are fully supported by the OECD Guidance in this, that the issuance of corporate guarantees, in the nature of quasi-capital or shareholder activity- as is the uncontroverted position on the facts of this case, does not amount to a service in which respect of which arm's length adjustment can be done.*

The Mumbai Tribunal in the case of ***Manugraph India Ltd. vs. DCIT (TS-190-ITAT-2016)***, relying on the decision of the Ahmedabad Tribunal in the case of Micro Ink has held that “issuance of a corporate guarantee may have an influence on the profits, incomes, losses and assets of an entity, in whose favour the guarantee is issued, but it has no impact on the same as long as it is issued without a consideration and as long as the guarantee is not invoked by the beneficiary”.

In the case of ***Foursoft Pvt. Ltd. vs. DCIT (TS -104-ITAT-2014-TP)***, the Hyderabad Tribunal held that ALP of the corporate guarantee had to be determined as it falls within the scope and ambit of an international transaction after the retrospective amendment to section 92B. It was also held that "As the corporate guarantee is not in the nature of bank guarantee, the rate applicable to bank guarantee provided by the bank cannot be applied to corporate guarantee which is provided by a group company."

There are contra views as in the case of ***Everest Canto Cylinder Ltd. vs. DCIT 2016-TII-527-ITAT-MUM-TP*** which was after the retrospective amendment by Finance Act, 2012 roping in guarantee within the scope

of international transaction. The Mumbai Tribunal held that a universal rate of 3% cannot be applied and it is largely dependent upon terms and conditions on which the loan was given; risks undertaken; relationship between the parties; and other economic and business interests. Similarly, in the case of ***Glenmark Pharmaceuticals vs. ACIT 2019-TII-390-ITAT-MUM-TP,*** the Mumbai Bench of ITAT upheld guarantee commission rate charged on loans and letter of credit facility at 0.53% and 1.47% respectively as ALP.

In the case of ***ACIT vs. Nimbus Communications Ltd 145 ITD 582 (Mum. Trib.)***, it was held that transaction of providing corporate guarantee involves service rendered to AE and, therefore, provisions of transfer pricing can be invoked in respect of such a transaction, since independent enterprise would have charged a fee for this service and therefore, arm's length price for such transaction should be determined.

The decisions prior to the amendment in Income Tax Act recognize the principle that provision of corporate guarantee by a holding company is quasi capital in nature and akin to shareholder activity. It does not involve any provision of service.

The issue has now surfaced in GST and since consideration is irrelevant where the transaction is between related parties, provision of corporate guarantee is sought to be treated as a service for the purpose of levy of GST.

It should be possible to contend that even though the parties are related, there is no supply of service. While consideration is not a criteria in a transaction between related parties, the transaction must involve a supply of goods or services.

Alternatively, the essence of Board Circular No. 199, dated 17.07.2023, is applicable. The Board has clarified that if head office has not issued a tax invoice to the branch office in respect of any particular services being rendered by head office to the said branch office, the value of such services may be deemed to be declared as Nil by head office to the branch office, and may be deemed as open market value in terms of second proviso to rule 28 of CGST Rules. While the Board has explained the concept in the context of distinct persons, the analogy is equally applicable and relevant to related persons since the valuation under Rule 28 is the same for both related and distinct persons.

In so far as corporate guarantee provided to an overseas subsidiary is concerned, even if a service is perceived, it will tantamount to an export of service and if a nil value is identified as the value, then, there is no necessity for realisation of foreign exchange.

> A practical and simpler solution would be to identify a particular fee or commission and discharge GST subject to the position adopted in direct taxes. Once a value is adopted in invoice and full ITC is available to the recipient, it is deemed to be open market value in GST.

Distinct and related persons under GST and related party transactions under IT

CA Jatin Christopher

Overview

People in a civil society have given themselves laws that are knowable with certainty of consequences so that it furthers their own development and fosters cooperation with others. The law on GST is no stranger to this truth and, in fact, it is truer still in GST than other modern legislations because Central GST Act is deeply pervaded first principles traceable to Contract law and Property laws such that no treatment in GST can operate in vacuo. This interdependence presents a piquant situation where assertions made by taxpayers to different regulators cannot be divergent on facts, that any incongruity in them could belie each other, especially, when advantageous tax consequences arise. It is in this conspectus of inter-dependence of assertions coupled with exposure of any incongruity in tax positions adopted touching the contours of:

a) Concept of 'distinct persons' in GST;

b) Domestic inter-branch activities and the limits to circular 199;

c) Cross-border activities and inapplicability of raison d'etre of circular;

d) Assertions in transfer pricing positions adopted and those contested;

e) Implications of anti-abuse adjustments accepted by taxpayers;

f) Cross-pollination effect of divergent assertions made in support of respective tax positions when underlying transactions remain the same.

Introduction

'Knowability of laws' is the most decent thing society can offer to its citizens and uniformity and certainty in implementation of knowable laws bear the marks of a progressive society. Contract law lays the foundation on which GST builds its edifice. And to bring something to tax needs no less uniformity and certainty; and being a new legislation, Central GST Act, is encumbered to explain itself properly to stay true to the decency of knowability of laws.

Capacity to contract lies at the heart of contract formation and where every 'form of supply' in GST is inevitably a contractual arrangement, essentials of a valid contract are baked into GST law.

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Non-taxability of income on the 'principle of mutuality' is a telling example of Income-tax law acknowledging that contractual capacity is eclipsed in transactions *inter se* members and their collective (in any form of organization). And to overcome this reality, GST needed the take support of a legislative fiction super-added in the definition of 'supply' and sidestep a 2021-decision of Apex Court that put its weight behind this salutary principle.

Existence of consideration is evidence of existence of a contract. Adequacy of consideration is no one's concern as long the stated consideration is real and valuable. GST is charged on the transaction price on the given form of supply. Existence of relationship between the transacting parties is one of three disqualifications for the discharge of tax based on transacted price. Existence of relationship casts a shadow of doubt about the price being the sole consideration. And without labouring to true-up the price, GST relegates transaction to suffer the ignominy of testing based on comparable price to reach the transaction price that would now form the basis for computing tax.

Deeming fiction in schedule I is another area in GST where the absence of consideration is rendered irrelevant by imputing validity to finite set of four (4) transactions, but all other ingredients still being required to fulfil the 'form' of supply involved. An attempt is made here to examine the contours of contracting capacity and the fiction in GST feeding to overcome principle of mutuality and essentiality of consideration to form a valid contract, to exact tax from transactions where either the consideration is suspect or consideration altogether absent. And present the dichotomy of tax treatment and inevitable overlap in factual assertions in income-tax that threaten to pollinate treatment in GST as if the two would operate under dictation from each other.

Concept of distinct person

Companies Act is voluminous because the idea of a legalistic form of entity is to be given birth and that requires extensive law-making on matters such as formation, ownership, management, scheme of arrangement and liquidation, which are taken for granted in the case of natural persons. GST in the context of a federal State cannot operate like any other unitary State and tax revenues need to flow to their location of consumption. And to this end, it has developed the concept of 'distinct person' which by definition is (i) each new registered location or (ii) location in another State with permanence or economic substance. Distinct persons while being integral to a legal entity are imputed to have independent existence inter se other distinct persons of that entity.

Where things stand thus, transactions between distinct persons are liable to be viewed as transactions between two entities simplicitor. As to which of them entered into the contract with a Customer and which of them engaged in executing that contract, needs to be investigated based on first principles of Contract Law once their independence is admitted.

Contract is awarded to that distinct person who made the offer who remains answerable for product warranty. And if this is the Corporate Office of the legal entity, say, in Mumbai, execution of this contract by another distinct person located, say, in Bangalore where Project Site is located, creates analogically a 'contractor and sub-contractor' relationship inter se. That distinct person which signed the contract cannot cede the contract to the distinct person engaged in fulfilling the contract, not without the Customer consenting. And when Customers who choose to be agnostic to these matters, permit tactical independence to their contractor so as to preserve their remedies against the legal entity, will operate above the

concept of distinct persons leaving the entity to deal with the predicament of 'contractor and sub-contractor' relationship and attendant GST treatment involved.

Contracts for cross-border transactions operate de hors roles to be played by distinct persons in their execution. And with an eye on preserving their contractual remedies, Customers remain indifferent to matters outside their frame of reference as a contractee. Contracting entity in India is free to establish a branch outside India for execution of the contract or the manner of execution of the contract may result in the constitution of a PE outside India. Neutralizing effect of transactions inter se in consolidated financial statements can have blurring effects on the insight need to unbundle and report transactions between all these distinct persons and satisfy the attendant GST treatment.

Domestic inter-branch activities

BFSI-FAQs issued by CBIC in 2018 states that head office of a banking company, although does not engage in operations with customers, is a supplier of management supervision and oversight services to its various distinct persons and liable tax based on a cost construction method (Q55). But the widespread non-compliance by corporate India compelled the Government, while addressing the same sort of services with a new moniker – internally generated services – CIBC issued circular 199/11/2023-GST dated 17th July 2023, declaring transactions between distinct persons to be the (i) value declared on any invoice issued and be deemed to be its open market value and (ii) where no such invoice is issued, be deemed to have been issued at value of Rs. Nil and admitted to be sufficient compliance with the requirements qua distinct persons.

It is one thing to be satisfied with the value declared on an invoice properly issued, but it is something else to be satisfied even though none was ever issued. And after the celebrations subside, this circular has made an unequivocal declaration that domestic inter-branch transactions attract incidence of tax and non-compliance excused only where they are revenue neutral; even though revenue neutrality is the anti-thesis of a multi-point tax system that GST asserts to be. With States, where distinct persons involved in execution of contracts are located, standing to lose their share of revenue and States, where corporate offices are located accumulate input tax credit will come in for severe scrutiny that their outward supplies are admitted being taxable but at a transaction price of Rs. Nil.

Domestic inter-branch activities that do not avail this exclusion from compliance due to the revenue neutral result, have their work cut out because and the fact – that some credit clearly remains to be denied – is no longer a secret. Of greater importance is the role of deeming Rs. Nil to be adequate consideration and merits some discussion. Consideration of Rs. 1 or 10 is sufficient to execute a document and register it, as seen in some lease agreements that must be registered. But consideration to be valid must be real and valuable. Nominal consideration is not valuable consideration. This is not to say that consideration in a contract can be questioned by an authority. But for that contract to be enforceable, its consideration must be real – in the eyes of those involved in that trade – and valuable – in that it will not shock the conscience of a Court who is to enforce its payment.

In ***Stilk vs. Myrick (1809) 2 Camo 317***, it was held that the Captain who agreed to pay additional sum to the seamen who offered to bring the ship to shore when certain others bailed in high-seas, was not liable to pay this additional sum as the seamen only carried out their original bargain. And to enforce payment of additional sum, there was no consideration

flowing to the Captain. In ***Chappel & Co. Ltd. vs. Nestle Co. Ltd. (196) AC 87***, when a scheme for giving music record for money (1s/6d) plus three (3) empty wrappers of any Nestle chocolate bar was announced, it was held that the value of the record was money consideration and cost to be incurred to secure those empty wrappers.

Rule 28 contains a *proviso* that forms the basis for circular 199 to overlook the principles surrounding valuable consideration and extend this largesse to include Rs. Nil as the admissible consideration for completing self-assessment of inter-branch activities. When a rule offends the mandate in the statute, long-standing jurisprudence says that this is abuse by delegate. After all, rule-making is delegated by Legislature and section 15(4) can be pressed into service only when price asserted in section 15(1) is not the sole consideration to be admitted as transaction price and accept tax arising thereon. When nominal consideration is not real and valuable, no rule can change that to render Rs. Nil to be acceptable, not even on the back of revenue neutrality. And if this proviso is read without offending prevailing jurisprudence about latitude available in delegated legislations, value declared on the invoice requires that (i) an invoice be issued for domestic inter-branch activities and (ii) such value being real and valuable consideration for purposes of section 15(1). And when these two aspects are shown to exits, proviso in the rules can then ringfence these invoices from any scrutiny by Proper Officer on the ground of price being disqualified due to parties being related.

But then you are told not to 'look the gift horse in the mouth'. Relief that corporate India stands to avail in respect of their non-compliance with tax incidence on supplier-distinct person (and that credit omitted to be claimed by recipient-distinct person will be lost due to limitation), multi-locational entities need to be circumspect while relying on this circular for the reasons that (i) it addresses only (internally generated) services but reference in rule 28 covers goods and extending this raison d'etre can be perilous (ii) scope and extent of the definition of internally generated services is yet to be discovered and (iii) existence of invoice is different from imagining existence of invoice for these inter-branch activities. Also of interest incidentally is that interchangeability of ISD with cross-charge bears the risk that unlike cross-charge, ISD permits passing same rate of tax paid as credit to distinct persons.

Cross-border inter-branch activities

Imports from branch outside India is liable to duty under Customs law in respect of goods and tax under IGST Act is applicable on as 'import of services', subject to its definition in the law. There is nothing in circular 199 that applies to import of goods and for that matter to import of services too. Exports to branch outside India is generally excluded from duty under Customs law, subject to alterations to a short positive list of dutiable exports from time to time, and ineligible to zero-rated benefit in view of express exclusion of distinct persons from the definition of 'export of services' itself.

This basic layout of the land applies to branch office, project office or any other forms of PE outside India of an Indian entity. Financing the cost of a liaison office ("LO") outside India is liable to tax as 'import of services' since the restrictions on LO is only to engage in business in that jurisdiction but the costs incurred are indubitably of value to the Indian entity which has set up an office 'to act as a channel of communication' in that jurisdiction. While GST is not a tax on outlays but on supply, LO is not to engage in business in that jurisdiction but activities of LO is pithily the business for Indian entity. Financing the expenses of LO not being 'transactions in money' because it is neither repayable

in future to Indian entity nor covered by any other exclusion, will be exposed to the full extent of the incidence of tax as import of services. The impost here is not on the transactions between LO and vendors in that jurisdiction. The impost is on the transaction between distinct person in India and LO outside India. And there is no basis to assert that LO does not perform a service or that the service is of no value to the Indian entity as both will belie commercial wisdom in setting up that LO. Activities of Indian LO of overseas entities do not merit deliberation because services of such LO will anyway be zero-rated.

Legal entity in either jurisdiction operates through the instrumentality of the LO in the other jurisdiction, but the fiction of distinct persons begs re-examination of the facts 'as if' they were independent entities accommodating each other in carrying out whatever activities they are engaged in and for whatever commercial wisdom that supports it. Viewed in that light, entity in one jurisdiction pays for 'anything other than goods' to another entity in the other jurisdiction. And the entity in that jurisdiction incurs costs on various vendors out of the sum received and fulfils its obligations towards the entity in other jurisdiction under a deliberate arrangement is inviolable. Supply for anything other than goods, not being transactions in money, is supply of services. And where the LO is outside India then it will be 'import of services' liable to tax not only when there is no flow of consideration but inescapably so when there is flow of consideration – sums paid on non-repayable basis. When debate revolves around valuation, taxability stands conceded.

If the incidence of tax in respect of transactions with LO is admitted for discussion, there can be no other way to view transactions with branch office, project office and any other PE that is admitted and evidenced by corporate tax returns filed in those jurisdictions. Facts flow from assertions made about the existence of an establishment outside India of the legal entity in India. And when there is an assertion to an overseas regulator the adage 'if it is good for the goose must be good for the gander' settles any remaining debate. Transactions may vary but none are immune from inquiry into possible GST exposure. Transactions entered into with vendors in that jurisdiction by these distinct persons are not the subject matter of GST treatment in India, but the transactions *inter se* are the heart of this exposure. Where there is complete financial and operational autonomy allegedly enjoyed by these distinct persons then GST will still have a say unless it can be shown that contracts are entered into, executed and warranties fulfilled by each distinct person independently. Should this be the case, then it would be remarkable because wisdom in setting up branches is not to operate autonomously but to draw from each other's skills, competences, strengths and complement each other for their collective welfare. To assert absolute independent existence of overseas distinct persons would border on imprudence due to its near impossibility rather than admitting interdependence and offer a certain value to applicable tax treatment. With tax treatment admitted in self-assessment, unseating such admission to successfully foist additional demand would be herculean, one that will be more readily dismissed than sustained in later proceedings.

Copious amounts of data are readily available in CbCR disclosure by global entities where description of transactions even reveal their POS when viewed insightfully into likely GST exposure and transaction value of those arrangements anyway forms meat-of-the-matter in these filings. Related parties cannot conceal their transactions even when they mutually cancel out receivable with payable and are liable to be reported, at least disclosed in

financials to expose their existence and inflict the applicable GST treatment.

Disclosure of internal arrangements with a financial bearing are even less likely to miss regulatory attention due to increasing transparency being mandated in each new edition of standards of accounting. A shining example of accounting guidance engendering some GST exposure is the Guidance Note issued by ICAI on accounting treatment and disclosure of share-settled payment plans. It states that reporting entity through these plans makes an unequivocal statement of fact that a supplier (could be employee) received shares of one entity against obligations of another entity to whom supplies are made. And this is explained when occurring in a Parent-Subsidiary relationship, that fair value of the incentive given with shares of Parent tantamount to capital contribution to Subsidiary which is then expended in rewarding its employees. GST treatment is inescapable because (i) shares are not of Subsidiary and (ii) employees are not of the Parent (see Annexure X).

Transfer pricing bench-marking study and assessment

Existence of relationship need not impact the price at which parties transact. Functional analysis carried for purposes of demonstrating arm's length pricing, discloses all factors that have had a bearing on the pricing admits (i) flow of consideration without flow of money and (ii) applicability of GST treatment after disaggregating individual transactions whose cumulative effect of inflow-outflow falls within the acceptable range. Facts disclosed in this functional analysis cannot be denied when it comes to examining treatment necessary in GST. And GST is neither obliged to apply the treatment on the net adjustment nor estopped from unbundling each transaction and giving them the necessary treatment.

Taxpayers even carry out adjustments voluntarily in respect of (i) assets including working capital supplied at no charge and (ii) risks avoided by outsourcing to associate entities. GST treatment due in respect of each transactions is inevitable and at values determined by GST and not transfer pricing regulations. Transfer pricing adjustments may be compelled in adversarial proceedings which may be conceded either because the income-tax demand is far lesser than anticipated or the exposure of business arrangements in litigation proceedings is undesirable. Whatever may be the reasons, accepting adjustments also demands attendant GST treatment.

Income attributed to overseas PE admits (i) award of composite contracts (ii) execution by internal allocation of scope and revenue. When contractual privity cannot be vivisected, 'contractor and sub-contractor' relations are created and GST treatment ensues. Details of income attributed to overseas PE is readily available in tax returns in overseas jurisdictions, GST treatment on (i) contracted value on distinct person securing the contract and (ii) imputed value on distinct person executing the contract, will both be required. This requirement when applied along with the divergent tax treatment on 'import of services v. export of services' necessarily creates prejudicial outcome. Again, GST treatment is not in respect of deductibles marked against income attributed, that would anyway be extra territorial and lies beyond the reach of the long arm of legal fiction in GST. Adjustments accepted in adversarial proceedings in those jurisdictions demand a true-up of tax treatment applied previously along with interest.

Anti-abuse adjustments

When a contract is presented, Courts must enforce the terms of bargain. There is no occasion for the Court to substitute its wisdom to that of the Parties, even if the

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terms bargained are onerous or imprudent. In matters that are subject to strict construction such as tax, interpretation to arrive at the tax treatment follows the form of a transaction over its substance. But where abuse is detected, elements that have no purpose for their existence within the transactional matrix of facts but exist only to procure an advantageous tax consequence of the kind discussed in ***Furniss (Inspector of Taxes) vs. Dawson (1984) 1 All ER 530***, require to be adjusted to account only for the real facts and free of artificial elements and then determine the tax treatment. Substance of a transaction prevails over its form, only in matters involving purposive construction, which is unknown to tax and that privilege avails only to welfare legislations such as tort or labour or insurance laws.

Anti-abuse adjustments made in income-tax proceedings does not ipse dixit demand revision of treatment applied earlier in GST. But the weight of admission of wrongdoing, if any, will bear upon the correctness of self-assessment in GST and adjustments carried out in those proceedings will not instantly and proportionately pollinate the nature and extent of revision required in self-assessment carried out. Revision of tax position asserted in adversarial and anti-abuse proceedings implies mala fides in self-assessment which remains to be explained, due to the possibility of inherent divergence in the two legislations that yield different tax treatment and can coexist without offending each other. Uniformity must be in the facts and harmony in application of (respective) law to those facts. Harmonious implementation does not compel uniformity of treatment.

Another interesting aspect of divergence is the admission of PE without attributing any income due to adoption of arm's length pricing coupled with sufficiency of taxes withheld under the aegis of Treaty law. Assertion about non-existence of PE must be examined to determine that PE does not exist, or existence of PE is eclipsed due to the special dispensation. Unless PE explicitly does not exist, GST treatment on all fours will be due. However, the exercise of income characterization at the time of examining withholding tax requirements on outbound remittances has presented a depleting credibility due to conservative approach to withholding and availability of credit to Payee.

Conclusion

Business decision are seldom taken in placid waters. Income-tax law has income maximization in its crosshairs which is sought to be achieved by being frugal with deductibles and liberal with income, actual or implied. Notwithstanding the choppy waters, inherent divergence in underlying objections of GST and income-tax require evaluation of all implications in advance before making those decisions. And the perilous consequences befall due to any dichotomy of assertion in the exercise of income characterization which may result in no tax treatment in income-tax when determined in isolation but without considering the bearing it has on GST treatment applicable or that already applied. While motivations of taxpayers and regulators may vary, assertions on facts cannot be different when offering them to each regulator. In today's connected world, exchange of information is more intelligent and refined than ever before. And if tax is the means necessary for societal development, discovering the correct extent of its incidence will mark our contribution to leave behind a society better – on uniformity and certainty of its laws – than the one we inherited!

Business Reorganization – Goods and Service Tax ('GST') & Income-tax ('IT') Treatment

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Overview

Due to globalization, liberalization, technological developments and the resultant intensely competitive business environment, cross-border mergers and acquisitions ("M&A") have become very popular throughout the world in recent times. M&A transactions have historically been the favorite tool used by companies for restructuring their businesses. The tax statutes (IT and GST) do provide for various scenarios of business reorganization and their tax treatments. Yet, depending on the manner in which such transactions are structured and owing to complexities inherent to them, not all scenarios can be fathomed by the legislature. Thus, it becomes imperative to understand the implications of GST and income tax on such transactions in light of some judicial precedents.

Prologue

Due to globalization, liberalization, technological developments, and the resultant intensely competitive business environment, cross-border mergers and acquisitions ("M&A") have become very popular throughout the world in recent times. M&A transactions have historically been the favorite tool used by companies for restructuring their businesses.

To delve any further into the tax implications of business reorganization/restructuring, it is important to get a few denotations and connotations right, at least in its rudimentary sense. There is a difference between (i) merger, (ii) acquisition, and (iii) amalgamation. The first of the three connotes a combination of two companies into one company, where one company loses its identity. It is an arrangement whereby the assets of two companies become vested under the control of one company. The second of the three terms is also called 'takeover'. It refers to a growth strategy in which one company acquires all the shares (or all the assets and liabilities) of another company and becomes its new owner. Acquisitions can either be hostile (which entails resistance put by the company being acquired) or friendly (where the company being acquired willingly joins). Finally, amalgamation refers to bringing together or combining two undertakings into a single one such that both companies that come together lose their identities.

And then, there is demerger. This is just a variant of a merger. Typically, in a demerger, one of the undertakings or a part of the undertaking or a department or a division of an existing company is separated and transferred (or "hived off" or "spun-off") to one or more new company/companies, formed with substantially the same shareholders, who are allotted shares in the new company in the

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same proportion as the separated division, department, etc bears to the total undertaking of the company.

Any archetypal scheme of amalgamation, merger, or demerger, will necessarily define the undertaking of a "transferor company" (which would be transferred to the transferee company) to include, among a whole host of other things, the following:

- All permissions, approvals, consents, subsidies, privileges, permits, quotas, rights, claims, entitlements, refunds, registrations (including relating to sales tax, service tax, excise duty, value added tax ('VAT'), entry tax, octroy, GST), licenses, clearances, exemptions, authorizations, no objection certificates, registrations, income tax benefits and exemptions, indirect tax benefits and exemptions (including, but not limited to credits in respect of income tax, sales tax, service tax, excise duty, value added tax, turnover tax, goods and services tax, tax credits, tax refunds, tax holidays, security transaction tax, Minimum Alternative Tax ('MAT') credit, duty entitlement credit certificates) and all other similar interests in connection with or relating to the transferor company.
- Right to any claim not presented or made by the transferor company in respect of a refund of any tax, duty, cess, or other charges, including any erroneous or excess payment thereof made by the transferor company and any interest thereon, with regard to any law made by any governmental authority, and in respect of set-off, carry forward of un-absorbed losses, deferred revenue expenditure, deduction, exemption, rebate, allowance, amortization benefit, etc. under and in accordance with any law, whether in India or anywhere outside India.

So, by extension, among other things, when the scheme takes effect:

- The transferee company will be entitled to exercise all rights and privileges and be liable to pay appropriate taxes and other charges.
- All taxes (including income tax, sales tax, excise duty, service tax, VAT, GST, etc.) paid or payable by the transferor company in respect of its respective operations and/or the profits of the business will become the corresponding item paid or payable by the transferee company for the purpose of all proceedings.
- All the profits/income and taxes (including any carry forward accumulated losses, unabsorbed depreciation, advance tax, TDS[1], foreign tax credit, and MAT[2] credit) accruing or arising to the transferor company will become the profits/income and taxes of the transferee company.
- Incentives, deferral benefits, subsidies (including applications for subsidies), available tax credits (including MAT credit, if any), rehabilitation schemes, grants, permissions, approvals, sanctions, remissions, special reservations, tax holidays, concessions, and other benefits or privileges granted or to be granted to the transferor company will vest in the transferee company.
- Both transferor and transferee companies may also be permitted to revise their financial statements and returns under

1. Tax Deducted at Source.
2. Minimum Alternate Tax.

the concerned tax statutes to give effect to the scheme.

- TDS certificates issued to the transferor company will become those of the transferee company.
- The transferee company will be permitted to claim any deduction/exemption, refunds, and/or credit for taxes paid by the transferor company (including MAT, TDS, advance tax, carry forward of accumulated losses, unabsorbed depreciation, foreign tax credit, etc.).
- All tax assessment proceedings/appeals of whatsoever nature by or against the transferor company pending and/or arising at the appointed date and relating to the transferor company may be continued and/or enforced until the effective date by the transferor company. From the effective date, the tax proceedings shall be continued and enforced by or against the transferee company in the same manner and to the same extent as would or might have been continued and enforced by or against the transferor company.

Once the scheme of arrangement is approved by the National Company Law Tribunal ('NCLT') with effect from a particular date, it is binding on everyone including the statutory authorities (i.e., the tax authorities)[3].

The typical acquisition vehicles include holding companies, branches, joint ventures, asset purchases, share purchases (either directly from the promoters or from the secondary market), and foreign collaborations (such as financial, technical, marketing, consultancy, or by whatever name called).

Corporate reorganizations take the form of a mandatory statutory mechanism also. The Insolvency and Bankruptcy Code, 2016 has been enacted for this purpose to consolidate laws relating to insolvency, liquidation, reorganization of companies, etc.

As stated at the very beginning, India has, in recent years, experienced a sharp rise in M&A activity, owing to its dominant participation in the global economy. These activities invariably become subject to the interplay of various tax and regulatory regimes, ranging from direct and indirect taxation to securities laws, company law, foreign exchange control regulations, competition law, and stamp duty law. The focus of this indite is to get a glimpse of tax implications on business reorganization transactions.

Slump sale & asset sale

GST is an indirect tax introduced in India from July 1, 2017, and which is applicable throughout India. It replaced various statutes like the Central Sales Tax Act, States Sales Tax Act, Value Added Tax, Excise Act, etc of the Central Government and State Governments. It also affects some companies planning M&A transactions due to the definition of 'supply' in the Central Goods and Services Act ('CGST'). CGST Act defines 'supply' to mean and include all forms of supply of 'goods' or 'services' or both such as sale, transfer, barter, exchange, license, rental, lease, or disposal made or agreed to be made for a consideration by a person in the course or furtherance of business[4].

What is to be also noted is that permanent transfer or disposal of business assets, where input tax credit has been made available on those assets, is treated as a supply

3. *Pentamedia Graphics Ltd vs. ITO 2010 SCC OnLine Mad 6466; In Re: Casby CFS Pvt Ltd & Casby Logistics Pvt Ltd 2015 (3) TMI 816 (Bom).*
4. Section 7(1)(a) of the CGST Act.

even though the same is made without consideration. So, for example, 'A' gives his old laptops which were used in his business free of cost to his friend. This will constitute a 'supply' if 'A' had taken input tax credit on those laptops. Accordingly, 'A' has to remit GST on such a sale. Under different circumstances, the transfer of business assets is treated both as supply of goods and supply of services:

Transfer of business assets will be treated as	***Circumstance***
Supply of goods	When – Goods forming part of business assets are transferred or disposed of such that it no longer forms part of those assets.
Supply of goods	When – The taxable person whose goods form part of the business ceases to be a taxable person. However, two scenarios where cessation of a taxable person acting as such will still not constitute a supply of goods are: (a) if the entire business is transferred as a going concern to another; or (b) the business is carried by a personal representative who is deemed to be a taxable person.
Supply of services	When – Goods held/used for business are put to private use.

Some of the above scenarios have specific treatment even under the Income Tax Act, 1961. For instance, when the business assets (i.e., current assets) are put to private use, depreciation and other expenditures incurred on those assets will not be allowed as a deduction.

Slump sale, as distinguished from an ordinary asset sale, does not entail the sale of individual assets for fixed consideration; rather, it is a transfer of one or more undertakings (i.e, a unit or division or business activity) for a lump sum consideration without values being assigned to the individual assets and liabilities acquired[5]. Such transfer may even be by way of a scheme of arrangement approved by the NCLT under the provisions of the Companies Act, 2013[6]. Courts have treated even the sale of a branch office (along with all its assets and liabilities)[7] and the sale of windmills[8] as slump sale and not as an asset sale simpliciter.

The sale of the business as a going concern is exempt under the GST law[9]. The word "going concern" means that the entity is viewed to be continuing in business for the foreseeable future[10]. The transfer of business assets is not to be confused to mean the transfer of business itself. Ownership of assets is merely an incident rather than a characteristic of the business. Hence, the mere transfer of one or more species of assets does not necessarily

5. Section 2(42C) of Income Tax Act, 1961.
6. Section 230-232 of companies Act, 2013.
7. *CIT vs. Narkeshari Prakashan Ltd [1992] 196 ITR 438 (Bom).*
8. *ACIT vs. Devi Sea Foods Ltd [2020] 117 taxmann.com 440 (Visakhapatnam - Trib).*
9. Entry 2 of Notification No. 12/2017-CT(R) dated 28.06.2017.
10. Audit Standard ('SA') 570.

bring about the transfer of the ownership of the business[11]. However, the phrase "transfer of business as going concern" (used in GST law) and the term "slump sale" (used in Income Tax law) are synonymous as, even in the case of the former, no value can be attributed to any particular asset[12].

In GST law, while the transfer of business assets constitutes a 'supply' (as seen above), the transfer of business as a going concern does not constitute a supply. Consideration received for the sale of a business as a going concern can neither be regarded as proceeds received from the sale of goods nor can it be said to be a transaction in connection, in the course of, incidental or ancillary to such business, trade, or commerce[13].

Input tax credit, refund & carry forward of losses

The CGST Act entitles a person to avail input tax credit ('ITC') on inward supplies which are used or intended to be used in the course or furtherance of business[14] and restricts ITC on inward supplies used for effecting exempt supplies[15].

In the case of itemized sales, if depreciation is claimed on the tax portion, then ITC reversal shall not be required as no ITC would have been availed in the first place. However, in case, if ITC was availed on capital assets, one has to reverse ITC[16].

As stated above, the transfer of a business as a going concern is not at all a supply, not being "in the course of business". This means, it is not an exempt supply but is wholly out of the ambit of GST. Yet GST notification[17] positively 'exempts' such transfers. Nevertheless, can it be said that no reversal of ITC needs to be made, as the supply is not an exempt supply? This is one for the courts to decide at an appropriate time in the future.

Another area of confusion is in relation to the transfer of unutilized ITC from t transferor to the transferee in the event of a transfer of business. While the parent Section in the CGST Act uses the words "shall be allowed to transfer" signifying that it is merely an enabling provision allowing the transferor to transfer ITC, the corresponding rule[18] states that a registered person 'shall' transfer ITC. Central Board of Indirect Taxes and Customs has issued Circular No. 133/03/2020-GST dated 23.03.2020 clarifying various aspects in relation to the transfer of unutilized credit in the event of the transfer of business.

Ceteris paribus, the transferor must reverse ITC in case of non-payment by the transferee to the supplier of goods/services within 180 days, post-transfer of business[19]. The transferee can re-claim the ITC wrongly reversed by the transferor prior to the transfer of business. ITC can be availed by the transferee in respect of invoices (in the name of the transferor) received post-transfer of ITC[20]. The transferee

11. *State of Karnataka vs. Shreyas Papers Pvt Ltd (2006) 1 SCC 615.*
12. *CIT vs. Mugneeram Bangur & Co (Land Department) [1965] 57 ITR 299 (SC).*
13. *Deputy Commissioner vs. Behanan Thomas (1977) 39 STC 325 (Mad); Coromandal Fertilisers Ltd vs. State of AP (1999) 112 STC 1 (AP).*
14. Section 16(1) of the CGST Act.
15. Section 17(2) of CGST Act read with Rule 42 and 43 of CGST Rules.
16. Rule 44 of CGST Rules.
17. Notification No. 12/2017-CT(R) (ibid).
18. Rule 41 of CGST Rules.
19. As required under Section 16(2)(b) of CGST Act.
20. *CCE vs. Flex Laminators 2000 (120) ELT 114 (Tri).*

can issue credit notes and or debit notes in respect of the supplies effected by the transferor. Transferee will also be eligible to avail ITC in respect of the goods in transit as on the date of transfer. Of course, these conclusions could change under peculiar facts and circumstances.

The above conclusions follow as obligations and rights of the transferor form part of the principle of "going concern". Thus, where the transferee steps into the shoes of the transferor and continues the going concern, the obligations and rights of the transferor of the business arising after the date of transfer should also fall upon and be available to the transferee. Further, denial of credit would lead to a cascading effect and hence be contrary to the overall scheme of GST.

As far as Income Tax Act is concerned, the business loss of an amalgamating company shall be allowed to be carried forward and set off in the hands of the amalgamated company for up to eight years if certain conditions enumerated in the provision are satisfied[21]. Although there are no provisions in the Income Tax Act dealing with the transfer of MAT[22] credit, it has been allowed, by the courts, to be carried forward in case of amalgamation of two companies[23].

Refunds, under the Income Tax Act, could be relatable to adjustment of TDS/advances/MAT credit paid by the amalgamating/transferor company in the hands of the amalgamated/ transferor Company. Since all the 'property' of the transferor company becomes the 'property' of the transferee company as a pre-condition for an amalgamation[24], TDS and advance taxes paid by the transferor company [which is an asset (or property) of the amalgamating company] becomes the property of the transferee company.

Contribution of brands/licenses as share capital to JV – IT & GST implication

The expression "joint venture" or 'JV' connotes an entity in the nature of a partnership engaged in the joint undertaking of a particular transaction for mutual profit or an association of persons or companies jointly undertaking some commercial enterprise wherein all contribute assets and share risks. It requires a community of interest in the performance of the subject matter, a right to direct and govern the policy in connection therewith, and a duty, which may be altered by agreement, to share both in profit and losses[25].

GST is a tax on commercial activities[26]. GST is an economic concept in the sense that it is on goods or services which satisfy human needs[27]. Mere acquisition and holding of shares in a company cannot be regarded as an economic/ business activity conferring on the holder the status of a taxable person. This is because any dividend yielded by that holding is merely the result of ownership of the property and cannot be said to constitute an activity or transaction which consists of taxable supplies of a kind commonly made by those who seek to make

21. Section 72A(1) of Income Tax Act.
22. Provisions relating to MAT contained in Section 115JAA of the Income Tax Act.
23. *Ambuja Cements Ltd vs. DCIT [2019] 111 taxmann.com 10 (Mumbai - Trib); DCIT vs. Caplin Point Laboratories Ltd [IT Appeal No. 889 (CHNY.) of 2014 dt 25-11-2016]; Nila Infrastructures Ltd vs. ACIT [2023] 146 taxmann.com 154 (Gujarat); Skol Breweries Ltd vs. ACIT [IT Appeal No. 2313 of 2017] (Mum) (Trib).*
24. Section 2(1B)(a) of Income Tax Act.
25. *New Horizons Ltd vs. Union of India (1995) 1 SCC 478.*
26. *All India Federation of Tax Practitioners vs. Union of India (2007) 7 SCC 527; Union of India vs. VKC Footsteps India Pvt Ltd (2022) 2 SCC 603.*
27. *Association of Leasing & Financial Service Companies vs. Union of India (2011) 2 SCC 352.*

a profit from them. The same conclusion must be drawn regarding the contribution of any kind of capital into a firm in return for a share/stake therein[28]. However, if such capital contribution (into a JV, in return for a share therein) takes place beyond the compass of the simple acquisition and sale of holdings, such as transactions carried out in the course of a business, could it have fallen within the scope of GST[29].

As far as income tax is concerned, intellectual property such as a brand can be a capital asset[30]. Thus, licensing it as a capital contribution could potentially be taxable as capital gains under Section 45(4)[31] of the Income Tax Act.

Special Provision for effective date and registration

Under GST law, where a business carried on by a registered person is transferred as a going concern, the transferee will be required to obtain registration from the date of such transfer[32]. Further, when the business is transferred for any reason or amalgamated or demerged, etc the certificate of registration of the transferor shall be cancelled[33]. For this purpose, an application for cancellation will be required to be filed within 30 days of the occurrence of the event warranting the cancellation[34]. Thereafter, the transferee shall be liable to pay tax on the supply of goods or services made from the date of effect of the transfer and shall, if already registered, apply for an amendment to the certificate of registration[35].

Likewise, in the case of transfer pursuant to sanction of a scheme or an arrangement for amalgamation or demerger of two or more companies pursuant to an order of a High Court or Tribunal, the transferee shall be liable to be registered and obtain a fresh registration, with effect from the date on which the Registrar of Companies ('RoC') issues a certificate of incorporation giving effect to such order of the High Court or Tribunal[36]. However, if the effective date is to be anterior to the appointed date, the two companies shall be deemed to be distinct companies from the appointed date upto the date of the order of the Court or Tribunal and the Certificate of Registration of the said companies shall be cancelled with effect from the date of the order of the Court or Tribunal[37]. As a result, the certificate of registration of the transferor is required to be cancelled with effect from the date of order of the Court or Tribunal whereas the transferee, is entitled to obtain registration only with effect from the date when the RoC issues the certificate of incorporation giving effect of such order of the High Court or Tribunal.

28. *Kretztechnik vs. Finanzamt Linz (C-465/03).*
29. *Empresa de Desenvolvimento Mineiro SGPS SA (EDM) vs. Fazenda Pública (C-77/01).*
30. *Foster's Australia Ltd, In re 302 ITR 289 (AAR).*
31. Where a specified person (partner of a firm/member of AoP/BoI) receives during the previous year any money or capital asset or both from a specified entity (firm/AoP/BoI, as the case may be) in connection with the reconstitution (defined below) of such specified entity, then any profits or gains arising from such receipt by the specified person shall be chargeable to income-tax as income of such specified entity under the head "Capital gains".
32. Section 22(3) of CGST Act.
33. Section 29(1) of CGST Act.
34. Rule 20 of CGST Rules.
35. Section 85(2) of CGST Act.
36. Section 22(4) of CGST Act.
37. Section 87(2) of CGST Act.

Assessment & recovery

Section 170 of the Income Tax Act, 1961 deals with cases of succession in general and to be applied to the succession of companies by way of amalgamation. The predecessor shall be assessable up to the date of succession and the successor shall be assessable after the date of succession. In a case where a predecessor cannot be found (transferor company in case of amalgamation cannot be found) the assessment shall be made on the successor (transferee company) for (a) the year of succession till the date of succession and (b) for the year preceding the year of succession in the manner as if all the provisions of Act shall apply on such predecessor.

Further, as per Section 170A of the Income Tax Act, 1961, where prior to the date of order of a High Court or tribunal in respect of business reorganization, any return of income has been furnished by an entity, the successor shall furnish, within a period of six months from the end of the month in which the order was issued, a modified return. Also, where the assessment or reassessment proceedings are pending on the date of furnishing of the modified return, the Assessing Officer shall pass an order assessing or reassessing the total income of the relevant assessment year in accordance with the order of the business reorganization and taking into account the modified return so furnished.

Section 87 of the CGST Act envisages GST liability in the case of amalgamation or merger of companies. When two or more companies are amalgamated or merged in pursuance of an order of NCLT or of a Tribunal or otherwise, and the order is to take effect from a date earlier than the date of the order and any two or more of such companies have supplied or received any goods or services or both to or from each other during the period commencing on the date from which the order takes effect until the date of the order, then such transactions of supply and receipt must be included in the turnover of supply or receipt of the respective companies and they shall be liable to pay tax accordingly. Notwithstanding anything contained in the order, for the purposes of the Act, the said two or more companies would be treated as distinct companies for the period up to the date of the said order, and the registration certificates of the said companies will be canceled with effect from the date of the said order.

Courts have held, in the context of direct and indirect taxes alike, that the moment amalgamating entity ceases to exist consequent upon the approval of the scheme of amalgamation, the said entity cannot thereafter be regarded as a 'person' against whom assessment proceedings can be initiated or order passed[38].

Epilogue

Ultimately, business reorganization is a complex process involving significant planning and is structured bearing in mind commercial and tax incidences to all stakeholders. The income tax and GST impact on such transactions can be anybody's guess lest precise facts and circumstances and the structure of transactions are studied and analyzed on a case-to-case basis. Although several provisions have been engrafted into both the GST and the income tax law to cater to various circumstances, there are various areas of debate, potential disputes and the resultant litigation. These can be addressed if all organs of the state work in unison to ensure businesses achieve desired targets and do not meet with undue tax burden.

38. *Spice Entertainment Ltd vs. Commissioner of Service Tax 2012 (280) ELT 43 (Del); CIT vs. PCIT vs. Maruti Suzuki India Ltd [2019] 416 ITR 613 (SC).*

“Fake Invoices” and “Penalties” under GST and Income Tax

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Overview

‘Fake invoice’ not defined statutorily. But clarified by a circular as invoices issued by registered persons, without actual supply of goods or services or both, to enable the recipients to fraudulently avail and utilize ITC. In other words, non-satisfaction of Section 16(2)(b). However, the department often seeks to penalise the recipient when it suspects issue of fake invoice by the supplier. Albeit some exceptions, High Courts across the country have directed department to proceed against the supplier instead of recipient. Now the government also seeks to penalise fake invoices (“fake entries”) under the Income-tax Act, 1961, through section 271AAD. Can the activities of GST be penalised under the Income-tax Act? What is the scope of ‘person who causes’ fake entries?

Input Tax Credit (ITC) in GST

1.1 GST is a destination-based consumption tax. According to *J.S. Mill’s* classic economic principles, an indirect tax is something where the person who actually pays the money over to the tax collecting authorities’ shifts the burden and the real income of someone else is affected. This classic concept aptly describes this levy called Goods and Service Tax (GST). It is a tax on supply of goods and services in India. It is a value added tax. Conceptually and schematically, not a tax but a system where the tax is charged on the value addition. Our erstwhile Sales Tax levied by State Governments worked on clone principles. Likewise, CENVAT Credit Scheme shaped Excise duty and Service Tax into value added tax levies. Thus, conceptually, not novel, but spruced and rejuvenated form of value added tax beholds us.

1.2 The Prime Minister in his speech on the inauguration of Goods and Services Tax addressed GST as the taxation system of New India; of the digital India. Is it a vouchment for corruption free taxation system? ***It will ensure a seamless chain of credit.*** In a circular[1] issued by Directorate General, a clarification to

1. Circular issued by Director General of Taxpayer Services on 07.06.2017.

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similar extent was echoed. In another circular[2], it was clarified that "Final price of goods is expected to be lower due to ***seamless flow of input tax credit between the manufacturer, retailer and supplier of services"***. In a C.B.E. & C. Flyer[3], it has been, *inter alia*, clarified that uninterrupted and seamless chain of input tax credit ("ITC") is one of the key features of Goods and Services Tax. ITC is a mechanism to avoid cascading of taxes. Cascading of taxes, in plain language, is 'tax on tax'.

1.3 The Statement of Objects and Reasons of the CGST Act, 2017 clarified that GST was introduced to avoid the cascading effect of tax. The seamless transfer of input tax credit from one stage to another in the chain of value addition would incentivize tax compliance by taxpayers. Thus, the intention of the Government is very clear. However, the above intention has to be spelt out in the statute itself. It is well settled that the Legislature speaks through its words.

1.4 ITC is not a fundamental right flowing from Part III of the Constitution of India. ITC is not a constitutional right. It is a statutory right. It is conferred by the legislature. Therefore, the legislature is well within its powers to snip such right or couch fetters to it. Section 16(1) is the substantive provision allowing ITC. It is enabling provision. It is granting aright. Section 16(2) opens with a non-obstante clause. It lists out conditions which are to be satisfied cumulatively and the same are mandatory in nature. The conditions are: (a) recipient should be in possession of tax invoice, (aa) information of the invoice has been furnished by supplied in GSTR-1 and communicated with the recipient, (b) recipient has received goods and services, (ba) ITC has not been restricted, (c) input tax paid by recipient to the supplier has been paid to the government and (d) recipient has furnished return under Section 39. "Receipt" of goods or services would mean "legal receipt". It would mean ownership of the goods and services. The provision does not use the term "physical" or receipt in the premises. Unlike erstwhile Rule 3(1) of the Cenvat Credit Rules, the above provision speaks of legal receipt than physical receipt.

1.5 Whether such conditions and/or restrictions are arbitrary or not and hence, violative of Article 14 of the Constitution, capable of being complied with or not and reasonable or not, can be a subject matter of debate. However, these would be grounds for attack on the validity on the said conditions. As long as the statute stands, the conditions are valid and legal. Recipient must comply.

2. Circular issued by C.B.E. & C. as on 01.01.2018.
3. CBEC Flyer No. 19 dated 01.01.2018.

Invoice

2. 'Invoice' is defined under Section 2(66) of CGST Act as invoice or tax invoice referred to in Section 31. Section 31, *inter alia*, mandates issuance of invoice containing certain particulars. The use of colloquial term "fake invoice" does not find statutory backing. The term 'fake invoice', however, has been explained in Circular issued by CBIC[4] as tax invoices issued by registered persons, without actual supply of goods or services or both, in order to enable the recipients of such invoices to avail and utilize input tax credit fraudulently. In essence, the condition of section 16(2)(b) is not satisfied.

Penalty

3.1 Section 122, *inter alia*, seeks to penalise taxable person when invoice is issued without supply of goods or services or takes or utilizes ITC without 'actual' receipt of goods or services shall be liable to a penalty of ₹ 10,000/- or input tax credit availed of or passed on or distributed irregularly, whichever is higher. *Vide* Finance Act, 2020, sub-section (1A) was inserted in Section 122. It seeks to penalise "any person" who retains benefit of the above stated transactions and at whose instance such transactions were conducted.

3.2 **First**, Section 75(13) clearly states that when any penalty is imposed under Section 73 or 74, no penalty for the same act or omission shall be imposed on the same person under any other provision of this Act. Could there be dual penalty under section 73 or 74 and Section 122? Are they independent? Is section 122 a provision relating to general penalty?

3.3 **Second**, Section 122 does not provide for issuance of notice proposing imposition of penalty. Could there be imposition of penalty without issuance of a notice? The answer is in the negative[5]. In ***S.P.Y. Agro Industries Case***[6], notice demanded tax but there was no proposal for imposition of penalty. not demand of penalty in such notice. However, penalties were imposed while passing orders. The Andhra Pradesh High Court set aside such order.

3.4 **Third**, CBIC in Circular No. 171/03/2022 has clarified that: (a) "A" issues invoice without supply of goods or services, he shall be liable to penalty under section 122(1)(ii); (b) "A" issues invoice to "B". B avails ITC for payment of GST, B would be subject to demand and recovery under section 73/74. No penalty on B under section 122; and (c) A issues invoice to B and B in turn issues invoice to C, no demand from B, however, B would be liable to penalty under section 122(1)(ii) and (vii).

3.5 One would ponder, if there is no supply of goods or services, section 7 (scope of supply) and section 9 (charging section) would not apply, then would tax be payable?

4. Circular No. 171/03/2022-GST dated 06.07.2022.
5. *Isolators & Isolators vs. M.P. Madhya Kshetra Vidyut Vitran Co. Ltd., 2023 SCC OnLine SC 444.*
6. *S.P.Y. Agro Industries vs. Union of India 2022-TIOL-757-HC-AP-GST.*

Certainly not. If not, the supplier ought not to have charged tax to the recipient and consequently, the recipient would be entitled to refund of the same. ITC is nothing but refund of the said tax in the credit ledger. Where is the violation? Why penalty? Is Section 122 not amenable to challenge?

3.6 **Fourth**, "Actual" would not mean physical but constructive receipt. Once there is no tax liability, can there be a penalty is a question open to debate. Apart this, is 'mens rea' not relevant for section 122? Can a *bona fide* purchaser be subjected to penalty under section 122(1)(vii)?

Non-Existent Supplier

4.1 What is "fake registration"? What if the registration is cancelled by the Department? What if the registration is cancelled *suo moto* with retrospective effect? A taxable person is a person liable to registration under Section 22 or 24 of the CGST Act. Procedure thereof is under Section 25. In ***Apparent Marketing***[7], it was held that cancellation would be only under section 29(2) and no other. In ***Ashish Garg***[8], the High Court observed that although the concerned authority has jurisdiction to cancel the registration from a retrospective date, but the said power cannot be exercised arbitrarily.

4.2 Section 29, per se, does not refer to invoicing. 29(2)(e), however, provides for cancelation of registration in case it has been obtained by means of fraud, wilful misstatement or suppression of facts. This would only be cases where the registration has been obtained using forged, false or fabricated documents or it is a case of impersonation. In such cases, the Revenue should file FIR under section 419 and 420 of the IPC. Is this being, however, done?

4.3 The immediate effect of such retrospective cancellation is that the department also disputes the legitimacy of the credit availed by the purchaser on grounds of mismatch between GSTR-2A and GSTR-3B. Such actions are contrary to law as the supplier was registered at the time of purchase of the goods and services. If the buyer can prove that all conditions of section 16(2) are satisfied, even of the registration of the selling supplier has been cancelled, ITC cannot be denied to the buyer. In ***Gargo Traders***[9], the Calcutta High Court observed that when the name of the supplier as registered taxable person was available at the Government Portal showing its registration as valid and existing at the time of transaction, the department cannot deny ITC to the buyer merely on the grounds of retrospective cancellation of the supplier and without proper verification of documents produced by such buyer. Similarly, the Delhi High Court, in ***Balaji Exim***[10], set aside the

7. *Apparent Marketing Pvt. Ltd. vs. State of U.P. Writ Tax No. 348 of 2021 dt. 05.03.2022 [All HC].*
8. *Ashish Garg, Proprietor vs. Assistant Commissioner of SGST W.P.(C) 6652/2023 dated 20.07.2023.*
9. *Gargo Traders vs. Joint Commissioner 2023-TIOL-670-HC-KOL-GST.*
10. *Balaji Exim vs. Commissioner CGST 2023-TIOL-333-HC-DEL-GST.*

order rejecting refund application of the petitioner on the ground that one of its suppliers was found to have issued fake invoices. The Court also held that the petitioner is not required to examine the affairs of its supplying dealers. The allegations of any fake credit availed by the supplier cannot be a ground for rejecting the refund application unless it is established that the petitioner has not received the goods or paid for them.

4.4 In ***Sri Sarang Steel***[11], the department alleged that the Petitioner is engaging in circular trading/bill trading and availing ineligible credit of input tax without physical movement of goods. Department blocked his Electronic Credit Ledger and was asked to reverse ITC. The Petitioner produced documents like copy of invoices, e-way bills, measurement slips, proof regarding payment to supplier, etc. The Jharkhand High Court, following Madras High Court, in ***D. Y. Beathal***[12], held that action needs to be taken against the supplying dealer and then question of denial of ITC can arise. Per contra, the Patna High Court, in ***Aastha Enterprises***[13], held that if the condition of section 16(2)(b) has not been satisfied, ITC can be denied, whether the Revenue chooses to initiate recovery against the selling dealer or not.

4.5 In absence of any statutory machinery for the buyer to ensure that the supplier has paid tax, unlike section 42 and 43, which were never put in operation, the condition leads to impossibility of performance. One such machinery would be section 76 of the Act. The buyer needs to invoke section 76 and ask the Revenue to seek recovery from the selling dealer. The interplay of section 76 and section 16(2)(b) needs to be urged by the buyer.

Section 271 AAD of the Income-tax Act

5.1 Under the Income-tax Act, 1961, there is no definition of 'supply', 'goods', 'services' or 'invoice'. 'Tax' is defined under Section 2(43) to mean tax chargeable under the Income-tax Act. How the Income Tax Act is concerned with GST is a mystery. Was there no provision for disallowing purchases/ expense? Was there no provision for imposition of penalty for incorrect book keeping? Is Section 271AAD is an attempt of overzealous draftsmanship?

5.2 Section 271 AAD seeks to levy penalty for false entry in books of accounts. This provision was inserted w.e.f. 01.04.2020. Under *Explanation* appended to the section, "false entry" has been defined to include use or intention to use: (a) forged or falsified documents such as a false invoice; or (b) invoice in respect of supply or receipt of goods or services or both issued by the person or any other person without "actual" supply or receipt of such goods or services or both; or (c) invoice in respect

11. *Sri Sarang Steel vs. State of Jharkhand W.P.(T) No. 2762 of 2021 order dated 13.07.2022.*
12. *DY Beathel Enterprises vs. State Tax Officer W.P. (MD) Nos. 2127 of 2021 order dated 24.02.2021.*
13. *M/s. Aastha Enterprises vs. State of Bihar 2023-TIOL-1021-HC-PATNA-GST.*

of supply or receipt of goods or services or both to or from a person who does not exist.

5.3 Sub-section (1) opens with: "without prejudice to any other provisions of this Act". The term 'without prejudice' is usually used when a party to a dispute proposes a settlement. In ***Ofulue vs. Bossert***[14] (House of Lords) Lord Hope observed: "Where a letter is written without prejudice during negotiations with a view to compromise, the protection that these (negotiations) would claim would be given to it unless the other party can show there is a good reason for not doing so". In ***Tarapore & Company***[15], the Supreme Court held that this shows that when something is done without prejudice to a negotiation/finding, then no other action can be taken based on such findings. It is used to keep an option open. To state that Option 1 will not be affected (prejudiced), if Option 2 is in process in response to a cause of action. Thus, once penalty has been imposed on the assessee under section 271AAD, no penalty can be imposed under any other provisions of the Act.

5.4 The *Explanation* uses the term "actual" supply or receipt of such goods or services or both. Income Tax is concerned with income and not supply. "Supply" is an alien concept under the framework of the Income Tax law. There has been no borrowing as well. Would it empower the Income Tax officer, now, to determine whether there was 'supply' or not, as not necessarily as per section 7 of the CGST Act? Whether there was actual receipt of goods or services or not? It is a well settled that officers cannot exercise powers which are beyond the jurisdiction conferred upon them. In ***Ujjam Bai***[16], the Supreme Court observed that where the action of an officer of the State is wholly without jurisdiction (as, for example, when a sales tax officer imposes income-tax or *vice versa*), it can have no support from the law he purports to apply.

5.5 The provision seeks to penalise fake entry as well as omission of an entry. Invoices issued in name of persons 'who do not exist'. This would mean persons who are either fictitious or dead. What if the supplier dies subsequently? Would the Income Tax officer rely on cancellation of registration by the GST officers?

5.6 Sub-section (1) seeks to penalize the person who maintains the books of accounts. Section 128 of the Companies Act, 2013 mandates the company to prepare and keep books of accounts. Section 9 of the Partnership Act, 1932 makes it duty of the partners to render true accounts and full information of all things affecting the firm. Hence, it is the responsibility of the assessee

14. *[2009] 2 WLR 749.*

15. *Tarapore & Company vs. Cochin Shipyard Ltd. 1984 SCR (3) 118.*

16. *Ujjam Bai vs. State of Uttar Pradesh AIR 1962 SC 1621.*

to maintain the books of accounts. However, sub-section (2) opens with the words, "without prejudice to provisions of sub-section (1)". It seeks to penalise person who "causes" the person referred to in sub-section (1) to make a false entry or to omit an entry. The use of word 'causes' involves some degree of dominance or control in the person alleged to have caused the prohibited Act[17]. Thus, professionals like Chartered Accountants or financial advisors or even employees of the assessee would not be covered under sub-section (2). This provision would apply qua persons in control or authority such as Directors of the company, partners of the LLP/ partnership firm, Chairman in case of a society and so on.

5.7 The term 'books of accounts' has been defined in Section 2(12A) of the Income-tax Act to include ledgers, day-books, cash books, account-books and other books, whether kept in the written form or in electronic form or in digital form or as print-outs of data stored in such electronic form or in digital form or in a floppy, disc, tape or any other form of electro-magnetic data storage device. The use of the word 'includes' in definition of 'books of accounts' indicates that the definition is not exhaustive. The said definition also includes books in "electronic form". However, the Electronic Credit Ledger (ECL) under the CGST Act would not be considered as 'books of accounts' for the purpose of section 271AAD.

Conclusion

6. Penalty, as is well known, is punitive in nature. *Mens rea* is attached to it. In sum, whether penalty is imposable or not is a question of fact to be decided in each case, having regard to the above mentioned settled legal principles.

17. *Shave vs. Rosner (1954) 2 All ER 280.*

> "Do not hate anybody because that hatred which comes out from you must, in the long run come back to you If you love that love will come back to you completing the circle"
>
> — *Swami Vivekananda*

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Cross Charge v. Input Service Distributor ('ISD') v. Internally Generated Services ('IGS') – the interminable predicament

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Overview

The issue of cross charge and ISD between distinct persons has been an area of much confusion and debate. The industry has been following varied practices, where while some have been doing cross charge [with or without employee cost], others have resorted to allocation of costs through the ISD mechanism, and each of the practice has been challenged by the tax authorities for some reason or the other. To bring clarity, the Government has issued Circular No. 199/11/2023 - GST, dated 17 July 2023.

The authors have through this article analysed the Circular, highlighting that while the circular has brought the much-needed clarity, it has also raised additional challenges with respect to the concept of internally generated services, which like the idea of cross charge, continues to be indeterminate and undefined. As a way forward, the authors believe that it is crucial for taxpayers to re-evaluate the applicability of ISD and cross charge for the past and on a going forward basis, in light of the clarification.

To do or not to do or what to do has been the dilemma that many taxpayers have faced since the introduction of the Goods and Services Tax ("GST") for distribution of common input tax credit under the Input Service Distributor ("ISD") mechanism and the specious cross charge mechanism, which has created much ado about nothing. The Government recently tried unravelling and answering these questions vide its Circular No. 199/11/2023 - GST, dated 17 July 2023, which has come close to providing some relief to the industry but there are still a few gaps that may continue to create new challenges for the taxpayers. In the past, this muddle has seen many taxpayers saddled with baseless inflated demands resulting in crores of fictitious tax recoveries, which now hopefully will be adjudged by the State Revenue authorities considering the recent clarification provided by the Circular dated 17 July 2023. It's in this background that the concept of ISD, cross charge and the new concept of IGS have been discussed in the ensuing paragraphs.

It is a general practice that the Head Office (HO) of a Company is established at the primary place of business and multiple branches operate at various regional locations/ States. The HO is the nodal point of contact providing functional support to its branches. As is well known this support can be

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extended through incurring of costs either by hiring third-party suppliers for services or common costs incurred on functions such as finance, human resource, tax, Admin, IT, etc. at a central level, which are rendered by HO through its common pool of employees hired and located centrally at the HO. Conceptually, GST is leviable on "supply", which includes "*all forms of supply of goods or services or both such as sale, transfer, barter, exchange, licence, rental, lease or disposal made or agreed to be made for a consideration by a person in the course or furtherance of business*". Supply also includes supply of goods or services or both between related persons or between distinct persons without consideration, when made in the course or furtherance of business". Units of the same legal entity, operating in different States but having a separate GST registration number, are termed as distinct persons under Section 25(4) of the CGST Act (hereinafter referred to as 'branches'). Legally, the provisions relating to taxability in the context of a distinct person should trigger only where there is an actual 'supply' involved, and the moot issue has always been whether the HO provides any services to its branches (loosely termed as cross-charge) or is it the consumer of such services while performing its statutory duties. Independent of these provisions, like the erstwhile regime, the GST law also provides for a mechanism to distribute common input service credit through the ISD mechanism for third-party costs that are attributable to the branches. Both the concepts however have been mixed up and as a matter of practice, many taxpayers have been raising a single cross-charge invoice from HO for all charges, on the pretext that the HO is the consumer of all services, including third-party services and is in-turn providing services to its branches.

The above has resulted in multiple open issues requiring further deliberation and clarification – *Is ISD mandatory or instead can there be a cross-charge invoice? Can there be a supply of service between the HO to its branches to entail a cross-charge? If yes, what would be the value of such an invoice? Does employee cost have to be added? Can the recipient branch take credit for cross-charge if a view is taken that no 'supply' exists?*

ISD – whether mandatory or optional?

The term 'Input Service Distributor' has been defined to mean an office of the supplier of goods or services or both which receives tax invoices issued under Section 31 towards the receipt of input services and issues an ISD invoice for the purposes of distributing the credit paid on the services to a supplier of taxable services having the same PAN number as that of the ISD office. Thus, in case of expenses that have been incurred on the procurement of services provided by third-party service providers and which are attributable to multiple distinct persons, the GST paid thereon is required to be distributed. The issue had however arisen with the use of the words "may distribute" under Section 20 of the Central Goods and Service Tax Act 2017 ("CGST Act"). It is quite clear that the provisions itself do create a basis to argue that when the HO involves itself in incurring such costs on behalf of the branches, there is no supply being made by HO to the branches/distinct persons and the supply of such services is being made by the third parties, even if there could be some facilitation offered by the HO.

The Draft Circular released by the Government had indicated that the provisions of ISD are mandatory, however,

many taxpayers had opted not to follow the provisions of ISD, as these provisions were construed to be declaratory by the language used in the provisions of Section 20 of the CGST Act. The Revenue authorities [in some jurisdictions], however, were of the considered view that the only means to transfer common input service credit was by following through the ISD mechanism and any cross charge undertaken to allocate/transfer these credits was outside the four corners of the law and hence, not permissible. This view was also propagated by the advance ruling authority in ***re Cummins India Limited [GST AAAR Maharashtra- MAH/AAAR/AM-RM/01/2021-22]***. On the other hand, even credit was being disallowed to the branches stating that there is no supply involved in a cross-charge Invoice. Both the issues combined had resulted in multiple show cause notices across the industry.

Does there really exist a 'supply' between HO and its branches?

The entire foundation of Schedule I entries is the existence of a supply [but without consideration]. Thus, to justify a levy under the GST law one needs to first establish a supply between the HO and the Branch. It can be argued that even if HO gets involved in some activity/facilitation on behalf of Branches, the same is qua typically the third-party costs attributable to the branches which are anyways mandated to be distributed through the ISD mechanism or is an activity carried out by an employee for its employer, which now stands excluded from IGS. Thus, the HO is not really providing any supply with respect to any costs that the HO incurs for the operations of the legal entity. It is possible that some incidental benefit could occur to the branches, however, these are not attributable to the branches and thus do not merit the presumption of a supply. In the case of **FCE Bank C-210/04 (2006)**, the Court of Justice of the European Union ('CJEU') held that a HO and its branch established in two different member states are to be treated as a single person with the consequence that no taxable supplies take place between them. It was discussed that in order to establish whether an independent legal relationship exists between the HO and the branch, it is necessary to determine whether the branch carries out an independent economic activity, bears the economic risk arising from the business etc., and where the risk associated with the economic activity of branch lies with the Company and branch is dependent upon the Company, it is a single taxable person and not a legal entity distinct from the Company. Thus, to presume a supply between the HO and the branch merely by identifying them as distinct persons would not suffice.

The only instance that could entail a charge between the distinct persons for a service is that which is akin to stock transfer and could be loosely termed as "sub-contracting" by the HO to the Branch or vice versa. Thus, where the contract for the supply of services is contractually entered into by the HO but is performed by the Branch or the other way around, then the Branch can bill the HO for the services performed. The ultimate recipient, viz., the customer, would continue to be billed by the HO as the privity of contract for the supply is between the HO and the customer. However, these instances of charge by the Branch to the HO have also been disputed by the Revenue authorities and have been largely viewed as credit-shifting tactics.

The quandary of 'value' for cross-charge for services

Rule 28 of the Valuation Rules makes it clear that the value mentioned on the invoice shall be deemed to be the Open Market Value (OMV) where full credit is available. The question arises in a situation where credit is restricted or required to be reversed. Typically, one would follow the cost plus 10% Rule considering the difficulty in determining OMV and comparable values. However, whether the cost would include employee cost had become a matter of dispute. The AAAR in ***re M/s. Columbia Asia Hospitals Pvt. Ltd. [Karnataka AAAR Order No. KAR/AAAR/05/2018-19]*** had given a finding that employee cost is required to be added to the charge from the HO to the Branches. The same was confirmed in ***re Profisolutions Private Limited [GST AAR Tamil Nadu – Advance Ruling No. 07/ ARA/2023]***.

Recent circular dated 17 July 2023 – Does it clarify all the issues?

The Circular dated 17 July 2023 has clarified that the ISD mechanism is not mandatory but optional for the past and credit could have been distributed through the cross-charge mechanism as well (until ISD is made mandatory by way of an amendment in the future). The circular also clarifies the need for a cross charge for Internally Generated Services ("IGS") which can be at a deemed OMV or even NIL value where full credit is available, or to be determined as per the valuation rules where full credit is not available.

Clearly, the key difference between ISD vs. IGS is their valuation, where in the case of ISD only the GST on actual third-party cost will be distributed, whereas, in the case of IGS the cross-charge amount would depend upon the valuation mechanism followed by the HO in different scenarios.

What is Internally Generated service ('IGS') and its value?

The purpose and scope of the entry under Schedule I of the CGST Act was thought to be pari passu to transactions that were akin to stock transfers of the erstwhile regime. However, the Revenue authorities believe that every cost at the HO, which is generic to the functioning of the legal entity needs to be cross-charged to the branches/depots located in the other States. There is a presumption of an underlying supply by the HO to the Branch offices, that consists of the HO facilitating the functioning of the Branches. In this context, the Government vide the Circular dated 17 July 2023 has coined a new term to address these services – IGS. The term IGS does not find any mention in the GST law and has also not been elaborated in the Circular dated 17 July 2023. What would an IGS comprise has not been explained but it has been merely clarified that taxpayers are not required to add the costs of employees while determining the charge to its branches. The clarification does not expound on what these services are or how would one distinguish between the supplies that are internally generated and supplied by the HO to the Branch offices or the third-party service costs that merely get routed through the ISD. For example, one could argue that the audit services are consumed by the HO, which then provides/facilitates the provision of such services to its branches, whereas the authorities could allege that audit services

are also attributable to the branches and therefore, should be distributed through the ISD mechanism.

Why is the distinction relevant?

The clarification links the charge of IGS to the valuation provisions contained under Rule 28 of the CGST Rules and provides that where full credit is available to the recipient, the HO can choose to adopt any value for the IGS and even where such value adopted is NIL, the same shall be accepted by the Revenue authorities. However, where full credit is not available to the receiving branch, as discussed, a charge would have to be made following the cost plus 10%. Consequently, if the authorities are of the view that audit services should be distributed by way of ISD, a transfer through a cross-charge mechanism could be alleged as an excess transfer of credit. Similarly, if a view of cross-charge is taken, there is an issue of undervaluation of the invoice.

Position on no charge or zero value for IGS

Another contentious issue for the past is the clarification regarding deemed NIL value where no invoice is issued. The Circular dated 17 July 2023 clarifies that where the recipient branch is entitled to full credit, no invoice/charge by the HO will lead to an assumption of a NIL value supply by the HO to the Branch. Proviso to Rule 28 of the CGST Rules state that where the recipient is eligible for full input tax credit, **the value declared in the invoice** shall be deemed to be the open market value of the services. Hence, it appears that an invoice is mandatory and hence, legally, the position of no invoice/ charge may not be sustainable.

The impact of ISD and cross charge on segmental reporting under Income tax

The Income Tax law allows various deductions for Companies/taxpayers in specific sectors and/or States. The law requires the taxpayer to file separate reports for each undertaking or enterprise, where such deduction under the said provisions is claimed by the taxpayer. The taxpayer does segmental reporting and files a separate profit and loss account and balance sheet for each undertaking or enterprise as if such enterprise and undertaking were a distinct person. The provisions have been introduced with an aim to promote the sectors and States and hence the benefit of deductions is extended to only those units/undertakings that have been set up in the concerned sectors and States. The concept of distinct persons under these provisions is more specific to the nature of the activity undertaken by such undertakings or units and the area in which such activity is undertaken, it does not upset the concept of distinct persons created under GST, which is more generic in nature and driven by the mechanism and valuation provisions under the GST Laws.

It is to be noted that the charge created under IGS, or cross charge is notional under GST and would not convolute the benefit provided for under section 80IA to 80IC of the Income Tax Act, 1961 for difference in the quantum of allocation. The cross charge under GST is a deeming fiction whereby, a supply is created between distinct persons to attribute proper GST revenue to the respective State. This attribution by way of raising a GST invoice would not necessarily result in an equivalent income that is "derived from" for the business undertaking entitled to the

benefit under the said provisions. Further, even where an expense is considered incidental or attributable to said undertaking by virtue of GST Laws, it cannot be said as an expenditure relatable to such business entailing a deduction. The term "derived from" has a much narrower connotation as against the term "attributable to" and hence any distribution of GST credit or cross charge as per the GST provisions would not automatically entitle the undertaking to show an income or be forced to claim expense deduction. The direct link of such profits from the business undertaking would need to be established. Further, the concept of ISD/cross charge applies to a GSTIN in a different State, whereas the deductions/exemptions under Income tax are applicable at an undertaking/unit level, though it is likely that a separate GST registration may be taken for each such unit/undertaking.

Way Forward

Considering the recent circular, it is important for companies to re-examine the applicability of ISD and cross-charge for their respective fact pattern. This is a simpler exercise where full credit is available to the recipient branch but needs further analysis where the credit is restricted to the recipient branch. Another issue that needs deliberation is the interpretation of "full credit available" – whether the same is to be seen at an input service level or at a totality level.

Further, with respect to the various pending demands on the ISD and cross charge issue, though the Circular dated 17 July 2023 has sought to bring enough certainty, in the absence of any mechanism to withdraw the show cause notices already issued to the taxpayers and the lack of any specific instruction by the Government on how to deal with such existing demands, it will be interesting to watch the stand that the State Revenue authorities will take.

"Work for work's sake. There are some who are really the salt of the earth in every country and who work for work's sake, who do not care for name, or fame, or even to go to heaven. They work just because good will come of it. There are others who do good to the poor and help mankind from still higher motives, because they believe in doing good and love good. The motive for name and fame seldom brings immediate results, as a rule; they come to us when we are old and have almost done with life."

— *Swami Vivekananda*

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Convergence and Divergence of GST and Income Tax for Employer-Employee Transactions

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CA Mihir Gandhi

Overview

The recent judgement in the Northern Operating Systems service tax case has sparked new concerns in the GST landscape and this ruling is expected to have a knock-on effect on technical service fees and the taxability of reimbursements under Income Tax laws. Further in case of ESOP, while GST and IT law is aligned in case payment of exercise price by the employees to the overseas parent however there is a divergence in case of differential payment being made by the Indian entity to the overseas parent for the difference between the FMV and the exercise price. In this article, we have tried commenting on treatment under the GST and IT Act of various components of payments to employees by employers.

With the introduction of Goods and Service Tax ('GST') in July 2017, GST followed by income tax are the two big sources of revenue for the Government. So, we can safely say that GST and income tax are the two main pillars of taxation on which practically the majority burden of earning revenue for the Government is resting. Hence, it is important that the two pillars are suitably aligned to ensure that the building is stable and strong. While the Government is taking steps to bring in convergence between GST and income tax, there are instances where the GST and income tax are not aligned, or rather divergent views have been taken under the two legislations by the respective tax authorities and courts. While it is not possible to cover all such instances in this article, our endeavour in this article is to look at a few such situations in the context of components of remuneration by employer to employee. We will also try to bring out the treatment of components of payments to employees under the GST and income tax act.

1. Secondment – Is It a Service?

It is a common practice amongst group companies to second/depute employees to other entities within the group. During the deputation period, such employees work under the direction, supervision and control of the seconded entity and receive salary and other benefits as per their policy. However, in many cases to preserve the continuation of the employment benefits or to avoid migration pain in case of temporary cross-border secondment, the salary and/or social security of the said employee is processed and paid by the company that has deputed/seconded its employee and then such amount is recovered from the deputed/seconded entity.

Provisions under GST

Section 7(2) of the Central Goods and Services Tax Act, 2017 ('CGST Act') read with clause 1 of schedule III provides that services by an employee to the employer in the course of or in relation to his employment shall be treated

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neither as a supply of goods nor a supply of services.

While the above provision lays down that payment in relation to employment is not supposed to be treated as supply for the purposes of GST, the Hon'ble Apex Court in the case of ***Commissioner of Customs, Central Excise and Service Tax-Bangalore vs. M/s Northern Operating Systems Pvt. Ltd. ("NOSPL") [2022-TIOL-48-SC-ST-LB]*** in the context of service tax, has held that in case of secondment, the overseas group entity shall be considered as the real employer of the seconded employees. Accordingly, it held that the Indian entity was receiving the manpower recruitment and supply services from the overseas entity for the duration of the secondment or deputation of employees resulting in the import of services and be liable to service tax under the reverse charge mechanism.

While arriving at the above decision the key points noted by the Hon'ble Apex Court for treating the payments as payments made for manpower recruitment and supply services is that the employees continue to have a lien on employment with the overseas entity.

Based on the above, if it is concluded that the overseas company is the employer, the arrangement qualifies as manpower supply services and this could lead to a conclusion that even under GST, such payment is for supply and hence subject to GST. On the other hand, if it is concluded that the Indian entity is the employer, the arrangement could be considered outside the purview of GST.

Treatment under the Income-Tax Act, 1961 ('The IT Act')

Secondment of personnel from overseas entity to work for the Indian entity has been an issue which has been a subject matter of litigation under the IT Act. One of the issues that has generally arisen in such situation is where the IT department seeks to treat the payment by the Indian entity to the overseas entity to be in the nature of fees for technical services ('FTS') arising from providing services to the Indian entity, whereas the taxpayer seek to treat is as re-imbursement of expenses incurred by the overseas entity as the Indian entity is the employer of the seconded employees.

In this context there are decisions like in the case of ***Centrica Offshore Pvt. Ltd. vs. CIT [2014] 44 taxmann.com 300 (Delhi HC)*** where the Hon'ble High Court of Delhi (subsequently affirmed by the Apex Court) has upheld the principle that Indian companies cannot be called an employer of seconded employees and therefore, the services received by them is liable to be taxed in the hands of the foreign company as fees for technical services.

There are also contrary decisions where the courts have held that the receipt of money by foreign companies was not considered as FTS. The Indian entity is the employer of the seconded employees as:

- the seconded employees are working under the control and supervision of the Indian entity;
- the payment of salary by the overseas entity to the seconded employees is only for administrative convenience; and
- the Indian entity has withheld tax under section 192 of the IT Act on the salary paid to the seconded employees including the portion of the salary which is paid by the overseas entity.

While issues have been debated by the various decisions, the settled position seems to be that if employees were seconded and reporting to the Indian entity, the Indian entity would be considered to be the economic employer of the seconded employees and the payment by the Indian entity to the overseas entity for the portion of salary remitted by it to the

seconded employees should be in the nature of reimbursement. But post the decision of the Hon'ble Apex Court in the case of NOSPL, the IT department has started arguing that if the same payment is treated as payment for supply of manpower and recruitment services albeit for service tax purposes, it ought not to be treated as re-imbursement under the IT Act.

Apart from the above issue of treating the income in the hands of the non-resident entity as FTS, another issue could be of service PE if the income tax authorities seek to apply the NOSPL decision literally and treat the payments as consideration for services provided by the non-resident through the seconded employee over period of secondment. However, taking such position could lead to a very uncertain and vague situation as this will increase the risk of creation of service PE in nearly every instance of secondment.

While the risks of above issues arises from the NOSPL decision, thankfully, a few decisions of the Tax Tribunal, even after the NOSPL decision, have held that payments to the overseas entity ought not be held as taxable in India. While dealing with the decision of NOSPL, the members have mainly relied on the principle that the decision of the Apex Court in NOSPL to treat the payment as being in the nature of manpower supply and recruitment services was mainly in the context of its facts and in view of service tax legislation. The same may not necessarily be applied while arriving at the decision on the nature of the payment under the IT Act.

A few decisions which have followed the above approach and held that the payments are not FTS in the hands of the non-resident group company even after the decision of Apex court in Centrica (referred above) are:

- ***Google LLC v. JCIT (OSD)/DCIT (IT) [2023] 147 Taxmann.com 428 (Bengaluru Tribunal)***;
- ***Flipkart Internet (P.) Ltd. v. DCIT (IT) [2022] 139 Taxmann.com 595 (Kar. HC)***; and
- ***Ernst & Young U.S. LLP [TS-335-ITAT-2023(DEL)]***

While the above decisions can be relied upon, an additional argument is also available from income tax perspective to defend the position of non-taxability of the payments in India. Under the IT Act, reliance can also be placed on certain beneficial provisions in some of the Indian tax treaties with some countries (e.g., US, UK, Singapore) where the services which do not make available the knowledge, experience, skill and know-how etc. are not considered to be FTS and hence not liable to income tax. In this case, even if the payments are considered as made towards services, the same may not be liable to tax in India if they do fall under the definition of FTS/FIS under the tax treaties.

While it is not possible to predict the course that these issues could take in future, it is advisable for the taxpayer to ensure that the clauses in the agreements between the seconded employees, Indian entity and the overseas entity reflect the substance that the Indian entity is the employer of the seconded employees. Also, it will be relevant for the management of the Indian entities having similar arrangements to highlight the issue to the management of its overseas group entities.

2. ESOP to Indian Group Company Employees from Overseas Listed Entities – Is it a Supply?

ESOP (Employee Stock Ownership Plan) are quite commonly used these days to attract talent, incentivize employees and retain talent too. While there are many different types of ESOPs, we are currently discussing the case where employees of Indian subsidiaries (unlisted) of foreign listed entities are provided

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the option to participate in the ESOP plans of the overseas listed entity.

In such plans, normally the employees of the Indian entity receive the stock options of the overseas parent entity which is listed outside India. Once the options vest with the employees, they can exercise the options at the exercise price. This price is typically paid by the employees of the Indian entity to the overseas entity. Thereafter, the Indian entity typically reimburses the overseas entity the difference between the fair market value and the exercise price to the overseas entity and books the same as an ESOP cost in its books of account. The Indian entity also claims this expense in its tax return as a business expense.

Provisions under GST

*Section 2(52) of the CGST Act defines 'Goods' as 'every kind of movable property **other than money and securities** …*

Section 2(102) of the CGST Act defines 'services' as 'anything other than goods, money and securities but includes activities relating to the use of money or its conversion by cash or by any other mode, from one form, currency or denomination to another form, currency or denomination for which a separate consideration is charged.

Section 2(101) of the CGST Act defines securities as 'securities shall have the same meaning as assigned to it in clause (h) of section 2 of the Securities Contracts (Regulation) Act, 1956'.

Section 2(h) of the Securities Contract (Regulation) Act 1956 defines securities to include:

(i) shares, scrips, stocks, bonds, debentures, debenture stock or other marketable securities of a like nature in or of any incorporated company or other body corporate;

(ia) derivative;

(ib) units or any other instrument issued by any collective investment scheme to the investors in such schemes:

(ic) security receipt as defined in clause (zg) of section 2 of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002;

(id) units or any other such instrument issued to the investors under any mutual fund scheme;

(ii) Government securities;

(iia) such other instruments as may be declared by the Central Government to be securities; and

(iii) rights or interest in securities;

From the above definition of goods and services, it is evident that securities are neither goods nor services. The GST law uses the definition of term 'securities' as defined under the Securities Contract Regulation Act, which also includes rights and interest in securities. Since the payment is made by the Indian Company after issuance of shares, it can be said to be payment for securities (which also includes right or interest in securities).

Ironically, GST authorities have now started approaching Indian entities stating that the ESOP obligation remains with the Indian company to provide shares under the employment contract and not the overseas Company as it is not the employer. Accordingly, authorities are viewing the payment by the Indian Company/subsidiary as an import of services liable to reverse charge when such amount is cross charged from the overseas company to the Indian company/ subsidiary.

It is pertinent to note that the stock option is being provided under the employment contract for services rendered by employees, which does not qualify as supply in terms of S. No. 1 of Schedule III of CGST Act. Hence, there is no underlying supply for such transactions.

Recovery of ESOP costs by overseas entities from Indian subsidiaries is solely from an accounting treatment perspective, with the underlying transaction being that of employer paying for employee. Also, rights and interest in securities being outside the definition of goods as well as services, there cannot be any supply attributed to these transactions.

Treatment under the Income-Tax Act, 1961 ('The IT Act')

Under the IT Act, the ESOP scheme typically leads to the following types of implications:

- In the hands of the employee:
  - — At the time of exercising the vested options: The difference between the FMV (on exercise date) and exercise price is taxable as perquisite in the hands of employee; and
  - — At the time of selling the shares: The difference between the sale price and FMV on the exercise date is taxable as capital gains.
- In the hands of the Indian Company:
  - — Withholding tax obligation upon exercise of vested options by the employees; and
  - — Claiming a deduction of the amount to be reimbursed to the overseas parent entity for issuing the shares to the Indian entities employees.

Divergence between GST and Income Tax

Under the IT Act, the payment made by the Indian subsidiary to the overseas parent for the difference between the FMV and the exercise price is a reimbursement of an expense incurred towards compensation of Indian entities employees.

Let us take a simple example to understand the issue raised by the GST authorities and the divergence of view from the treatment under IT Act:

- The Indian employees of Indian subsidiary company i.e., I.Co. receive grant of stock options of shares of the overseas parent company "A" Company listed outside India.
- Once the options vest, the Indian employees purchase the shares at a value of $ 100 per share.
- The Indian employees make payment of $ 100 per share to "A" company.
- The FMV of the shares on exercise is $ 150 per share.
- I.Co. reimburses the parent "A" Company the balance $ 50 per share.

In essence, the transaction can be divided into the following:

Nature of payment	*GST view*	*IT Act*	*Remarks*
Payment of exercise price of $ 100 by the employees to the overseas parent	The payment towards purchase of securities not to be subject to GST	The payment is towards purchase of securities	Does not lead to any divergent view

Nature of payment	*GST view*	*IT Act*	*Remarks*
Payment by the Indian entity to the overseas parent for the difference between the FMV of $ 150 and the exercise price of $ 100	The payment should be treated as towards the purchase of securities (for employees) and hence outside the GST.	The payment is a reimbursement of expense incurred by the parent entity towards the compensation of the employees of the Indian entity. The same is treated as perquisites in the hands of employees and therefore liable to withhold tax by the employer. Further, in the hands of the company it is an allowable business expenditure U/s 37 of the IT Act.	Divergence of view between the GST and the IT Act

3. Treatment of Other Components of Payments to Employees

In the below table, we have brought out the treatment of some of the other components of payment to employees under GST and IT Act.

Nature of payment	*GST*	*IT Act*
Expenses incurred by employee on behalf of employer	• Expenses incurred by the employees in the ordinary course of their employment and reimbursed by the employer can be considered valid business expenses and the employer can claim input tax credit (ITC) for such reimbursements (subject to the invoice for goods/services being in the name of the employer). • GST would not be applicable on the money reimbursed by employer to employee.	• Genuine business expenses incurred by the employees in the ordinary course of employment are allowed as a deduction in the hands of the employer. • Genuine business expense paid as reimbursement to employee is not taxable in the hands of the employee.
Mobile and internet postpaid bill reimbursement	• GST would not be applicable on the money reimbursed by employer to employee. • Employer should also be able claim ITC on the expenses	• Actual amount incurred by the employee subject to reimbursement limits as per the employer's internal policy is not taxable in hands of employee

Nature of payment	*GST*	*IT Act*
	reimbursed to the employees subject to GST number and other details of employer are present on the invoices relating to said expenses.	
Allowances such as transport allowance/ uniform allowance/ Medical allowance	• GST would not be applicable in case it is a part of the employment contract. • Even if it is not covered specifically as a part of employment contract but provided under the companies employee policy (generally applicable to all the employees) it could be interpreted to mean that it is arising in the course of the employment relationship and hence outside the purview of GST.	• Taxable in the hands of the employees; subject to specified deduction/exemption limits under section 10(14) of IT Act.
Health Club Expenses reimbursed	• GST would not be applicable in case it is a part of the employment contract. Further, even if the invoice is in name of the employer, the ITC of the tax paid on health clubs' membership cannot be claimed due to specific bar under section 17(5)(b)(ii) of the CGST Act.	• Taxable in the hands of the employees as per the valuation of perquisites. • Not taxable if the club facility is provided uniformly to all employees.
Non-compete payment to exiting employees	• Said payment may fall under the ambit of 'agreeing to the obligation to refrain from an act or to tolerate an act or a situation, or to do an act' clause in terms of para 5(e) of schedule II of CGST Act which is specifically declared to be a supply of service and leviable to GST. • However, payments for any such obligation arising from	• Taxable in the hands of employees as Salary Income. • As per Section 17(3)(iii) of the IT Act any amount due to or received, whether in lump-sum or otherwise, by any assessee from any person, before his joining any employment with that person, or after cessation of his employment with that person will be taxable as "profit in lieu of salary"

Nature of payment	***GST***	***IT Act***
	employment agreement may also be treated as a payment made under the employment contract and hence, not taxable, depending on the actual terms and conditions of the employment contract.	under the head "Income from Salaries".
Joining bonus	• GST would not be applicable as such joining bonus is generally paid after joining.	• Taxable in the hands of the employee.
Gifts to employees	• Gifts with a value up to INR 50,000 per employee in a fiscal year are not covered under the scope of supply. • Gifts with value exceeding INR 50,000 per employee in a fiscal year, the same is covered under the scope of supply. • While the employer is not entitled to claim any ITC for the GST paid on purchase of such gifts, once such gifts take the character of supply, even for claiming ITC, they may not be considered as gifts and instead, may be considered as a procurement of goods/ services for making supply.	• A gift with value less than INR 5,000 per annum is not taxed in the hands of the employee. • Gifts with a value exceeding or equal to INR 5,000 per annum are wholly taxed in the hands of the employee.
Canteen services, medical insurance, transport facility, etc.	• Input Tax Credit is not available for canteen services, health insurance and transport facilities extended to employees. • But, if the employer is providing the said services to its employees as per the statutory obligation imposed under any of the laws in force, then input tax credit on such services shall be available to the employer.	• INR 50 per meal per employee (during working hours in business premises or through non-transferrable vouchers) is not taxed in the hands of the employee. • Medical insurance: Not taxable. • Transport facility: Taxable in the hands of employee.

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Nature of payment	*GST*	*IT Act*
Commission to director	• Not liable to GST under reverse charge mechanism if paid to employee director towards employment. • Liable to GST under reverse charge mechanism if paid to non-employee director.	• Taxable as salary if paid to employee director. • Taxable as income from other sources/business income for non-employee director.
Rent free car or rent-free accommodation	• Not liable to GST if it is paid in the course of employment.	• Taxable as perquisite in the hands of the employee and value of taxable perquisite to be determined in accordance with Income-tax Rules, 1962.
Personal expenses reimbursed	• Not eligible for ITC in terms of clause (g) of section 17(5) of the CGST Act, 2017	• Liable to be treated as perquisite in the hands of the employee. • In the hands of employer, it will be treated as an expense and hence it should be an allowable business expenditure.
Business asset put to personal use	• The amount of ITC would be restricted to so much of the input tax as is attributable to the purposes of business.	• Taxable perquisite if the employee/member of household uses a movable asset provided by employer (other than laptops/computers etc.)

4. Conclusion

Taxability of secondments remains a contentious issue under the current GST regime. The judgement in the case of Northern Operating Systems under the service tax regime has raised new issues in GST, leading to revenue issuing notices for secondment agreements to be taxed for GST. This judgement will also have ripple effects on issues such as fees for technical services, permanent establishment, and taxability of reimbursements under Income tax laws. It is crucial to plan such arrangements considering factual similarities with this judgement and revisiting aspects that overlap with existing issues.

Further, analyzing every case viz. expenses incurred for employee, reimbursement to employees, facilities extended as a part of employment contract, etc. in detail is important to determine GST taxability and income tax implications, especially when it comes to employment agreements. With linkage to various provisions under GST and IT Act, it is crucial to cover all practical scenarios under the employment agreement/contracts to avoid any loss due to GST liability/ income tax implications.

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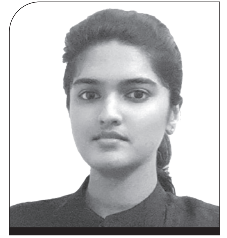
THE DASTUR ESSAY COMPETITION 2023

Do Indian Labour Laws Require To be Reformed and If So, How?



Neha Maria Antony

Introduction

Labour forms one of the most essential pillars of the economy, and in a world with a fast ageing population,[1] India, with its brimming potential in terms of human capital, stands at the threshold of a new dawn. This growth of human capital, can however, be a double edged sword, if it is not supported by policies, legal, and regulatory regimes, which can sustain a healthy growth pattern. This growth is also to be enabled by robust labour laws which balances the rights of the workforce with the economically oriented goals and maximises productivity. The question therefore arises as to whether Indian labour laws require to be reformed or not. The paper argues that in so far as labour laws in India are concerned, there is a viable framework in place, which can be further augmented to support the demands of a dynamic world. There is also a need to focus on certain areas where reform is most suited for potential change, especially in the realm of tying together corporate social responsibility and labour laws, which is taken up for discussion in the latter half.

The Present Legal Framework and the Need For Reform

The historical context in which labour legislations arose in India shows an exploitative side to the laws, with piecemeal efforts being made to remedy the damage done by the vestiges of the colonial era. An umpteen number of legislations blossomed, with most dealing with bits and parts of the labour rights regime[2]. The key legislations in this regard are the Employees' Compensation Act, 1923; the Trade Unions Act, 1926; the Payment of Wages Act, 1936; the Industrial Employment (Standing Orders) Act, 1946; the Industrial Disputes Act, 1947; the Minimum Wages Act, 1948; the Employees' State Insurance Act, 1948; the Factories Act, 1948; the Employees' Provident Funds and Miscellaneous Provisions Act, 1952, and so on.

There are certain legislations which attempt to pave the way for a better working environment for certain categories of workers and to ensure certain goals. For instance, it is relevant to note the Maternity Benefit Act, 1961 which has been a critical legislation in many regards,

1. Ageing and Health, WORLD HEALTH ORGANISATION (Oct. 1, 2022), https://www.who.int/news-room/fact-sheets/detail/ageing-and-health.
2. See List of Enactments in the Ministry, MINISTRY OF LABOUR AND EMPLOYMENT, https://labour.gov.in/list-enactments- ministry.

especially considering the recent changes thereto[3]. Similarly, the Contract Labour (Regulation and Abolition) Act, 1970, while fraught with many lacunae, is another critical legislation seeking to bring a large chunk of the workforce under some legal protection. The Bonded Labour System (Abolition) Act, 1976 is also to be mentioned in so far as it seeks to root out the use of labour as a means to suppress and perpetuate harmful notions stemming from discrimination and a violation of constitutional protections. The lofty goals of equality, particularly when it comes to labour, have been enshrined in the Equal Remuneration Act, 1976 which seeks to embody the 'equal pay for equal work' principle. The Child and Adolescent Labour (Prohibition and Regulation) Act, 1986 is also relevant in so far as it seeks to regulate child labour, though the widespread employment of children in particularly hazardous work has been a cause for much concern. The Unorganized Workers' Social Security Act, 2008 is also a well-meaning legislation which has faltered in actual practice.

Notably, specific legislations were also enacted for certain industries or pockets of the working landscape of India. Examples include, the Plantation Labour Act, 1951; the Mines Act, 1952; the Working Journalists and Other Newspapers Employees (Conditions of Service) and Miscellaneous Provisions Act, 1955; the Beedi and Cigar Workers (Conditions of Employment) Act, 1966, the Motor Transport Workers Act, 1961 and so on.

The plethora of legislations, their inherent problems, a fragmented legal and infrastructural framework – are all problems which stemmed from the situation as it stood then. The Labour Codes were therefore envisioned as a means to rework and consolidate the legislations into four codes – the Code on Wages, 2019; the Occupational Safety, Health and Working Conditions Code, 2020; the Code on Social Security, 2020; and the Industrial Relations Code, 2020. The new codes have been viewed as an exercise 'to balance the welfare of employees and ease of doing business in India[4].' There have been quite a few bouquets and brickbats raised towards the labour codes and the attempted overhaul which hint at quite a few issues[5].

However, streams of research on the said labour codes and the attempt at reforms are aplenty. This paper seeks to narrow down one aspect which stands at the intersection of corporate interests and labour welfare. This is done through the lens of corporate social responsibility, and a case is sought to be eked out in relation to labour reform in India.

The Potential for CSR in Labour Laws

The perennial struggle between the capital and the labour has been the intense focus

3. Maternity Benefit Act, 1961, K&K, (June 29, 2022), https://www.khuranaandkhurana.com/2022/06/29/all-about-maternity- benefit-act-1961/.
4. Suma R.V. & Shrivar Bajoria, New Labour Codes – Impact On The Employers And Employees, MONDAQ, (Feb. 06, 2023), https://www.mondaq.com/india/employee-benefits--compensation/1279206/new-labour-codes--impact-on-the-employers- and-employees
5. See Tanya Chaudhary & Babu Remesh, Changing Scenario of Indian Labour and New Labour Codes: A Critical Analysis, 10 CHRIST UNIVERSITY LAW JOURNAL 2 (2021).

of society at large, and today, after centuries perhaps, of repression and suffocation, there is a more equitable condition for the labour class, or at least opportunities for the same. Though the situation at present is far from ideal, it can be said that advances made in labour welfare and the increased stress on the employee as compared to the earlier single minded pursuit of exploitation and profit making, has allowed for a holistic move in the right direction. The interplay between capital and labour, viewed mostly as a point of contention and dispute, can be reinterpreted in light of the advancements being made in labour relations and the legislative measures introduced. In the modern world, there is a better understanding of the ideal of labour welfare and how it can actually aid in boosting productivity and bringing in a more stable workforce.

However, it may also be said that the current system, particularly in India, relies heavily on the legislative mandate to get labour welfare realised. But there is also another angle to be considered. The employers, often companies and corporate entities, have a role to play as well, which is above and beyond what is required of them based on the statutes. Considering that employers like companies and corporates have huge economic power, they can be called on to give back to society, and in particular to the workers, which will also aid in enhancing their own business interests by heightening productivity, output and worker loyalty and motivation. In this light, an interesting facet that may be looked at is that of Corporate Social Responsibility ['CSR'] and the possible impact it may have on labour welfare. Understanding the potential utility of CSR in enhancing labour welfare and the impact of the inclusion of CSR funding in the recent labour codes is sought to be analysed in this light and to look ahead in order to arrive at a model which can be applied in the Indian context centred around utilising CSR for labour welfare and the overall wellbeing of the workforce.

As understood generally, CSR is an integration and recognition of the responsibility of corporates to give back to the community by engaging in spending or initiatives aimed at improving or supporting the world around them. Understood in a more practical sense, corporates usually have immense economic power, often comparable to the GDP of entire nations, and use more resources and leave huge carbon footprints. The impact of such an entity on the environment, society and the community cannot be disregarded and so CSR, both in its voluntary and mandatory forms began to take shape across the world. The beginnings of CSR, particularly in India, stemmed from the philanthropic endeavours undertaken by family owned businesses[6] and following several international shifts in business perceptions, and other concerns, it was incorporated into the legal framework. Today, the commercial world is characterised by an increasing deference to CSR and like initiatives, though the outlook towards the same varies greatly between countries and legal systems[7].

The development and features of CSR are often sought to be explained on the grounds

6. Sabharwal D. & Narula S., Corporate Social Responsibility in India–Introspection, 5 JOURNAL OF MASS COMMUNICATION & JOURNALISM (2015).

7. Christopher M. Bruner, Power and Purpose in the 'Anglo-American' Corporation, 50 VIRGINIA JOURNAL OF INTERNATIONAL LAW 579 (2010).

of certain models. Particularly viewed in the light of the Indian experience, the evolution of CSR in India was found to have followed four stages- the ethical model; statist model; liberal model; stakeholder model- in a chronological flow[8]. The ethical model espouses Gandhian ideals and saw businesses as a trust held in the name of the community. This period was marked by the family-owned businesses, as seen in case of the Tata Group[9] giving back to society by their own volition. The statist model, under the aegis of Nehru, was a situation where a mixed socialist economy brought in legal requirements and traces of state ownership. The liberal model was based off Friedman's shareholder model[10]. The basic idea is that it is enough for companies to generate wealth while obeying the law and that social responsibilities or the choice to meet them are left up to the companies themselves.

Assessing the governance structure, and depending on the extent to which it focuses on satisfying the interests of the narrow interests of the shareholders or the border interests of the society's diverse stakeholder groups, the model can either be a shareholder model or a stakeholder model[11]. The stakeholder model is the one in prevalence now, stressing on the several stakeholders that come into play and also brings in a focus on accountability and transparency. The shareholder model and the stakeholder model have been the most discussed models of CSR and the shareholder model, espouses that the corporation should be managed in the sole interests of its shareholders; and that the market value of shares is the primary measure of the interests of the shareholders, and CSR is viewed through the lens of shareholder primacy[12]. There are also arguments to the effect that newer hybrid models have already come into play and that there being a collective interest r `elevant to shareholders and the larger and more diverse group of stakeholders, there is an interest overlap which has gone above and beyond the aforementioned models[13].

CSR is also, interestingly enough, found to be motivated and coloured by the political ideologies of the companies or its boards, and even by the nuances of individual behaviour[14]. Research shows that those influenced by left-wing political ideology especially socialist perspectives were believed to promote the stakeholder view of CSR, while right-wing

8. Sabharwal D., supra note 1.
9. See, Amit Kumar Srivastava et. al., Corporate Social Responsibility: A Case Study Of TATA Group, 3 IOSR JOURNAL OF BUSINESS AND MANAGEMENT 17, (2012).
10. Milton Friedman, A Friedman doctrine - The Social Responsibility Of Business Is to Increase Its Profits, THE NEW YORK TIMES, (Sept, 13, 1970) https://www.nytimes.com/1970/09/13/archives/a-friedman-doctrine-the-social-responsibility-of- business-is-to.html.
11. Collins G. Ntim, Defining Corporate Governance: Shareholder versus Stakeholder Models, in Global Encyclopedia of Public Administration, Public Policy and Governance, (Springer ,2018).
12. Oliver Weinstein, The Shareholder Model of the Corporation, Between Mythology and Reality, DE GRUYTER, (June 19, 2013) https://www.degruyter.com/document/doi/10.1515/ael-2013-0032/html.
13. Lynn A. Stout, New Thinking on Shareholder Primacy, 2 ACCOUNTING, ECONOMICS, AND LAW (2012).
14. Fuming Jiang et. al., Mapping the Relationship among Political Ideology, CSR Mindset and CSR Strategy: A Contingency Perspective Applied to Chinese Managers, 147 JOURNAL OF BUSINESS ETHICS 419 (2018).

or capitalist thinkers would tend to deviate towards the shareholder model[15].

One of the main goals behind CSR is to 'align a company's social and environmental activities with its business purpose and values[16].' It is also stressed that good corporate citizenship is related to good financial performance and if the corporate negates such ethical obligations or moves towards an exploitative model, then the corporate may be shunned by society thereby affecting its financial performance and existence even[17]. We find that globally, CSR is slowly being accepted as the norm, and interestingly enough the Indian CSR model is unique and dynamic, which stands at a special nexus of commercial freedom while simultaneously ensuring that there is a staunch CSR regime which works in the Indian system.

CSR In India

In India, the CSR regime is primarily encased in the Companies Act,[18] in which section 135 requires every company meeting a certain threshold is required to constitute a Corporate Social Responsibility Committee and to ensure that the company spends at least two per cent of its profits in pursuance of the CSR policy of the company. The section also provides that the failure of the company to spend such amount would have to be explained by the Board in its reports. The Act, under Schedule VII[19] lays out the list of activities which can be included in the CSR policies and this includes - eradicating hunger and poverty; promoting education; promoting gender equality and women empowerment; ensuring environmental sustainability; employment enhancing vocational skills; social business projects; contribution to various funds and so on. This 'comply or explain' model[20] has been attributed to increased CSR spending by companies though there have also been concerns about passive compliance and a tendency to merely forego disclosure. In 2020, the CSR provision was amended[21] to bring in a penalty of twice the CSR amount to be spent in case of default or failure to comply with the provisions and a separate liability is also ascribed to every officer who may be in default.

The mandatory CSR provisions in the Indian system are unique in the world roster and there have been critics who have argued that the voluntary aspect of CSR is what makes it efficient and making it mandatory would relegate it to the status of a government imposition like a tax expenditure and make India a less lucrative marketplace. However, it may be considered here that the CSR provisions in India, though anomalous, was a 'rational response to major tension in

15. Id.
16. V. Kasturi Rangan et.al., The Truth About CSR, HARVARD BUSINESS REVIEW (Feb. 2015).
17. S.B. Banerjee, Corporate Social Responsibility: The Good, the Bad and the Ugly, 34 CRITICAL SOCIOLOGY 51, (2008).
18. The Companies Act, 2013, Acts of Parliament, No.18 of 2013.
19. Id., Schedule VII.
20. Umakanth Varottil, Initial Experience in Implementing CSR Law in India, OXFORD BUSINESS LAW BLOG (July 6, 2018) https://www.law.ox.ac.uk/business-law-blog/blog/2018/07/initial-experience-implementing-csr-law-india.
21. The Companies (Amendment) Act, 2020, Acts of Parliament, No. 29 of 2020.

the Indian economy and that in choosing mandatory CSR India may be trying to 'forge a middle path between extreme liberalism and the resurgence of the regulatory state.'[22] In a country like India, which is still developing, in most senses of the term, it seems to be proper to have a CSR model like the one in force currently. This ensures that CSR is not dependent on the whims and fancies of those in charge of the corporates and there is a steady flow of funding or initiatives into causes that can help aid the environment, workforce or others as aforementioned. While the 2020 amendment has brought in a more coercive effect, this can also perhaps be justified on the ground that there is a need to make sure that as the company grows, its growing responsibility to give back is also honoured, with the legislative sanction increasing the seriousness and possibly ensuring better compliance with the same.

CSR in Labour Welfare

The movement of governance from various forms of the security state to the modern welfare state was also characterised by an increased interest and protection accorded to the labour class. The concept of welfare, particularly labour welfare, is to be interpreted as a dynamic term which depends heavily on the historic, social and economic growth and outlook of the nation. The sheer economic power of corporates has been found to be akin to those of the GDP of a few countries combined and the responsibility arises from this end, particularly in light of the workforce that engages most closely these entities[23]. CSR is hailed as being capable of enhancing 'human rights, labour rights, and labour standards in the workplace by joining consumer power and socially responsible business leadership'[24].

The role that CSR has played in several areas, including the environment[25] and public utilities[26] has been especially potent. Attention is now drawn to the interplay between CSR and labour welfare. The OECD Principles of Corporate Governance[27] finds that 'employees and other stakeholders play an important role in contributing to the long-term success and performance of the corporation, while governments establish the overall institutional and legal framework for corporate governance.' The ASEAN Guidelines for CSR on Labour,[28] endorse the incorporation of labour standards

22. Caroline Van Zile, India's Mandatory Corporate Social Responsibility Proposal: Creative Capitalism Meets Creative Regulation in the Global Market, 13 ASIA-PACIFIC LAW & POLICY JOURNAL 270.
23. Barbara Fick, Corporate Social Responsibility for Enforcement of Labor Rights: Are There More Effective Alternatives?, (2014) https://scholarship.law.nd.edu/law_faculty_scholarship/1223?utm_source=scholarship.law.nd.edu%2Flaw_faculty_scholarsh ip%2F1223&utm_medium=PDF&utm_campaign=PDFCoverPages.
24. Lance A. Compa, Corporate Social Responsibility and Workers' Rights, 30 COMPARATIVE LABOUR LAW AND POLICY JOURNAL 1, (2008).
25. See generally, Mousami Prasad et. al., Corporate Social Responsibility And Environmental Sustainability: Evidence From India Using Energy Intensity As An Indicator Of Environmental Sustainability, 31 IIMB MANAGEMENT REVIEW 374, (2019).
26. See generally, Michael Blowfield, Reasons to Be Cheerful? What We Know about CSR's Impact, 28 THIRD WORLD QUARTERLY 683 (2007).
27. OECD Principles on Corporate Governance, OECD (2004) https://www oecd.org/corporate/ca/corporategovernanceprinciples/31557724.pdf, p. 14.
28. ASEAN Guidelines for Corporate Social Responsibility (CSR) on Labour, ASEAN SECRETARIAT (2017), https://asean.org/storage/2012/05/ASEAN-Guidelines-for-CSR-on-Labour.pdf.

as set forth by international instruments and to promote social dialogue between the employers and employees and their organisations at all levels, as a preliminary means to set the stage. The essential basics of labour welfare like ensuring the eradication of child labour, eliminating any form of discrimination and refraining from exploitative labour practices, should be strengthened at a primary level and then CSR initiatives are to be brought in to enhance the human resources and to constantly aim at providing the best possible wages and other conditions to the workers. Such initiatives have the potential to strengthen the workforce and increase the motivation, productivity and work environment, which perpetuates a virtuous mutually beneficial cycle.

A pause may be required here in order to revisit the theories of CSR which were discussed in the initial pages. It becomes pertinent to assess whether the idea of CSR being used as a vehicle for labour welfare is tenable in light of the theories, particularly in the context of India. The earlier ethical model stressing on family based companies, found an strikingly close relationship between the employers and the employees, the latter who would often spend their whole lives with the company. This sense of belonging to the company, also seen as an extended family characterised by close relations to the employers, was often a motivator for better performance. It can also be seen that their loyalty was often rewarded and in anecdotes related by former employees we hear of how the corporate heads would sponsor the education of their children's education or pay for vacations where the entire family could come along. This setup, unique to India offers much scope for tying together labour welfare and CSR, though it may not be labelled as such. However, India is seen to be witnessing a surge in start- ups, and foreign subsidiaries, which may require a different approach. In such a case, several arguments have stressed on the idea that the employee is a key stakeholder as per the stakeholder model which effectively offers a justification for the utility of CSR to the employee as well. The ethical standards which may operate, that of trust and the alignment of individual and organisational values,[29] also offers interesting perspectives to understanding the hybrid models of CSR discussed prior and its ability to operate as a cross cutting, intersectional tool for meeting the modern day requirements of social responsibility, particularly geared towards the employee.

While labour welfare was stressed on and improved owing to the aegis of the government, it is seen that this approach may have failed or that the entire labour welfare approach in India is based on providing the minimums needed for them. This approach does not bode well in a growing economy like India and therefore bringing in the funds and initiative put forth by CSR into the realm of labour welfare can be reasonably expected to raise the standards a bit higher from the erstwhile single-minded focus on giving the minimum.

29. Frida Hjarpe & Sofia Persson, CSR with Focus on the Employee Perspective, LINKOPINGS UNIVERSITET, (Jan. 21, 2004), http://www.ep.liu.se/exjobb/eki/2004/iep/003/.

The Inclusion of CSR in the Labour Codes

Two specific legislative moves are to be noted in this context. The first would be the changed CSR mandates under the recent amendment to the Companies Act[30] and the second being the inclusion of CSR in the Labour Codes. The Code on Social Security, 2020[31] looks upon CSR as a possible and permissible source of funding, bringing in much clarity and statutory backing in this regard. Under section 25 of the Code[32] the Employees State Insurance Fund, is allowed to accept contributions from the CSR funds among other sources. Section 109 of the Code encourages the formation of schemes for unorganised workers and such schemes can also be supported by CSR funds. Similarly, schemes for gig workers and platform workers formulated in pursuance with section 114 can be funded by CSR resources.

The incorporation of the CSR funds into the Code is to be seen in light of the confusion that existed in this regard considering that CSR and labour law requirements were seen as mutually exclusive. The Ministry of Corporate Affairs[33] had earlier clarified that the entries in Schedule VII of the Companies Act specifying the various areas for CSR policies are to be interpreted 'liberally' and that they are intended to cover a wide range of activities. It was also made clear that the expenses incurred by companies for the fulfilment of any statutory obligations, including those relating to labour law, could not be brought under CSR spending. By bringing clarity through the Code, labour welfare initiatives can now be integrated into CSR initiatives, giving a much needed boost for the same.

This move is seen as a positive step in integrating CSR funding into labour welfare where the company, need not actively undertake separate CSR initiatives and can simply contribute to a body like the Employees State Insurance Corporation or contribute to government schemes which are already being run with the requisite expertise and may only require the funding, which the company can easily provide. India, as a nation requires funding for development and CSR is a viable source, considering India as a hub for booming businesses and international entities seeking to explore the Indian market.

This inclusion opens up a large number of possibilities which can ultimately filter down to the workforce, positively. There have also been studies carried out which attempt to determine the relationship between CSR and employee engagement,[34] though the empirical literature in the Indian context is sparse. Particularly considering the backdrop of COVID 19, there have been renewed calls to consider the employee as one of the key stakeholders, along with customers, suppliers, communities and shareholders[35]. The labour class has been severely and adversely affected

30. The Companies (Amendment) Act, 2020, Acts of Parliament, No. 29 of 2020.
31. The Code on Social Security, 2020, Acts of Parliament, No. 36 of 2020.
32. Code on Social Security, § 20.
33. Clarifications With Regard To Provisions Of Corporate Social Responsibility Under Section 135 Of The Companies Act, 2013, Ministry of Corporate Affairs, (India) General Circular No, 21/2014.
34. Ante Glavas, Corporate Social Responsibility and Employee Engagement: Enabling Employees to Employ More of their Whole Selves at Work, FRONTIERS IN PSYCHOLOGY, (May 31, 2016), https://doi.org/10.3389/fpsyg.2016.00796.
35. Lynn S. Paine, Covid-19 Is Rewriting the Rules of Corporate Governance, HARVARD BUSINESS REVIEW, (Oct. 06, 2020), https://hbr.org/2020/10/covid-19-is-rewriting-the-rules-of-corporate-governance.

by the pandemic and its repercussions and therefore, the time is ripe for utilising CSR to the causes of the workforce, at least in these uncertain times, before the economy falls further.

Assessing the current position and paving the way forward

CSR regimes stand at a unique point in the legal and business ethics framework and have immense potential to be shaped into a tool for social benefit. The problems that can be identified in present CSR frameworks have to be rectified and the possibilities of utilising CSR for labour welfare has to be assessed and reinforced.

Legitimate concerns have been raised about corporates viewing CSR as a means to further their own goals and to get the benefits accompanying the same, or to view it as some form of passive compliance. This is also evident when companies may simply make donations to various organisations under the CSR spending and leave it at that. It should be stressed here that the responsibility of such entities should be much more than what is currently attributed to them.

There are also severe apprehensions as to the lack of appropriately skilled personnel who can evolve proper CSR frameworks and implement them. In addition to this, a lack of transparency is also inherent and there is usually no follow up once a CSR initiative has been flagged off. This can perhaps be solved by timely and consistent reporting by the corporate entity, not just to the board or to the statutory authorities, but to the wider set of stakeholders, including employees, both actual and potential. As pertaining to the employees, the management should focus on building trust and long term contractual relationships and form a holistic governance model[36]. The concept of a CSR Impact Assessment[37] may also be pushed for here, which seems to be a better alternative than passive spending and reporting of CSR activities. This can also help in curbing the practice of spending for the sake of meeting the statutory requirement in a 'check the box' attitude[38] or where the company might transfer the amount to a fake entity and then covertly take it back. Strengthening disclosure and making transparency the priority should take precedence in order to capitalise on the CSR momentum in India. Funding for labour schemes from CSR should also be facilitated and intermediaries like trade unions or labour welfare associations should be able to accept such funding and disseminate the same.

Currently, India's CSR outlook is haphazard, which may result in scenarios like corporates taking up what is 'trendy' or what may help their sales the best. In this regard, there seems

36. Collins G. Ntim, Defining Corporate Governance: Shareholder versus Stakeholder Models, GLOBAL ENCYCLOPEDIA OF PUBLIC ADMINISTRATION, PUBLIC POLICY AND GOVERNANCE, (Springer ,2018).
37. Ruchi Khandelwal & Swarna Bakshi, The New CSR Regulation In India: The Way Forward, 11 PROCEDIA ECONOMICS & FINANCE 60 (2014), p.64.
38. Umakanth Varottil, Initial Experience in Implementing CSR Law in India, OXFORD BUSINESS LAW BLOG (July 6, 2018) https://www.law.ox.ac.uk/business-law-blog/blog/2018/07/initial-experience-implementing-csr-law-india.

to be much traction in the suggestion that there needs to be a national level agency[39] which can coordinate the focus areas, and perhaps a specialised all India program can be identified specific to the goals of labour welfare, coordinated by the said body.

Here, attention is drawn to the fact that corporates will essentially always seek to enhance profits or boost productivity. Considering that CSR spending is mandatory, corporates will have to spend the requisite amount on CSR. While initiatives supporting other causes like environment, promotion of education etc. are equally important, it is suggested that a portion of the CSR spending (perhaps 0.1-0.5% of the total CSR expenses) should be mandatorily spent on labour welfare. Considering that this would be in addition to the statutory requirements which are to be spent in this regard, it is predicted that the corporates will be forced to look at alternate initiatives and such which will ultimately enhance labour welfare. In this regard, the question may arise as to what appears to be an unfair preference to labour welfare when other concerns like the environment are present. This can be justified on the ground that only a small portion of the CSR expenditure is sought to be utilised in this regard.

It can be reasonably argued that the companies will be more willing to spend on their employees which will have a direct result on their sales, profits, or productivity. This can bring about considerable changes in India, where the concept of minimum wage is still emphasised and the statutory guarantees are often not enough for the workers in the changing local and global landscape where the cost of living is significantly higher.

Especially in the times before and beyond COVID, CSR can be seen as a possible answer to meeting various challenges. This amount utilised for labour welfare can perhaps be utilised for introducing digital literacy programmes, skill based training and so on, and if the company spends on the employee in this manner, then the employee is less likely to be replaced or terminated, as the intrinsic value of the employee to the company is now significantly higher. It was seen during the time of COVID, as to how digitally literate employees were able to tide the wave and adapt to the changing circumstances, whereas others were left behind to face the brunt of being unable to navigate the digital space. The utility of the digital medium as a cost effective mechanism as well as the relative flexibility offered to the employee can be considered as an extension of this argument, benefiting all involved. The CSR initiatives which aim at enhancing the amenities and benefits available to the employee will also indirectly enhance productivity. Here again, the possibility of tying in COVID related relief measures to employees can again be possibly met out of CSR funds, which also provides an added impetus for the company to bring in a better equipped workforce in the times in which we are attempting to ease out of lockdown mode.

The suggestion of mandatory CSR expenditure on labour welfare is not a panacea by any means, and the concerns of passive compliance etc. still exists. It may also be noted that where there is spending to be made on the employees of the same company, the

39. Ruchi Khandelwal & Swarna Bakshi, The New CSR Regulation In India: The Way Forward, 11 PROCEDIA ECONOMICS & FINANCE 60 (2014), p. 63.

company can simply move around funds and puff up the reports with apparent spending without any of the benefits going to the employees. However, as suggested before, the push for disclosure, increased transparency and perhaps a central agency to oversee CSR policies, initiatives and spending, would be helpful here.

Another major area for consideration would be the case of women workers and the utility of CSR in improving their conditions, both as workers as well as in their domestic life, where aid can be provided. An example would be providing a certain sum of money to the dependants of the employee, if they have no other means of income or do substantial house work, or provide modern home appliances, accessible and affordable babysitting services and childcare, provision for continuation of education for women and so on, all of which will improve the conditions of women workers, and bring more of them into the workforce.

Conclusion

CSR in itself has been a very intriguing concept with its potential impact lying embedded across several areas of human life and even the environment and labour welfare. The concept in itself has been progressing in India, with the legislative steps taken and the increased value given to public perception of companies based on their practices and initiatives. There are also several positives and negatives with the current system which have to be addressed, moving forward.

Ultimately, it can be said that CSR is a very potent tool that can be utilised for a myriad of causes and to give back to the society. While redirecting the attention of CSR funding and initiatives to uplifting and bringing about labour welfare, it is not only the labour class that benefit, but it can be reasonably expected that productivity and job satisfaction levels also rise, leading to positive growth. Harnessing this power, both economically or as a source of funding, alongside the softer benefits in terms of productivity among others; in the right manner and not merely leaving CSR to be a corporate law requirement that is fulfilled just for the sake of meeting the statutory stipulations would be the next policy goal. Uplifting the workers aided with strong policies aimed at not just providing the minimum, but reaching the best possible conditions should be the primary aim, and in this regard, CSR should be polished into an instrument aiding in change.

The Way Forward

It is therefore evident that India stands on the cusp of being a world leader in many respects. However, this growth should also take into account the various issues, both latent and patent, that the labour laws are failing to tackle. Addressing these issues, along with developing a more facilitative legal framework, needs to be underscored as a top priority. In this regard, lasting change can perhaps be wrought by taking in elements like CSR and tying it together with the labour law requirements which can open up new avenues for collaborative growth. The glory of India can burn brighter when the rights of the workforce attain the sanctity owed to it and create a fruitful path to the nation's future.

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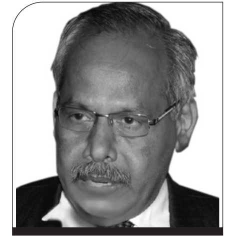
DIRECT TAXES
Supreme Court



Keshav B. Bhujle
Advocate

1 *CIT (IT and TP) vs. IJM Corporation Berhad; [2023] 455 ITR 357 (SC): dated 08-05-2023*

Deduction of tax at source — Recipient of income assessed at loss and not liable to pay tax — Deductor cannot be held in default and made liable to interest — Direction to Department to refund sums collected from deductor with interest, to be paid over to assessee — Supreme Court dismissed special leave petition of Department: Ss. 195 and 201 of ITA 1961: A. Ys. 2008-09 to 2011-12

Assessment in the case of the assessee for the A. Ys. 2008-09 to 2011-12 was completed u/s. 143(3) of the Income-tax Act, 1961 at a loss. The Department recovered amounts from the deductor on account of interest u/s. 201(1A) of the Act, which in turn had been paid by the deductor.

The High Court held that in a situation where the assessee, having been assessed at a loss figure, was not required to pay any tax on its income, there was no reason to hold the deductor in default u/s. 201(1) and (1A) of the Act, that interest recovered u/s. 201(1A) of the Act could not be legally retained by the Department and ought to have been refunded and directed the Department to refund the interest amount collected u/s. 201(1A) of the Act from the deductor on behalf of the assessee together with interest u/s. 244A of the Act, who in turn, shall pay it to the assessee in accordance with law.

The Supreme Court dismissed the special leave petition filed by the Department and held as under:

"1. Delay condoned.

2. Heard learned counsel for the petitioners.

3. We are not inclined to interfere with the impugned judgment and order of the High Court.

4. The special leave petitions are dismissed."

2 *CIT(IT) vs. Air India Ltd.; [2023] 456 ITR 139 (SC): dated 04-07-2023*

Deduction of tax at source — Payments to non-resident — Lease of an aircraft engine — Lessor non-resident without permanent establishment in India or permanent account number — Tribunal holding rent of engine covered under equipment under DTAA — Provisions requiring recipient to

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quote permanent account number cannot override provisions of DTAA — High Court held order of Tribunal not erroneous and no substantial question of law arising — Supreme Court dismissed special leave petition of Department: S. 206AA of ITA 1961: DTAA between INDIA and The Netherlands, ART. 12(4): A. Y. 2013-14

The Tribunal held that the engine was a part of the aircraft and could not be said to be an aircraft and the payment being made for rent of engine was covered under equipment in article 12(4) of the Double Taxation Avoidance Agreement between India and the Netherlands, that the lessor was a foreign company having no permanent establishment in India or permanent account number, that section 206AA of the Income-tax Act, 1961, could not have overriding effect on the Double Taxation Avoidance Agreement, that the assessee had rightly deducted the tax at 10 per cent. According to the provisions contained under the Double Taxation Avoidance Agreement, and that hence no demand was payable by the assessee.

The Delhi High Court held that the Tribunal was right and no question of law arose.

On a petition for special leave to appeal filed by the Department, 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."*

3 *Tejpal Chaudhary vs. CIT; [2023] 456 ITR 360 (SC): dated 06-07-2023*

Industrial undertaking in special category states — Special deduction u/s. 80-IC of ITA 1961— Initial assessment year — Unit availing of deduction of 100 per cent for the first five years and thereafter at 25 per cent for the next five years — Carrying out substantial expansion within ten year period — Year of substantial expansion would be the initial year for start of 100 per cent. Deduction: A. Y. 2011-12

On the question whether the assessees were entitled to 100 per centexemption u/s. 80-IC of the Income-tax Act, 1961, the Tribunal held that the benefit of substantial expansion at 100 per cent deduction would not be granted to existing units where the assessee had already availed of full deduction at 100 per cent in the earlier five years and the benefit of deduction at 25 per cent was available for the remaining period where the substantial expansion had taken place after January 7, 2003, and before April 1, 2012.

On appeals, the Punjab and Haryana High Court affirmed the order of the Tribunal.

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

> *"As conceded by the Department, the assessees were entitled to 100 per cent exemption. In the case of one of the assessees, the Assessing Officer had clearly held that the assessee was entitled to exemption u/s. 80-IC but to the extent of 25 per cent only which was now held to be 100 per cent. The finding that the assessee was entitled to deduction had attained finality. In the case of the other assessees, the Department conceded that it was entitled to exemption."*

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4 *CIT vs. Gracemac Corporation; [2023] 456 ITR 135 (SC): dated 03-07-2023*

Non-resident — Taxability in India — Royalty — Computer software — Payment for licensing of software products of a non-resident in the territory of India whether taxable in India as royalty — High Court following Supreme Court ruling in favour of assessee — Supreme Court dismissed special leave petition of Department: S. 9(1)(vi) of ITA 1961: DTAA between INDIA and USA, Art 12: A. Y. 2006-07

Precedent — Supreme Court — Finality of litigation — Decision rendered following earlier decision — Subsequent overruling of earlier decision does not revive judgment passed following it: CPC, 1908, Order XLVII, R. 1.

The Tribunal held that payments for licensing of software products of M in the territory of India by the assessee were not taxable in India as royalty u/s. 9(1)(vi) of the Income-tax Act, 1961 read with article 12 of the Double Taxation Avoidance Agreement between India and the United States of America.

The Delhi High Court held that the issue of law raised in the appeal having been conclusively decided in the favour of the assessee by the Supreme Court in ***Engineering Analysis Centre of Excellence P. Ltd. vs. CIT [2021] 432 ITR 471 (SC)***, no substantial question of law arose.

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

"i) Once a judgment is passed by a court following another judgment and subsequently the latter judgment is overruled on a question of law, it cannot have an effect of reopening or reviving the former judgment passed following the overruled judgment nor can the same be reviewed.

ii) The Explanation to rule 1 of Order XLVII of the Code of Civil Procedure, 1908 is in the nature of an exception. In other words, the Explanation being in the nature of a proviso qualifies or is an exception to what is stated in rule 1 of Order XLVII of the Code, which states the grounds for seeking a review. Hence, the object and intendment of the *Explanation* must be given its full effect. The object and purpose of the *Explanation* can be related to the three maxims: nemo debet bis vexari pro una et eadem causa (no man should be vexed twice for the same cause), interest reipublicae ut sit finis litium (it is in the interest of the State that there should be an end to litigation), and res judicata pro veritate occipitur (a judicial decision must be accepted as correct). There must be an end to litigation, otherwise, the rights of persons would be in endless confusion and fluidity and justice would suffer. This is against public policy and not in the interest of the State.

iii) As of today the judgment of the three-judge Bench of the court in ***Engineering Analysis Centre of Excellence P. Ltd. vs. CIT [2021] 432 ITR 471 (SC)*** is holding the field and therefore the said judgment would have to be followed in the instant case.

iv) In view of the above, the special leave petition stands dismissed."

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DIRECT TAXES
High Court

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Income deemed to accrue or arise in India – Section 9(1)(vi) of Income Tax Act, 1961 – payment of Royalty for providing technical support inextricably linked with the manufacturing activity – allowed in earlier years – exclusion of the royalty payment from the manufacturing segment while determining the arm's length price – unjustified. (Doctrine of judicial precedent)

Facts

1. The Assessee before the Hon'ble High Court is engaged in the business of manufacturing and sale of internal combustion engines, spares, etc. It paid royalty to Cummins Inc. (AE) for providing technical knowledge in the manufacturing of engines to be sold to its customers.

2. The rates prescribed in the agreement entered into with the AE of royalty payment for domestic market stood at 1% to 5% and 8% for export sales. The Assessee benchmarked the royalty transaction along with other international transactions under the "manufacturing segment" using TNMM.

3. During the course of Transfer Pricing Proceedings, the assessee justified the inclusion of royalty payment under the manufacturing segment while determining the Arm's Length Price. The TPO accepted the TNMM benchmarking of the Assessee except for the royalty on export sales. The TPO contended that CUP method be used for the royalty on export sales.

4. Aggrieved by the action of TPO, the assessee challenged the same before the DRP. However, the DRP upheld the view of the TPO.

5. Being aggrieved by the order of the DRP, the assessee further filed an appeal before the Hon'ble ITAT, Pune. Before the ITAT, the assessee heavily relied upon the order of the earlier years wherein the benchmarking of royalty payments was accepted. However, the ITAT also upheld the view of the lower authorities by observing that the new agreement entered into with the AE was not available at the relevant period and hence, not considered by the ITAT while passing the orders in the earlier years. The ITAT also relied on the decision of ***Magneti Marelli Powertrain India (2016) 389 ITR 469 (Delhi)*** and held that international transaction of payment of royalty by Assessee for use of technical support cannot be clubbed with

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other international transactions under manufacturing segment.

6. The assessee being aggrieved by the order of the ITAT, filed an appeal before the Hon'ble Bombay High Court under section 260A of the Act.

Arguments of the Assessee

7. Before the Hon'ble Bombay High Court, the assessee, contended that in the A.Y. 2006-07, under similar facts and circumstances the ITAT held that the transaction of payment of royalty for the use of technology as inextricably linked with manufacturing activity should be aggregated with other international transactions.

8. The assessee further brought to the notice of the Hon'ble Court that even the TPO had accepted the benchmarking of royalty under the aggregation approach along with transactions of the manufacturing segment for the A.Y. 2011-12 up to the A.Y. 2014-15.

9. As far as reliance placed by the ITAT on the decision of Hon'ble Delhi High Court in the case of Magneti Marelli Powertrain India (supra) was concerned, the assessee contended that the same was rendered in the facts of that case and even in that decision, the Hon'ble court has held that it is not permissible to the TPO to pluck out a single transaction from the host of transactions, if the same is inextricably linked with the manufacturing activity.

Department's arguments

10. The Revenue relied on the Magneti Marelli case and contended that each international transaction needs to be benchmarked separately. It further stated that a transaction is considered 'closely related' when the decision of price of one product/service depends on the price of another product/service. And as per the Revenue, there is no link between the royalty transactions and the pricing of the sale price or other transactions.

Decision of the Hon'ble Bombay High Court

11. Hon'ble High Court was pleased to allow the claim of the assessee by observing that the facts in Magneti Marelli case and the present assessee's case are factually different. In the Magneti Marelli case, the assessee failed to substantiate the need for payment of technical assistance fee whereas in the case of the assessee, the TPO accepted that the assessee received technical assistance from its AE's. Therefore, the reliance placed by the Revenue on the Magneti Marelli case is incorrect.

12. Hon'ble High Court further held that the adoption of different method of benchmarking for an international transaction disturbs the soundness of international transaction ALP fixing exercise. Hon'ble High court also noted that the TPO having accepted that TNMM method applied by the assessee was Most Appropriate Method (MAM) in respect of all the transactions including payment of royalty, he therefore cannot separately use CUP method as MAM for transaction relating to the payment of royalty.

13. The Hon'ble High Court also observed that ITAT had failed in recognizing the

royalty agreements for the years under consideration was identical to the royalty agreements entered with the AE in the earlier years and relying on the said agreements the TPO himself had accepted the benchmarking approach adopted by the assessee in the previous years.

14. Hon'ble High Court, by making the above observations, held that the ITAT should have followed the order of the co-ordinate bench and relied on the Supreme Court's decision in ***Radhasoami Satsang vs. CIT: [1992] 193 ITR 321 (SC)*** wherein it said that the Department was bound by the previous decision in absence of any change in material facts. (A.Y. 2015-16, 2016-17 and 2017-18)

Cummins India Ltd. vs. ACIT [2023] 153 taxmann.com 223 (Bombay)

Limitation – Section 153 of the Income Tax Act, 1961 – Limitation period provided under section 153 has to be strictly adhered to for passing the fresh assessment orders pursuant to remand from the Appellate Tribunal – assessment orders passed beyond the period provided under section 153 is void ab initio even though passed in compliance with the provisions of Section 144C of the Act.

Facts

1. The Petitioner is a company incorporated under relevant laws of Cayman Island and headquartered in Dubai, UAE (eligible Assessee as per section 144C of the Act). It is engaged in the business of shallow water drilling for clients engaged in the oil and gas industry.

2. On 29th November 2014 Petitioner filed its Return of Income for Assessment Year 2014-15 declaring a total loss of ₹ 120,18,44,672/-. The loss had been arrived at by exercising its option not to be assessed on the presumptive basis of taxation as per Section 44BB(3) of the Act and computing its income under the regular provisions of the Act.

3. The Petitioner's ROI for the A.Y. 2014-15 was selected for scrutiny. The AO passed the draft assessment order on 26 December 2016. Invoking section 145 of the Act, the AO rejected the petitioner's book of accounts (which reflected a low profitability) and computed the petitioner's income from providing services in connection with prospecting for or extraction or production of mineral oils under section 44BB(1) of the Act at a rate of 10% of the receipts as provided in the Act.

4. The Petitioner filed objections before the DRP which was disposed vide order dated 28 September 2017 rejecting Petitioner's objection.

5. ITAT, vide order dated 4 October 2019, remanded the matter back to AO for fresh adjudication holding that AO and DRP failed to consider books of account and other documentary evidence.

6. The Petitioner informed AO about the ITAT order on 5 February 2020 and requested early disposal. AO took over one year to call for details from Petitioner and passed the draft assessment order on 28 September 2021.

7. The Petitioner filed objections with the DRP on 27 October 2021.

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Simultaneously, the Petitioner also filed a writ petition on 20 October 2021 before the Bombay High Court challenging the impugned order passed in violation of the provisions of section 153 of the Act.

Arguments of the assessee

8. The Petitioner challenged the draft assessment order on the ground that the limitation under section 153(3) to pass the final order expired on 30 September 2021 (read with provisions of the Taxation and other laws (Relaxation and Amendment of Certain Provisions Act, 2020 and notification issued thereunder) and placed reliance on the decision of Madras High Court in the case of ***Commissioner of Income-tax vs. Roca Bathroom Products Private Limited: [2022] 140 taxmann.com 304 (Madras)*** which stated that no final assessment order can be passed beyond the limitation period.

Department's Arguments

9. On the other hand, the department argued that the time limit given under section 153(3) would be in addition to the time prescribed under section 144C and it does not get subsumed. The nine months' time is prescribed only for DRP to pass an order under Section 144C(12) and thereafter one month is prescribed for the assessing officer to pass the final assessment order in conformity of the direction given by DRP.

10. The Revenue further stated that no time limit is prescribed under section 144C(1) for passing of draft assessment order of the Act and therefore no question of the assessment being barred under section 153(3). Section 144C of the Act was held to be self-contained code by earlier decision of Madras High Court and placed reliance on the decision of ***CIT vs. Sanmina SCI India Private Limited: [2017] 85 taxmann. com 29 (Madras)***.

11. It was further highlighted by the Revenue that section 144C being special provision for matters concerning 'eligible assessee' will take precedence over general provision under section 153. And that the interpretation as per the decision of Roca Bathroom (supra) will make machinery provisions unworkable.

Ruling of the Hon'ble High Court

12. Hon'ble High Court was pleased to allow the Writ Petition filed by the assessee by observing that the provisions of section 144C *inter-alia* requires various actions that culminate into the DRP for passing its directions. At none of these stages are there any exclusion provided to the overall assessment timelines prescribed under section 153.

13. Exclusions of section 153 are provided by Section 144C only at the time of passing the final assessment order. The purpose of section 144C is to fast-track a particular type of assessment, and it cannot be considered to mean that the overall timelines prescribed have been given an extension.

14. Section 153 provides various instances when time limits are to be extended and no such extension has been given on account of the provisions under section 144C.

15. Law provides set timelines for every step of the proceedings. Therefore, there is no reason to assume that the proceedings remanded back to the AO, may be done at leisure sans the imposition of any time limit at all.

16. Accepting the department's argument would run counter to the objective with which the provisions of section 153 were framed and bought into effect.

17. Accordingly, the Hon'ble Bombay High Court concluded that in case of remand proceedings under section 153(3), the AO must ensure that the entire procedure prescribed under section 144C is completed and pass the final assessment order within the twelve-month period as prescribed. The non-obstante clause in Section 144C(13) is only for the limited purpose to ensure that an order based on DRP directions has to be passed within 30 days from the end of the month of receipt of such directions. The object is to conclude the proceedings as expeditiously as possible.

18. Further, Hon'ble Bombay High Court also held that even in case of normal assessment proceedings, the AO must ensure that the entire procedure prescribed under section 144C is completed and the final assessment order is passed within the time limit prescribed under Section 153 of the Act.

Shelf Drilling Ron Tappmayer Limited Ltd vs. ACIT [2023] 153 taxmann.com 162 (Bombay)

Search and Seizure – Section 132 of the Income Tax Act, 1961 – recording of satisfaction is a condition precedent for initiating the search action and the same can be examined by the High Court in Writ Jurisdiction.

1. The assessee before the Hon'ble High Court was subjected to search and seizure action under the provisions of section 132 of the Act on 23.10.1997. Pursuant to the said search action a block assessment order dated 31.12.1999 was passed under section 158BC of the Act making certain additions/disallowances.

2. The assessee being aggrieved by the block assessment order preferred an appeal before the Ld. CIT(A). During the course of appeal proceedings, the assessee filed an additional ground challenging the validity of search itself on the ground that jurisdictional pre-conditions in section 132(1) *viz.*, clauses (a) to (c) thereof had not been fulfilled and that there ought to have been a valid satisfaction note justifying the fulfillment of the requirement of the said section before the search was initiated. The Ld. CIT(A) however rejected the grounds taken by the assessee and upheld the validity of search action.

3. The assessee challenged the order of the Ld. CIT(A) before the Mumbai Appellate Tribunal raising the validity of search action. The Appellate Tribunal vide its order dated 17.06.2002 directed the Departmental Representative to produce the records containing the satisfaction recorded

before issuance and authorization of the search warrant under section 132(1) of the Act.

4. The department instead of complying with the directions of the appellate tribunal, filed a writ petition before the Hon'ble Bombay High Court for quashing of the above directions issued by the Appellate Tribunal. Hon'ble court was pleased to issue rule in favour of the department and therefore the assessee has filed a writ petition challenging the validity of the search action & seeking quashing and setting aside of the consequent block assessment order U/s 158BC, order levying penalty U/s 158BFA and also complaint being criminal case filed before the court of Additional Chief Metropolitan Magistrate.

5. Hon'ble Bombay High Court was pleased to dismiss the Writ Petition filed by the department by observing that it is settled law that if no reason was ascribed for search and seizure action taken under Section 132 of the Act it would be illegal. The exercise of power under Section 132 of the Act is a serious invasion upon the rights, privacy and freedom of the tax-payer. Hon'ble High Court has further observed that the officer concerned must satisfy the Court about the regularity of his action. If the action is maliciously taken or power under the section is exercised for a collateral purpose, it is liable to be struck down by the Court. If the conditions for exercise of the power are not satisfied the proceeding is liable to be quashed.

6. Hon'ble High Court has therefore held that the reasons will have to be placed before the High Court in the event of a challenge to formation of the belief of the competent authority in which event the Court would be entitled to examine the reasons for the formation of the belief, though not the sufficiency or adequacy thereof.

7. Thus, as in the present case the Revenue has failed to produce the satisfaction note the Hon'ble High Court has held that the search action under section 132(1) of the Act and, consequently, the block assessment order dated 31.12.1999 passed under section 158BC of the Act cannot survive as they are predicated on the existence of a valid search.

ACIT vs. Marico Industries Ltd & Anr. [W.P. No. 2849 of 2008 order dated 28/07/2023, Bombay High Court]

> "Experience is the only teacher we have We may talk and reason all our lives but we shall not understand a word of truth until we experience it ourselves"
>
> — *Swami Vivekananda*

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DIRECT TAXES
Tribunal

CA Viraj Mehta CA Kinjal Bhuta

1 *Sheel Agarwal vs. ITO [ITA No. 123/Del/2023 dt. 10.07.2023 (Del) (Trib.) (AY: 2012-13)*

Sec. 271F - AO levied penalty u/s. 271F –ITAT held that order of CIT(A) is cryptic – penalty u/s. 271F is directory and not mandatory – penalty not to be levied when there is a reasonable cause for not filing return of income

Facts

The assessee was a senior citizen and was not required to file return of income. The AO completed the assessment ex-parte u/s. 144 r.w.s. 147 of the Act and levied a penalty of ₹ 5,000/- u/s. 271F of the Act. The CIT(A)-NFAC though waived off the penalty levied u/s. 271F of the Act but the ground of waiving was that the assessee is a senior citizen and widow aged 82 years and has never filed return of income as she is a housewife and had no taxable income. Against this order of NFAC, the assessee is under an appeal.

Held

Before Hon'ble ITAT, the assessee raised several grounds including that, the order passed by NFAC was cryptic, arbitrary. The contentions of assessee were that she was not required to file return of income u/s. 139(1) of the Act and that the penalty levied u/s. 271F is directory and not mandatory. It was also contended that, The CIT(A)- NFAC failed to provide direction in consonance with the speaking reasons provided in the impugned order. The Hon'ble ITAT held that, the CIT(A) order was without any rhyme and reason. The Hon'ble ITAT deleted the penalty levied u/s. 271F of the Act on the grounds that the provisions of 271F of the Act are not attracted in case of the assessee, as the assessee did not have any taxable income and, therefore, was not required to file return of income.

2 *Deepika Subramanian vs. PCIT [ITA No. 394/Chny/2023 dt. 24.07.2023] (AY: 2017-18)*

Sec. 263 – Delay of 319 days in filing appeal condoned – Difference in Stamp Duty Value and sale consideration cannot be a sole reason for making revision if the same has been considered by the AO in assessment

Facts

1. There was delay in filing of appeal of 319 days. The assessee filed a condonation application along with an affidavit stating that, the assessee was unaware of the fact that the revision order passed u/s. 263 of the Act is

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an appealable order and was under a misconception that she had to wait for the AO to pass consequential order. The assessee became aware that an appeal can be filed against the revisional order, only when she sought a legal advice.

2. The assessee's case was selected for a limited scrutiny. The assessee had purchased a property for ₹ 66 lakhs, and the stamp duty value of the same was ₹ 77.87 lakhs. The assessee responded to all the notices and elaborately explained the source of payment made towards the purchase of the property, details of the sale consideration and the stamp duty paid were given. The same was accepted by AO, and no additions were made. The Pr. CIT decided to revise the order passed by the AO alleging that AO has failed to invoke add the differential amount u/s. 56(2)(vii). As a result, the assessment done u/s. 143(3) of the Act was set aside, and the AO was directed to redo the assessment by referring the matter to the valuation officer.

Held

1. The Revenueopposed the condonation request of the assessee citing that the assessee had legal advice at all the times during assessment and revision proceedings and took a conscious decision to not file the appeal against revisional order and preferred appeal only upon passing of adverse consequential order of AO. The Hon'ble ITAT based on the facts reproduced by the appellant at the time of hearing held that, the assessee has only sought online legal advice and she had represented the case herself during the assessment proceedings. The plea of the assessee was accepted, and the delay was therefore condoned.

2. Before the Hon'ble ITAT for the Assessee it was contended that was selected for limited scrutiny and one of the points to be scrutinised was the purchase/sale of property. She had elaborately explained the source of payment made towards the purchase of the property, details of sale consideration and details of stamp duty paid. The Hon'ble ITAT held that, when the AO has already examined the issue and has taken one of the possible views and chose not to make any addition, the Ld. Pr. CIT is not justified in directing fresh assessment by referring the matter to the valuation officer. The Pr. CIT has also not rendered any finding that the market value of the property was higher than the one shown by the assessee.

3. The Hon'ble Tribunal in its conclusion relied on the decision of Hon'ble Madras HC in case of ***CIT vs. Padmavathi*** (citation) wherein the Hon'ble Court held that the stamp duty value was only an indicator for calculating stamp duty, and merely because the stamp duty value was higher than the sale consideration cannot be a sole reason for holding that the assessment was erroneous and prejudicial to the interest of the revenue. The Hon'ble Tribunal also held that this decision of Hon'ble Madras High Court shall take precedence over the Kochi Tribunal decision quoted by CIT-DR. Thus, the impugned revisional order was quashed.

3 *Sri Bhagavanta Ramrao Deshpande vs. ITO [ITA No. 435/Bang/2023 dt. 24.07.2023] (AY: 2017-18)*

Sec. 69A – No addition u/s. 69A on account of deposits made during demonetization period if the same was accepted and added by the AO as a part of turnover and the assessee has not disputed the same

Facts

The assessee was engaged in the business of plying and also had a salary income. For the FY: 2016-17, the AO issued notice u/s.133(6) of the Act to the bank and obtained bank statements wherein it was observed that, the assessee had deposited a total of ₹ 76 lakhs throughout the year in two different bank accounts. Out of the total deposits of ₹ 76 lakhs, amounts of approx. ₹ 12 lakhs were deposited in two separate bank accounts during the demonetisation period. The AO, in the absence of any books of accounts, treated the entire cash deposits including the cash deposited during the demonetisation period as the business turnover and the net profit was calculated by applying 8% on turnover on the total deposits as per sec. 44AD of the Act. Over and above, the AO also considered the cash deposits made in one of the two banks, during the demonetisation period as unexplained income u/s. 69A of the Act. The CIT(A) confirmed the order of the AO. Against the addition made u/s. 69A, the assessee has preferred an appeal before the Hon'ble Tribunal.

Held

Before Hon'ble ITAT, it was argued by the AR, the once AO had accepted the entire cash deposits made throughout the year as the turnover of the assessee and the net profit was computed by applying 8% as per sec. 44AD of the Act, the AO was not justified in taxing the some deposits u/s. 69A of the Act, failing to appreciate the fact that the same amount had already been included as a part of the turnover by him and if such actions of the AO are upheld, then it would lead to double taxation. The Hon'ble ITAT held that, once the AO had accepted the entire cash deposits as turnover and computed income u/s. 44AD of the Act, and the assessee had not disputed the same, then no additional amount which is part of the same turnover can be taxed under other provisions of the Act, as it would lead to double taxation. Therefore, the addition u/s.69A was deleted.

4 *Pramila Gupta vs. CIT(A) [ITA No. 1828/Del/2022 dt. 03.08.2023] (AY: 2017-18)*

Sec. 55A – No reference by AO to DVO – if the AO fails to bring out any material on record to controvert the value adopted by the assessee's registered valuer – valuation report of DVO not tenable

Facts

The assessee is a non-resident, and has sold a residential property and declared capital gains on the sale of residential property. The assessee considered the FMV of the property as of 01.04.1981 based on an approved valuer's report. The AO referred the matter to the DVO, who reduced the value of the property and recomputed indexed cost of acquisition and added the difference to the LTCG computed by the assessee. The CIT(A) confirmed the additions made by the AO.

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Held

Before Hon'ble ITAT, it was argued that the assessee was not provided with the full copy of valuation report at the time of filing objections to the said report. Further, the CIT(A) has ignored the disparities adopted by the DVO in his report, which were brought to the notice of the CIT(A) by the assesse through his written submissions. The Hon'ble ITAT held that, the reference made by the AO to the DVO cannot be upheld because the AO has not given any justification in his order as to why he is referring the matter to DVO. The AO only mentioned that he is not satisfied with the report given by the assessee's valuer but failed to bring out any material on record to show how the valuation report given by the assessee is unacceptable. The valuation report submitted by the assessee has taken into consideration the sale deeds from the Income Tax Department auction and other comparable registries. On the other hand, the DVO had not considered any comparable cases of the relevant year while determining the value of the property. Further, in computing the FMV of the property, the DVO had worked backwards, deducting 1.5% per month for 27 months from the value of properties from 1983. As a result, the DVO deducted 41.41% from the rates of 1983 to arrive at the FMV as at 1981. The DVO had assumed a rise of 41% from 1981 to 1983. Hence, the methodology adopted by the DVO could not be accepted. The Hon'ble ITAT held that, the re-computation of LTCG made by the AO as confirmed by the Ld. CIT(A) cannot be sustained.

5 ***DCIT vs. Motilal Oswal Securities Ltd. [ITA No. 1795 & 1796/ Mum/2023 dt. 18/08/2023 (Mum) (Trib.) (AY 2017- 2018 & 2018 – 2019)***

Section 37(1) – Employee Stock Option Plan ('ESOP') Expenses –– Deduction allowed as revenue expenditure

Facts

During the year under consideration, assessee has claimed ESOP expenses. The Assessing Officer passed under section 143(3) of the Act and disallowed the ESOP expenses and held that the loss due to ESOP is a notional loss to the extent of receipt of lesser amount towards share premium. Assessee nowhere has incurred any expenditure so as to claim the same is allowable under section 37(1) of the Act. Assessee has issued shares to the employees at a concessional rate which has increased the capital base of the company and therefore, such expenditure was to be considered as capital expenditure. Such expenditure which has not been crystalised in terms of quantum and therefore can be treated as contingent liability. Accordingly, the ESOP expenditure was disallowed under section 37(1) of the Act. CIT(A) relying on decision of the Hon'ble Karnataka High Court in ***CIT vs. Biocon Ltd [2020] 121 taxmann.com 351 (Karn.)*** allowed the claim of the assessee. Hence, department is in appeal before ITAT.

Held

ITAT confirmed the view of CIT (A) and held that ESOP expenses are allowable u/s 37(1) as revenue expenditure.

6 *DCIT vs. Motilal Oswal Securities Ltd. [ITA No. 1795 & 1796/ Mum/2023 dt. 18/08/2023 (Mum) (Trib.) (AY 2017- 2018 & 2018 – 2019)*

Section 80G – CSR Expenditure though not allowable u/s 37(1) — Deduction u/s 80G is allowed

Facts

Assessee incurred CSR expenses of ₹ 2,25,71,775, and claimed donation under section 80G of the Act amounting to ₹ 2,21,41,893. AO in assessment made under section 143(3) of the Act did not agree with the submissions of the assessee and held that the expenditure incurred by the assessee under the provisions of the Companies Act, 2013, cannot be claimed as a donation under section 80G of the Act. It was further held that the expenditure under the aforesaid provisions of the Companies Act, 2013 is a mandatory contribution and not a voluntary contribution and this expenditure has categorically been disallowed under section 37 of the Act. Accordingly, deduction under section 80G of the Act was disallowed. CIT (A) allowed assessee's appeal and hence, department is in appeal before ITAT.

Held

ITAT confirmed the view of CIT (A) and held that coordinate benches of the Tribunal have consistently taken the view in favour of the assessee and held that the CSR expenses even though not allowed under section 37 of the Act pursuant to insertion of *Explanation-2* to section 37 *vide* Finance Act, 2014 with effect from 01/04/2015, but the said expenditure is allowable under section 80G of the Act.

7 *ITO vs. AMS Trading & Investment Pvt Ltd [ITA No. 1863/Mum/2021 dt. 25/08/2023 (Mum)(Trib.) (AY 2010 – 2011)*

Section 68 – Share Application Money Received – Identity, Creditworthiness and Genuineness Proved – No addition can be made

Facts

Assessee received the share application money from M/s Empower Industries Ltd of ₹ 1,55,00,000/- consisting of paid up share value at ₹ 8/- per share and share premium of ₹ 392/- per share. Assesee submitted the details vide letter dated 17-03-2016 the copy of Audit, Copy of PAN of the investor company, bank statement reflecting the transactions, copy of share application form, copy of Form No. 2 filed with the R.O.C. and the judicial decisions. However ignoring the submissions, AO found that the share application money and share premium does not satisfy the test of genuineness, creditworthiness and identity as per the provisions u/s 68 of the Act and treated as unexplained credit u/s 68 of the Act ₹ 1,55,00,000/-. CIT(A) considered the grounds of appeal, statement of facts, findings of the A.O, submissions of the assessee, the remand report and the catena of Hon'ble High Court and the Hon'ble Tribunal decisions on the genuineness, creditworthiness and identity as per the provisions u/s. 68 of the Act. CIT(A) held that assessee has discharged its burden by submitting the information and the A.O has failed to make enquiries and deleted the additions and hence, appeal before ITAT.

Held

ITAT allowed the assessee's appeal on the ground that assessee has complied with the

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ingredients required u/s 68 of the Act of genuineness, identity and creditworthiness. A.O has failed to make further enquiries and relied only on statement of the key person, which was retracted subsequently. CIT(A) relied on the catena of judicial decisions in his order and has test checked the creditworthiness and identity of shareholders and came to a reasonable conclusion that the assessee has discharged its burden on submitting the information.

8 ***ITO vs. Hindustan Breweries and Bottling Ltd [ITA No. 1673/Pune/2019 dt. 01/06/2023 (Pune) (Trib.) (AY 2013 – 2014)***

Section 68 – No amount credited during the year – since no amount received as share capital no addition can be made as unexplained credit – Addition cannot be sustained

Facts

Assessee filed its return declaring Nil income, after set off of brought forward loss of ₹ 41,39,617/- against the current year's income. The AO issued various notices, which remained unresponded. Eventually, the assessment order was passed u/s. 144 of the Act. The AO observed that the assessee received fresh share capital amounting to ₹ 6 crore. In the absence of the assessee participating in the assessment proceedings or furnishing any evidence in support of the claims, the AO made the addition of ₹ 6 crore u/s. 68 of the Act. CIT(A) deleted the addition by accepting the assessee's contention that the credit to share capital was only through journal entries. Hence, appeal before ITAT has been filed by Department.

Held

It is apparent that the assessee company converted unsecured loans into Equity share capital worth ₹ 6 crore. From page 132 of the paper book, which is a copy of share application money account , this page indicates transfer of ₹ 6 crore to share application money account through 7 entries passed on 31.3.2013. Assessee transferred ₹ 6 crore to share application money account from various accounts and all the transfers were made out of respective opening balances. Once the position is such, no addition u/s. 68 just on the passing of transfer entries. Pages 9 and 10 of the impugned order record that Mr. Neelabh Agnihotri, ITO, Ward-1(1), Aurangabad, present AO of the assessee, appeared before the ld. CIT(A) on 29-07-2019, who: "affirmed that share capital of ₹ 6,00,00,000/- was not received in the current year and unsecured loans/sundry creditors were converted in the share capital". It is abundantly clear that the transfer to share capital account was only by means of transfer entries, which, obviously, cannot lead to addition u/s. 68 of the Act.

9 ***Hasmukhbhai B Patel (HUF) vs. ITO [ITA No. 699/Mum/2023 dt. 28/08/2023 (Mumbai)(Trib.) (AY 2011 – 2012)***

Section 68 – Sale of Shares – All documents available – No name of the assessee in the reports of Investigation Wing - No penny Stock Transation - Exemption cannot be denied

Facts

Case was reopened on account that the assessee has claimed an exemption of long-term capital gains of ₹ 8,18,51,632, on the

sale of shares of Comfort Intech Ltd and Splash Media under section 10(38) of the Act. All evidences relating to the sale of shares were submitted. However, based on the statement given by Mr. Anil Agarwal, the Assessing Officer took the view that the share transactions shown by the assessee are bogus in nature and hence the sale value of the shares needs to be assessed as unexplained income. CIT(Appeals) also dismissed the assessee's appeal. Hence, being aggrieved appeal is filed before ITAT.

Held

ITAT held that Mr. Anil Agarwal though agreed that he was engaged in providing bogus long-term capital gain/short-term capital loss, however neither there was any mention of any benefit being provided to the assessee nor Mr. Anil Agarwal stated that the bogus long-term capital gains was provided to the beneficiaries of the scrips Comfort Intech Ltd and Splash Media. Therefore, even if it is assumed that Mr. Anil Agarwal was involved in rigging the price of certain scrips, no admission has been brought on record that he was involved in rigging the price of the scrips in which the assessee has transacted or the assessee is the beneficiary of such rigging. Further, the assessee specifically requested the AO to provide the details of the brokers who have given a statement that the assessee has taken accommodation entries in the form of bogus long-term capital gains. However, no such statement was furnished by the Revenue. . Therefore, the nexus of any tainted investor/exit provider/entry provider with the assessee was not established by the Revenue. It is pertinent to note that the assessee purchased and sold the shares on the recognised stock exchange. Mere fact that notice under section 133(6) of the Act is returned unserved in respect of 24 out of 93 entities cannot be the sole basis for assuming that the shares of Splash Media sold by the assessee were purchased by the paper companies to provide benefit to the assessee, without any other substantial evidence being available on record. AO has not given any adverse comments or drawn adverse inferences against the documentary evidence submitted by the assessee. AO merely on the basis of suspicion rejected the claim of the assessee, without establishing any link between the assessee with the entry operators/ exit operators, who were allegedly involved in price rigging of shares. Therefore, in view of the above, addition was deleted.

"We want that education by which character is formed, strength of mind is increased, the intellect is expanded, and by which one can stand on one's own feet."

— *Swami Vivekananda*

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CA Naresh Sheth CA Jinesh Shah

INDIRECT TAXES
GST – Recent Judgments and Advance Rulings

A. WRIT PETITIONS

1 *Aastha Enterprises vs. State of Bihar – Patna High Court [(2023) 153 taxmann.com 491 (Patna)]*

Facts and issue involved

Petitioner had procured certain goods from selling dealer against tax invoice on which appropriate GST was levied. The said goods were moved under appropriate e-way bill.

Petitioner made payment of invoice (including tax component) to selling dealer. The selling dealer did not discharge his tax obligation to government on supplies made to the petitioner.

Assessment order dated 25.05.2022 was passed against the petitioner for denial of ITC on account of non-payment of tax by selling dealer. Petitioner could not prefer an appeal against the said order within statutory time limit and hence, it preferred the present writ petition.

Petitioner's submissions

The purchases were made against tax invoice issued by selling dealer. The payments against said invoices (including tax component) were made through bank accounts. The selling dealer has not paid up the tax liability to the State, which stood satisfied by the purchasing dealer and collected by the selling dealer. The underlying object of Input Tax Credit regime brought in, is to avoid the cascading effect of tax and this would be totally frustrated if the department officials attempt recovery of tax from the purchasing dealer, which tax liability has already been satisfied by payment of the tax component, to the selling dealer.

The recovery now sought has the character of a double taxation and it should be the department who proceeds against the selling dealer to recover the collected amount of tax; which if not paid after collection, entails penalties under the tax enactments. Petitioner also relied on two decisions of learned Single Judges of the Madras High Court – ***Sri Vinayaga Agencies vs. The Assistant Commissioner (CT) & Anr. in WP Nos. 2036 to 2038 of 2013 dated 29.01.2013*** and WP (MD) No. 2127 of 2021 and connected cases; ***M/s D.Y. Beathel Enterprises vs. The State Tax Officer (Data Cell) dated 24.02.2021*** which squarely applied to its case.

Respondent's submission

Section 16 of the CGST/BGST Act ties entitlement of Input Tax Credit to certain conditions stipulated therein (especially payment of tax by selling dealer to

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government); non- fulfilment of which would result in denial of such credit.

Respondent relied on decision of ***ALD Automotive Pvt. Ltd. vs. The Commercial Tax Officer & Ors. (Civil Appeal Nos. 10412-10413 of 2018)*** wherein it was held that Input Tax Credit is in the nature of a benefit/ concession and not a right extended to the dealer under the statutory scheme, which benefit can accrue to the assessee only as per the scheme of the statute. Further, respondent relied on decision of ***Godrej & Boyce Mfg. Co. Pvt. Ltd. and Others vs. Commissioner of Sales Tax and Others [1992 (3) SCC 624***] to submit that the rule making authority can provide restrictions in extending the concession.

Discussions by and observations of High Court

In case of M/s D.Y. Beathel Enterprises it was held that when the seller has collected tax from the purchasing dealer, the omission on the part of the seller to remit the tax in question should be viewed very seriously and strict action ought to have been initiated against the seller. The impugned orders were quashed on the grounds that the selling dealer was not examined and on the ground that there was no recovery initiated against the selling dealer.

However, the said decision ignored the provision under sub-clause (c) of Section 16(2) of the GST Act.

Sub-section (1) of Section 16 deals with the eligibility of a registered person to avail of Input Tax Credit on any supply of goods or services which are used or intended to be used in the course or furtherance of his business. The conditions for enabling such benefit, are available in Clauses (a), (b) and (c) which are in seriatim; the existence of a tax invoice or debit note issued by the supplier, proof of receipt of goods or services or both and the tax charged in respect of such supply having been actually paid to the Government, either in cash or through utilization of Input Tax Credit admissible in respect of the said supply. The said conditions are to be satisfied together and not separately or in isolation, and these are the conditions and restrictions which would regulate the availment of Input Tax Credit.

Petitioner has produced not only the invoices but also the account details and the documents evidencing transportation of goods. But this does not absolve the petitioner from the rigor provided under sub-clause (c) of Section 16(2) of the CGST/BGST Act, which requires the tax, collected from the purchasing dealer; having been actually paid to the Government. This in effect is a burden of proof cast on the purchasing dealer who claims Input Tax Credit, which is a right created under statute; sustained only under the specific terms of the statute.

It is true that Input Tax Credit is a concept introduced in the tax regime for the purpose of avoiding the cascading effect of taxes. The benefit of such credit being availed by a purchasing dealer is a benefit or concession conferred under the statute as has been held in ALD. Automobile Private Limited. Necessarily, the conditions for such availment of credit have to be scrupulously followed failing which there can be no benefit conferred on the assessee. The benefit is one conferred by the statute and if the conditions prescribed in the statute are not complied with, no benefit flows to the claimant.

The contention of double taxation does not stand since the claim is denied only when the

supplier who collected tax from the purchaser fails to pay it to the Government.

Further, the mere fact that there is a mode of recovery provided under the statute would not absolve the liability of the taxpayer to satisfy the entire liability to the Government. The purchasing dealer who claims Input Tax Credit could only claim the Input Tax benefit if the supplier who collected the tax from the purchaser has paid it to the Government and not otherwise.

The word 'Input Tax Credit' itself postulates a situation where the purchasing dealer has a credit in the ledger account maintained by it with the Government. The said credit can only arise when the supplier pays the tax collected from the purchaser. The mere production of a tax invoice, establishment of the movement of goods and receipt of the same and the consideration having been paid through bank accounts would not enable the Input Tax Credit; unless the credit is available in the ledger account of the purchasing dealer who is an assessee.

When the supplier fails to comply with the statutory requirement, the purchasing dealer cannot, without credit in his account claim Input Tax Credit and the remedy available to the purchasing dealer is only to proceed for recovery against the seller. Even if such recovery from the supplier is affected by the purchasing dealer; the State would be able to recover the tax amount collected and not paid to the exchequer, from the selling dealer since the rigor of the provisions for recovery on failure to pay up, after collecting tax, enables the Government so to do.

Decision of High Court

The claim of Input Tax Credit raised by the petitioner cannot be sustained when the supplying/selling dealer has not paid up the amounts to the Government; despite collection of tax from the purchasing dealer.

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2 ***Suncraft Energy (P.) Ltd. vs. Assistant Commissioner of State Tax – Calcutta High Court - [2023] 153 taxmann.com 81 (Calcutta)***

Facts and issue involved

Appellant had claimed ITC in respect of certain invoices which were not reflected in its GSTR-2B because the supplier had not uploaded the same in its GSTR-1 and therefore, had not discharged GST liability on the same. GST Authorities issued notice for recovery of the ITC claimed by the appellant, on the basis of the difference of the amount of ITC in Form GSTR-2A and Form GSTR-3B, without conducting any enquiry on the supplier.

Discussions by and observations of High Court

Section 16(2) of the GST Act prescribes the conditions to be fulfilled by a registered person to avail ITC. Appellant claims that it has fulfilled all conditions as stipulated under the said section and therefore it should be able to claim ITC on the same.

Appellant placed reliance on decision of the Hon'ble Supreme Court in case of ***Union of India vs. Bharti Airtel Limited*** wherein it was held that:

- Form GSTR-2A is only a facilitator.
- ITC is to be availed on self-assessment basis as per books of accounts.
- Non-performance or non-operability of Form GSTR-2A or for that matter, other

> forms will be of no avail because the dispensation stipulated at the relevant time obliged the registered persons to submit return on the basis of such self-assessment in Form GSTR-3B manually on electronic platform.

Press release dated 18.10.2018 clarified that furnishing of outward details in Form GSTR-1 by the corresponding supplier(s) and the facility to view the same in Form GSTR-2A by the recipient is in the nature of taxpayer facilitation and does not impact the ability of the taxpayer to avail ITC on self-assessment basis in consonance with the provisions of Section 16 of the Act.

Further, it has been clarified that the apprehension that ITC can be availed only on the basis of reconciliation between Form GSTR-2B and Form GSTR-3B conducted before the due date for filing of the return in Form GSTR-3B for the month of September 2018 is unfounded and the same exercise can be done thereafter also.

Press release dated 04.05.2018 clarified that there shall not be any automatic reversal of input tax credit from buyer on non-payment of tax by the seller. In case of default in payment of tax by the seller, recovery shall be made from the seller however, reversal of credit from buyer shall also be an option available with the revenue authorities to address exceptional situations like missing dealer, closure of business by supplier or supplier not having adequate assets etc.

In light of the above, GST Authorities are not justified in directing the appellant to reverse the ITC.

Decision of High Court

It was held that before directing the appellant to reverse the input tax credit and remit the same to the government, the GST Authorities ought to have taken action against the supplier unless they can prove that the buyer was colluding with the supplier or the supplier has closed down his business and such other contingencies.

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3 *Luminous Power Technologies Private Limited – Madras High Court [W.P. No. 17241 of 2023]*

Facts and issue involved

Petitioner transported consignment of solar panels to buyer in Tirupur under four separate invoices and corresponding e-way bills. Due to heavy rain, goods got damaged in the course of transportation due to which the buyer refused to accept the delivery of goods. Petitioner re-transported back to its factory under the fresh e-way bills. Goods were intercepted by State Tax officer and order for detention was passed on the grounds that petitioner did not issue credit notes for goods returned by buyer to petitioner.

Petitioner's submissions

Since buyer has refused to take delivery of impugned goods, credit notes cannot be issued. Credit notes can be issued only after delivery is taken and goods are thereafter returned. In the instant case, buyer did not accept the delivery of goods itself and therefore, question of credit note does not arise.

Discussions by and observations of High Court

Goods which are being returned need not necessarily accompany credit notes. Credit notes or debit notes are intended only for the adjustment of tax liability.

Goods which were detained were covered under the tax invoice. Hence, the detention of goods was per se illegal particularly in the light of the fact that goods accompanied the e-way bills, which were generated for returning the goods.

Decision of High Court

Writ petition is allowed.

B. RULINGS BY ADVANCE RULING AUTHORITY

1 *Paragon Polymer Products Private Limited – Kerala AAR [KER/03/2023 dated 02.03.2023]*

Facts and Issues involved

Applicant is engaged in business of manufacturing and trading of footwear. In the course of manufacturing footwear, the applicant outsources some activities to its vendors. The applicant is planning to sell few raw materials to such outside vendors. The supply of materials to these vendors will be made as sale by raising a tax invoice. The vendors along with raw materials procured from applicant and other vendors manufacture footwear or parts of footwear as per applicant's requirement. Thereafter, the vendor sells the footwear or parts of footwear back to the applicant under the cover of tax invoice.

The applicant intends to settle these mutual debts through book entries and settle the net dues only through bank transfer. In light of above, applicant sought an advance ruling in respect of whether in case of sale and buyback transactions, input tax credit ('ITC') is admissible in respect of goods purchased from outsourced vendors, when payment is settled through book adjustment, against the debt created on outward supplies to these vendors.

Applicant's submissions

Second proviso to Section 16(2) of the GST Act provides that if the recipient of supply fails to make the payment (value + GST) to the supplier within 180 days from the date of issue of invoice by the supplier, then the recipient shall reverse the amount equal to ITC availed on such supplies along with interest. The above proviso makes availing of input tax credit dependent upon the payment to be made for the inward supply. The proviso does not prescribe or restrict the mode in which the payment has to be made.

The definition of term 'consideration' under Section 2(31) of CGST Act is wide enough to include almost all modes of payment. Payment through adjustment of the books of accounts is a prevalent Commercial practice.

Para 42 of Indian Accounting Standards 32 provides that a financial asset and a financial liability shall be offset, and the net amount should be presented in the balance sheet when an entity (a) currently has a legally enforceable right to set off the recognized amounts; and (b) intends either to settle on a net basis, or to realize the asset and settle the liability simultaneously. The applicant also relied on ruling in case of Senco Gold Ltd. by the West Bengal Authority for Advance Ruling on similar issue.

Discussions by and observations of AAR

The term consideration defined under Section 2(31) of CGST Act includes, in relation to the supply of goods or services, any payment made or to be made, whether in money or otherwise, and also the monetary value of any act or forbearance. Thus, definition of

'consideration' is an inclusive definition which covers in its ambit any form of payment. Therefore, if the payee owes the payer a debt, and accepts a reduction in such a debt liability as a valid form of payment, that should also be regarded as a valid 'consideration' for a supply.

Section 12 of CGST Act provides that the time of supply of goods shall be the earlier of the following dates, namely:-

(a) the date of issue of invoice by the supplier or the last date on which he is required, under section 31, to issue the invoice with respect to the supply; or

(b) the date on which the supplier receives the payment with respect to the supply:

Explanation 2. - For the purposes of clause (b), "the date on which the supplier receives the payment" shall be the date on which the payment is entered in his books of account or the date on which the payment is credited to his bank account, whichever is earlier.

The above explanation identifies entry in the books of accounts of the supplier/recipient as a mode of payment under GST law.

Therefore, on a combined reading of the above referred provisions and the definition of consideration in Section 2 (31) of the CGST Act, 2017 it is evident that the settlement of the mutual debts through book adjustment by the applicant is a valid mode of payment of consideration for the receipt of goods and/or services and it satisfies the requirement of the second proviso to sub-section (2) of Section 16 of the CGST Act, 2017.

Ruling of AAR

The input tax credit is admissible when consideration is paid through book adjustment subject to the other conditions and restrictions prescribed in Sections 16, 17 and 18 of the CGST Act, 2017 and the rules made there under.

2 *MANAPPURAM FINANCE LTD – KERALA AAR [KER/13/2023 dated 03.04.2023]*

Facts and issue involved

The applicant is a Non-Banking Financial Company registered under GST. They own 0.5 acres of land in Valapad village in Thrissur District which is a wetland as per the records. The applicant wanted to change the description of the land from wetland to dryland in the records for the purpose of construction of office complex. The applicant is required to remit prescribed amount of fees to the state government as per the Kerala Conservation of Paddy land and Wetland Act 2018 for change in description of land. Such payment is required for conservation or reclamation of paddy land and wetland in order to promote agriculture growth to ensure food security and to sustain the ecological system. The applicant has sought an advance ruling on whether reverse charge liability under Notification No. 13/2017-CT (Rate) dated 28.06.2017 is attracted on payment made to Kerala government for change of description of land from wetland to ordinary land.

Applicant's submissions

Notification No. 14/2017 CT (Rate) dated 28.06.2017 provides that activities or transactions undertaken by the Central Government or the State Government or any local authority in which they are engaged as a public authority shall be treated neither as a supply of goods nor a supply of service i.e.

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services by way of any activity in relation to a function entrusted to a Panchayat under Article 243 G of the Constitution.

The scope of this notification is that to become a non-supply, the service rendered by Central or State Government or local authority must be in relation to a function entrusted to a Panchayat under Article 243 G of the Constitution. "In relation to" means that services other than directly rendered by the Government for the purpose of any function entrusted to Panchayat under Article 243 G of the Constitution also will qualify within the meaning of service rendered by the Government as per the Notification.

While allowing conversion, the permitting authority should ensure water conservation measures in the said land and free water flow into neighboring fields. The functions performed are related to the functions entrusted to Panchayat under 11th Schedule of Article 243G which are (1) Agriculture including agricultural extension; (2) Land improvement, implementation of land reforms, land consolidation and soil conservation; (3) Minor irrigation, water management and water shed development. Therefore the activity undertaken by the Kerala government in granting permission under Section 27A of the Kerala Conservation of Paddy land and Wetland Act, 2018 is an activity in relation to a function entrusted to Panchayat under Article 243G of the Constitution and Notification No. 14/2017 Central Tax (Rate) dated 28.06.2017 squarely applies to the facts and circumstances of the case and hence there is no supply of service attracting GST liability and consequently reverse charge liability is also not attracted.

As there is no supply as discussed above, the amount paid as fee to the Kerala government is a statutory payment under Section 27A of the Conservation of Paddy land and Wetland Act, 2018 to get certain privilege under statute and is not a consideration for rendering any service.

The above transaction does not qualify as a supply as per Notification No. 14/2017 and hence fee paid to Kerala Government is not a consideration for rendering any service. Therefore, above transaction is not liable to GST, and consequently reverse charge liability does not get attracted.

Discussions by and observations of AAR

Section 27A of the Conservation of Paddy land and Wetland Act, 2018 deals with provisions in respect of permission to be taken for conversion of unnotified land which has been included as paddy land or wetland in the tax register maintained in Village offices for residential, commercial or another use subject to conditions and levy of fees. This is primarily an activity in the interest/or for the benefit of the persons who are applying for such conversion. It cannot be considered as an activity in relation to any of the functions entrusted to Panchayat under Article 243 G of the Constitution.

Therefore, the fees charged by the State Government for permitting the conversion of unnotified wetland for construction of residential, commercial, or other projects can only be considered a consideration/compensation charged for conferring such private benefit at the cost of the public good of conservation of paddy land and wetland.

Even though change of description of unnotified land is an activity undertaken by the State Government as a public authority the same cannot be considered to be an activity in relation to any function entrusted

to a Panchayat under Article 243 G of the Constitution.

Ruling

The activity of permitting conversion of land by Kerala government cannot be treated as 'neither a supply of goods nor a supply of service' in terms of Notification No. 14/2017 Central Tax (Rate) dated 28.06.2017 and hence is liable to GST under reverse charge mechanism by virtue of Notification No. 13/2017 CT (Rate) dated 28-06.2017 i.e. Services provided by government.

3 *UVEE Glass Private Limited – Rajasthan AAR [Advance Ruling No. RAJ/AAR/2023-24/05]*

Facts and issue involved

Applicant is going to start business of manufacturing toughened, reflective, laminated, secured, low glass and so on. Applicant intends to set up plant and machinery for manufacturing glasses. The said plant and machinery will be erected on structural support so as to keep it intact.

One of the questions on which applicant has sought an advance ruling is :

Whether ITC is eligible on GST paid on the inward supplies for structural support of the plant and machinery, which is used for making outward supply of the goods/services?"

Discussions by and observations of AAR

The eligibility and conditions for taking ITC are specified in Section 16 and 17 of the CGST Act. ITC shall be available in respect of goods and services or both received by a taxable person for construction of "Plant and Machinery" on his own account including when such goods and services or both used in the course of furtherance of business.

The expression "Plant and Machinery" has been defined under explanation to Section 17(5) of CGST Act which means apparatus, equipment, and machinery fixed to earth by foundation or structural support that are used for making outward supply of goods or services or both and includes such foundation and structural support but does not include:

(i) land, building or any other civil structure;

(ii) telecommunication towers; and

(iii) pipelines laid outside the factory premises.

Thus, ITC of GST paid on the inward supply of structural support of plant and machinery which is used for making outward supply of goods/services is admissible to the extent of provisions/conditions laid down in Section 16 and 17 of the CGST Act.

Ruling

ITC of GST paid on the inward supply for fixing of plant and machinery to earth by foundation or structural support which is used for making outward supply of goods/services is admissible up to that extent only.

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INDIRECT TAXES

Service Tax – Case Law Update

CA Rajiv Luthia CA Keval Shah

1 *M/s Tripura State Cooperative Bank Ltd vs. Commissioner of Central Excise and Service Tax 2023-TIOL-749- CESTAT- KOL*

Backgrounds and facts of the case

- THE TRIPURA STATE COOPERATIVE BANK LTD, AGARTALA (TSCBL), registered under banking and financial services awarded contract for construction of a multi-storied building for the bank purpose to TRIPURA HOUSING AND CONSTRUCTION BOARD, AGARTALA (THCB) for an amount of rupees 4,56,00,000/-. The appellant submits that THCB further awarded and has subcontracted the construction of the building to Shri Dipak Paul, for a value of ₹ 4,06,16,850/-. That the service tax liability on works contract services provided by Dipak Paul amounted to ₹ 19,13,494.00/-. In view of RCM related notification 30/2012 ST dated 20.06.2012, the service provider, is liable to pay 50% of the service tax i.e. ₹ 9,56,747.00/-, & the balance 50% is to be paid by the service receiver. Dipak Paul has discharged service tax liability along with interest and paid an amount of ₹ 10,21,525/- to the department, towards his service tax liability.
- SCN was issued to TSCBL & they were called upon to pay the balance 50% service tax amounting to ₹ 8,91,969/- u/s 73(1) of the Finance Act. Commissioner (Appeals) has fastened the balance liability on the appellants on the plea that upon completion of the construction of the building M/s THCB had handed over the building to TSCBL, who upon getting possession of the said building released all funds due as per contract to THCB towards construction of building and the fact that the appellants are using the said office building and beneficiary/ultimate recipient of the construction service. Therefore, Appellant are required to pay the balance 50% of service tax as recipient of service in terms of Notification no. 30/2012-ST, dated 20/06/2012.

Decision of the Hon'ble Tribunal

- The simple test of a service receiver and service provider would be borne out of the fact, as to who is paying as

a client and who is getting paid as a provider of service - The obvious answer to this, as borne out of the facts of the case is that DIPAK PAUL gets paid for (hence a service provider) by THCB (hence a service recipient) - Thus it is undoubtedly clear that DIPAK PAUL has rendered services to THCB and not to the appellants herein. Thus, in terms of RCM it was between both THCB & DIPAK PAUL to pay equally the service tax liability.

- For service rendered by DIPAK PAUL, no liability can accrue to the appellants, as there is no direct contract of DIPAK PAUL with appellant.
- It is an admitted position that DIPAK PAUL has been engaged by THCB and they alone can therefore derive the benefit of the tax paid by their service provider. As there exist, no relationship between TSCBL and DIPAK PAUL as a service receiver and a service provider for the impugned works order. No liability accrues upon the noticee to pay Service Tax.
- The finding of the Ld. Commissioner (Appeals) that the appellant released funds to THCB for construction of the office building and subsequently THCB in their turn engaged the contractor for such work though is factually correct but the Ld. Commissioner (Appeals) has failed to appreciate its true purport. The mere fact that the appellant are making use of the said building and have moved their office into the same is not the test for the delivery of the service. The end user status/ultimate recipient of service test cannot therefore be interpreted to fix TSCBL as the service recipient directly from DIPAK PAUL. It is undisputed that DIPAK PAUL has been engaged at the behest of THCB. There is no contract evidencing engagement of Dipak Paul by TSCBL.
- The impugned order is accordingly set aside and the appeal filed by the appellant is allowed with consequential relief, in accordance with law.

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2 *M/s Rajendra Mittal Construction Company Pvt. Ltd. vs. Commissioner of CGST, Alwar (Raj.) 2023-TIOL-743- CESTAT- DEL*

Backgrounds and facts of the case

- The appellants are engaged in providing 'Works Contract Services' and construction other than residential complex. Department had pointed out that they had failed to pay service tax on the services provided in capacity of a sub-contractor of M/s NBCC. The appellants' had not discharged service tax under *bona fide* belief that such services were exempt from service tax vide entry no. 12A of the Mega Exemption Notification No. 25/2012-ST dated 20th June, 2012. On demand, the appellants deposited an amount of ₹ 2,00,290/- with interest of ₹ 35,342/- during the course of investigation.
- The demands raised in the SCN were initially confirmed by the adjudicating authority. However, the appeals against the said orders were allowed by the Ld. Commissioner (Appeals). Pursuant to the orders, the appellants' filed a refund claim of ₹ 12,00,290/- with interest of ₹ 35,342/- along with amount of pre-

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deposit paid u/s 35F of ₹ 18,39,238/-. The Department, however, observed that out of the aforesaid amount of refund the amount of ₹ 12,00,290/- with interest of ₹ 35,342/- was deposited after being pointed out by the Audit. Also the claim is barred by time.

- Accordingly, the refund claim to that extent was initially rejected vide Order-in- Original No. 30/19-20 dated 19.08.2021 and the appeal against the said order has been dismissed vide the impugned Order-in-Appeal under challenge. Being aggrieved the appellant is before the Tribunal.

Appellants' Submissions

- The amount of ₹ 12,00,290/- is an amount which was paid during the investigation when the audit team impressed upon for the discharge of the liability. The said amount was paid as a partial discharge of the liability. It is impressed upon that the amount paid pending investigation has been held to be an amount paid under protest and it is nothing but a revenue deposit. Hence, Section 11B which is about the refund of duty will not be applicable to the aforesaid amount.

- Ld. Counsel has placed reliance upon the decision of this Tribunal in the case of ***Parle Agro Pvt. Ltd. vs. Commissioner reported as 2022 (380) ELT 219 (Tri.)***

Department Submissions

- Ld. D.R. has mentioned that the refund has been rejected was deposited by the appellant in the year 2015 whereas the refund application for the said amount was filed in January, 2021 i.e. after a period of more than 5 years had elapsed. The only section in the Central Excise Act for the refund of amount is section 11B of the act. One year limitation is prescribed under the said provision to reckon from the date of deposit. As per general law of limitation also the period of limitation for seeking refund cannot be more than 3 years from date of the deposit. Ld. D.R. has relied upon the decision of Hon'ble SC in the case of ***Commissioner of Central Excise vs. Evershine Marbles & Exporters Pvt. Ltd. [2009 (240) ELT 239 (Tri.-Delhi), M/s. Veer Overseas Ltd. vs. CCE, Panchkula [2018 (4) TMI 910-CESTAT Chandigarh LB =2018-TIOL-1432-CESTAT-CHD-LB & Miles India Limited.***

Decision of the Hon'ble Tribunal

- The ground of rejecting this amount is that the same cannot be an amount covered u/s 35F of CE Act, 1944. Hence, section 11B shall be applicable for refund of this amount. This section provides a period of limitation and the refund claim is beyond the said period of limitation. The amount of pre-deposit means amounts paid u/s 35F and the refund thereof has been ordered by the adjudicating authorities. However, the amount of ₹ 12,00,290/- with interest is not an amount of pre-deposit.

- But in the light of discussion above, it was the amount of Revenue deposit paid under protest. No doubt, Hon'ble Apex Court in the case of *Mafatlal Industries (supra)* has held that no claim of refund of any duty shall be entertained except in accordance with

the provisions of the statute and every claim of excise duty can be made only under and in accordance with section 11B in the forms provided by the Act. But in present case it is observed that it is not the case of refund of the duty. The Department cannot retain the same and the amount has to be refunded alongwith the interest to the assessee.

- Explanation B in Clause (5) of Section 11B of the Act defines Relevant Date. Sub- clause (ec) thereof clarifies that where the duty becomes refundable as a consequence of judgement decree order or direction of appellate authority Appellate Tribunal or any Court, the date of such judgement decree, order or direction shall be the relevant date. In the present case the refund claim was filed pursuant to the order passed by the Commissioner (Appeals) dated 18.01.2021. The claim was filed on 25.01.2021 i.e. within less than a week of the aforesaid order. It is not the case of Department that said order was ever appealed against by the Department. Therefore the refund is filled well within the time period. Accordingly, it is held that refund of ₹ 12,00,290/- with interest of ₹ 35,342 has wrongly been rejected. Department is held liable to refund the said amount also alongwith the interest. Relying upon the decision of this Tribunal in the case of ***Parle Agro Pvt. Ltd. (supra)*** and ***Dugger Fibers Pvt Ltd. (supra)*** the Department is directed to grant interest on the said amount at the rate of 12% from the date of deposit till the date of payment.

"No knowledge comes from outside; it is all inside. What we say a man "knows", should, in strict psychological language, be what he "discovers" or "unveils"; what a man "learns" is really what he "discovers", by taking the cover off his own soul, which is a mine of infinite knowledge."

— *Swami Vivekananda*

"I will fly I am born with potential I am born with goodness and trust I am born with ideas and dreams I am born with greatness I am born with confidence I am born with wings So, I am not meant for crawling, I have wings, I will fly I will fly and fly."

— *Dr. A.P.J. Abdul Kalam*

CORPORATE LAWS
Case Law Update

CS Makarand Joshi

Companies Act – Case 1

Adjudication order of Registrar of Companies, Bangalore dated 7 February 2023, in the matter of Sushruta Medical Aid and Research Hospital Limited

Facts of the case

- Sushruta Medical Aid and Research Hospital Limited ('the Company'), was registered with Registrar of Companies, Bangalore ['ROC'] on 8 July 1982. The Company had received certain share transfer applications alongwith share certificates in physical form with a request to transfer the shares. The board of directors of the Company approved the transfer of shares which were in physical form in the board meetings held on 28 November 2018, 3 March 2019 and 18 November 2020.
- Pursuant to Rule 9A(3)(a) of the Companies [Prospectus and Allotment of Securities] Rules 2014 ['Prospectus and Allotment Rules'] every holder of securities who intends to transfer securities of an unlisted public company on or after October 2, 2018 shall get such securities dematerialized before the transfer. The Company being an unlisted public company, Rule 9A(3)(a) of Prospectus and Allotment Rules was applicable to it. Accordingly, transfer of shares of the Company should have been done only if the shares were in dematerialized form. Hence it can be seen that the transfer of shares done by the board of directors three times as mentioned above is in violation of rule 9A(3) of Prospectus and Allotment Rules.
- The Company made a *suo-motto* application to ROC for adjudication of the non-compliance.

Company's contentions

- The contention of the Company was that the Company has taken steps to facilitate the dematerialization of shares by taking an International Security Identification Number ('ISIN'). The Company further stated that after the above three instances of transfer of shares, the Company has not approved any further transfer of shares in physical mode.

ROC's contentions

- ROC stated that transfer of shares in physical mode is not in compliance with Rule 9A(3)(a) of Prospectus and Allotment Rules. Further, the Company has defaulted in permitting the transfer of shares in physical form in all three board meetings as mentioned above. In

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the context of penalty, ROC stated that the Company is a public company and not covered under the definition of a small company and therefore, section 446B of the Companies Act, 2013 shall not be applicable in this case.

Penalty

- Since Rule 9A of of Prospectus and Allotment Rules does not prescribe any penalty for non-compliance, the penalty is imposed under section 450 of the Act.

Sr. No.	*Penalty Imposed upon*	*Amt*
1.	Company (for all 3 Board Meetings)	30,000
2.	Whole-time Director (for the first 2 board meetings where he was director)	20,000
3.	Managing Director (only for the last board meeting where he was director)	10,000

Companies Act – Case 2

ROC Bangalore adjudication order dated 22 February 2023, in the matter of Lululemon Services Private Limited

Facts of the case

- Lululemon Services Private Limited ('the Company'), is a subsidiary of Lulu US Holding LLC and was registered with the Registrar of Companies – Karnataka ('ROC') on 22 March, 2021.
- The Company appointed Mr. Gareth Daniel James Pope, as an additional director of the Company on 28 February, 2022.
- Mr. Gareth Daniel James Pope attended his first board meeting as an additional director of the Company on 22 March, 2022. In the said board meeting, Mr. Gareth Daniel James Pope missed to disclose his concern or interest in any company or companies or bodies corporate, firms, or other association of individuals in form MBP-1 which was required under sub-section (1) of section 184 of the Companies Act, 2013. Mr. Gabreth Daneil James Pope, the additional director made the disclosure in MBP-1 as was required under section 184(1) on 13 May 2022 (i.e., the second board meeting attended by him as additional director).
- As per section 184(1) of the Companies Act, 2013 every individual shall at the first board meeting where he participates as a Director shall give a disclosure of his concern or interest in any company or companies or bodies corporate or firms or other association of individuals in the manner as may be prescribed. Rule 9(1) prescribes as follows: *Every director shall disclose his concern or interest in any company or companies or bodies corporate [including shareholding interest], firms or other association of individuals, by giving a notice in writing in Form MBP-1.* Since an individual is required to give disclosure of concern or interest in the first board meeting in which he participates as a director, the disclosure given on 13 May 2022 was a delayed disclosure resulting in non-compliance of section 184(1) of the Act read with Rule 9(1) of the Companies [Meetings of Board and its Powers] Rules, 2014. Hence the Company filed a *suo-moto* application for adjudication of the said non-compliance.

Defaulting Director's contentions

- Mr. Anup Kumar, authorized representative of Mr. Gareth Daniel James Pope submitted that his client

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had attended his first Board meeting on 22 March, 2022 but had missed to make a disclosure of interest [MBP-1]. It was submitted that such non-compliance of section 184(1) read with Rule 9(1) of the Companies [Meetings of Board and its Powers] Rules, 2014 was inadvertent. On identifying the default it was made good and the additional director accordingly made the disclosure of his concern or interest in MBP-1 in the board meeting dated 13th May, 2022. Further, it was submitted that the concerned additional director was not a director in any other Indian company other than the **Lululemon Services Private Limited.**

ROCs Contentions

- The disclosure of concern or interest in any company or companies or bodies corporate, firms, or other association of individuals has to be given at the first board meeting wherein the individual participates as a director. Even if MBP-1 is submitted in next board meeting it is in violation of Section 184(1) read with Rule 9(1) of Prospectus and Allotment Rules. In the context of levying penalty ROC stated that the Company being a subsidiary of foreign entity Lulu US Holding LLC cannot be considered as a small company and hence for levying penalty provision of section 446B of the Act cannot be applied. Hence penalty was levied under section 454(3) of the Companies Act, 2013 for violation of section 184(1) of the Companies Act, 2013.

Penalty

- The ROC levied a penalty on the concerned director amounting to ₹ 1,00,000/- for the delay in disclosing the interest in other entities in form MBP-1.

SEBI Case I

Securities and Exchange Board of India Adjudication order in the matter of Metropolitan Stock Exchange of India Ltd.

Facts of the case

1. Metropolitan Stock Exchange of India Limited (hereinafter referred to as 'MSEI/Noticee 1') is a recognized stock exchange of India. During the period July 20, 2019 - July 02, 2021, the Securities and Exchange Board of India ("SEBI") had received various complaints against MSEI, wherein, irregularities in working of the management of MSEI were alleged. In view of the said complaints received during 2019-2021, *vide* letter dated June 09, 2021 and July 09, 2021, SEBI had advised MSEI to appoint a reputed forensic auditor to conduct the audit of MSEI covering the allegations.

2. SEBI further advised the Governing Board of MSEI to take suitable action on the observations in Forensic Audit Report ("FAR") against the entities/persons found to be involved in the malpractices, if any, and to submit the ATR to SEBI within 15 days from the date of FAR.

3. Accordingly, MSEI appointed Ernst & Young LLP ("EY") as a forensic auditor to conduct a forensic audit. EY submitted its report to the Chairman of MSEI, *vide* email dated November 11, 2021.

4. Subsequently, Chairman, MSEI, *vide* its email dated March 02, 2022 submitted the Action Taken Report ("ATR") to SEBI and also submitted clarification as sought by SEBI.

5. Based on the adverse findings of the forensic auditor comments/ATR,

SEBI observed certain violations of provisions of, *inter-alia*, of the Securities and Exchange Board of India Act, 1992 (hereinafter referred to as "SEBI Act"), SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, (hereinafter referred to as "LODR Regulations"), Securities Contracts (Regulation) (Stock Exchanges and Clearing Corporations) Regulations, 2018 (hereinafter referred to as "SECC Regulations"), Securities Contract (Regulation) Act, 1956 (hereinafter referred to as "SCRA"), Securities Contracts (Regulations) Rules, 1957 (hereinafter referred to as "SCRR")

Charges levied

1. MSEI ('Noticee no. 1') has violated Regulation 33(1) of the SECC Regulations read-with Regulation 4(1)(a) of LODR Regulations pertaining to principles governing disclosures and obligations to be observed by a listed entity/recognized stock exchange) and clauses 25-26 of Indian Accounting Standard-1 ('Ind AS 1') (pertaining to main principles governing accounting policies and stating that information shall be prepared and disclosed in accordance with applicable standards of accounting and financial disclosure.)

Contentions by Noticee no. 1

1. **SEBI lacks jurisdiction to assess violation of accounting standards**
   a. Noticee no. 1 contended that jurisdiction to examine an entity's compliance with accounting standard vests with the National Financial Reporting Authority ('NFRA') and not SEBI. Noticee no. 1 further argued that SEBI cannot proceed against Noticee no. 1 for violation of provisions of the SECC Regulations/LODR Regulations, unless the NFRA has conclusively determined non-compliance with AS-1. It needs to be noted that Noticee contended that he has not violated AS-1 but SEBI had levied a charge for violation of Ind AS-1. In support of this contention, Noticee no. 1 quoted the judgment of the Hon'ble Supreme Court in ***Arun Kumar and Ors. vs. Union of India [(2007), 1 SCC 732]***. In this case it was held that by erroneously assuming the existence of jurisdictional facts, no authority, such as SEBI in the instant matter, can confer upon itself jurisdiction which it otherwise does not possess. Hon'able Supreme Court quoted as follows: "*A "jurisdictional fact" is a fact which must exist before a Court, Tribunal or an Authority assumes jurisdiction over a particular matter. A jurisdictional fact is one on the existence or non-existence of which depends jurisdiction of a court, a tribunal or an authority. It is the fact upon which an administrative agency's power to act depends. If the jurisdictional fact does not exist, the court, authority or officer cannot act. If a Court or authority wrongly assumes the existence of such fact, the order can be questioned by a writ of certiorari. The underlying principle is that by erroneously assuming the existence of such jurisdictional fact, no authority can confer upon itself jurisdiction which it otherwise does not possess." From the above decisions****, it is clear that existence of "jurisdictional fact" is sine qua non for the exercise of power. If***

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the jurisdictional fact exists, the authority can proceed with the case and take an appropriate decision in accordance with law. *Once the authority has jurisdiction in the matter on the existence of "jurisdictional fact" it can decide the "fact in issue" or "adjudicatory fact" A wrong decision on "fact in issue" or on "adjudicatory fact" would not make the decision of the authority without jurisdiction or vulnerable provided essential or fundamental fact as to the existence of jurisdiction is present.*" (Emphasis Supplied)

2. MSEI has not prepared financial statements on going concern basis

- Noticee no. 1 contended that MSEI financial reports had been prepared in compliance with AS-1. Noticee no. 1 further stated that 'Going Concern as per AS-1' is a fundamental assumption and a specific disclosure is required only if this assumption is not followed. Noticee no. 1 was continuously contending that he had not violated AS-1 but SEBI had levied a charge for violation of Ind AS-1.

- MSEI had provided the statutory auditor with the plans and various other steps taken/being taken by them in this regard, forming the basis of such assumption in September 2021. Under such circumstances, an absence of financial projections to support the going concern assumption in the management's representation is not a violation of the AS-1. Considering that MSEI is currently a business operation, it is submitted that it was a valid assumption to make that MSEI is running on a going concern basis.

Submissions by Adjudicating Officer

1. SEBI lacks jurisdiction to assess violation of Accounting Standards

- SEBI stated that Noticee no. 1 has challenged the jurisdiction of SEBI with regard to the examination of compliance with accounting standards, considering the existence of a specialised statutory authority National Financial Reporting Authority ("NFRA") to monitor and enforce the compliance with accounting standards and auditing standards. In response to this SEBI contended that SEBI is not stepping into the shoes of NFRA for determining the non-compliance with accounting standards by the exchange, instead SEBI is placing its reliance upon the report prepared by a reputed forensic accounting expert, in this case EY, and as per the said report the "Auditors" of the Noticee No. 1 have expressed a qualified opinion on the preparation of the books of accounts on going concern basis. Further, if non-compliance or non-adherence with a particular standard of accounting and financial disclosure is going to have an impact on the functioning and operation of the stock exchange or may adversely affect the interest of any stakeholders, in that case, SEBI has every right to look into such issues and violations pertaining to such issues considering the consequential impact on stakeholders and securities market. In this regard, SEBI placed reliance on the

judgment of NFRA dated March 29, 2023, passed under Section 132 of the Companies Act, 2013 and NFRA Rules, 2018 in respect of a complaint made by Brigadier Vivek Chhatre against Mahindra Holidays Resorts India Limited (MHRIL), wherein it was held that:

"3 ……… The SEBI (Listing Obligations and Disclosure Requirements) Regulations 2015, (LODR hereafter), require the listed companies like MHRIL to prepare and disclose information in accordance with applicable standards of accounting and financial disclosure. The relevant accounting standards, known as Indian Accounting Standards or Ind AS, have been notified by the Central Government in 2015. All listed companies including MHRIL are required by law to follow the Ind AS in preparing their accounts….

29 ……. In the present context, it is desirable for the CODM of MHRIL to take note of the international developments and practices and also adopt a proactive stance in its disclosures, taking a cue also from the SEBI LODR that expects the entities to follow the disclosure norms in letter and spirit…."

In view of the above and the placing reliance on the aforesaid order of NFRA the contention raised by Noticee 1 is not valid. The judgment of ***Arun Kumar and Others vs. Union of India and Others [(2007) 1 SCC 732]***, as referred by Noticee 1 is factually distinguished from the present case.

2. MSEI has not prepared financial statements on going concern basis

a. SEBI submitted that the statutory auditor of MSEI had made qualifications in his audit report to MSEI for the financial years 2019-2020 and 2020-2021 referring to the findings in the FAR. The audit report for 2019-2020 and 2020-21 stated that the statutory auditor is unable to comment on the aspects relating to preparation of accounts on going concern basis and not making provisions for impairment of GST Credit and MAT Credit Entitlement along with other adjustments, if any, that will be arising if accounts are not prepared on going concern basis. The statutory auditor had stated below mentioned reasons for making such qualifications:

   a) Preparation of financial statements on going concern basis despite of incurring significant losses in current and preceding periods

   b) Business volumes are not sufficient

   c) No clarity on increasing revenue and making profits

   d) Non-achievement of projected revenues

   e) Consideration of GST Credit (INR 4171 Lakh in FY 2019-20 and INR 4328 lakhs in FY 2020-21) and MAT Credit Entitlement (INR 186 Lakh in FY 2019-20 and FY 2020-21) as recoverable treating the company as a going concern.

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b. SEBI stated that Noticee 1 in its reply had contended that financial statements of MSEI have been prepared in compliance with AS-1 and Noticee 1 had provided the statutory auditor with the plans and various other steps taken/ being taken by them in this regard, forming the basis of such assumption in September 2021. In this regard, SEBI replied that the allegation levelled against Noticee no. 1 is w.r.t. violation of Ind AS 1 which is broader than Ind AS-1. SEBI stated that with respect to going concern, Ind AS 1 prescribes as follows:

   a) *For preparation of financial statements, management shall assess an entity's ability to continue as a going concern.*

   b) *Financial statements shall be prepared on a going concern basis unless management either intends to liquidate the entity or to cease trading or has no realistic alternative but to do so*

   c) *However, in cases, where an entity does not have a history of profitable operations and ready access to financial resources,*

   d) *management may need to consider a wide range of factors relating to current and expected profitability, debt repayment schedules and potential sources of replacement financing before it can satisfy itself that the going concern basis is appropriate.*

   By assessing Notice 1's replies with the requirements of Ind AS 1, SEBI stated that in management representation made by Noticee no. 1, in accordance with the requirements of LODR Regulations as well as Ind AS 1, to the statutory auditor for FY 2019-20 does not contain any financial projections with respect to future funding, revenue, costs etc. Though Noticee 1 *vide* its email dated July 20, 2023 has stated that there is a reduction in losses, as compared to previous years, but it can be seen that Noticee 1 is still incurring losses and in line with the letter dated January 25, 2022 submitted by Noticee 1 to SEBI on Noticee 1's future prospects to close and/or merge with some other exchange. Further SEBI stated that the subsidiary of Noticee 1 has no viable plan and also has no incentive to improve performance. Further trading volumes of Noticee 1 have declined significantly from July 2021 and Noticee 1 does not have the required leadership and managerial talent to turn it around and take it to the next level by significantly improving business and implementing new initiatives. SEBI further stated that, from the letter dated January 25, 2022 written by the Chairman of Noticee 1 to SEBI, on future prospects to close and/or merge with some other exchange, the net worth of Noticee 1 has been continuously eroding and if exchange's net worth falls below ₹ 100 crores it needs to be closed down.

c. In view of the same, and in accordance with the qualifications made by the Auditor of Noticee 1,

in its Audit Report, SEBI concluded that Noticee 1 has not complied with the Clause 25-26 of Ind AS 1 and therefore violated the provisions of Regulation 33(1) of the SECC Regulations read with Regulation 4(1) of the LODR Regulations and Clause 25-26 of Ind AS 1.

Penalty

SEBI levied a penalty on Noticee 1 for violation of Regulation 33(1) of SECC regulations read with Regulation 4(1) of LODR Regulations and Clauses 25-26 of Ind AS 1 under section 15A(b) of SEBI Act read with 23A(a) of SCRA – ₹ 2,00,000/-

In this CTC Summary we are only discussing violations concerning the Indian accounting standards and SEBI LODR regulation by MSEI ('Noticee').

IBC Case 1

In the matter of *Mr. Mayur Suchak - Appellant vs. Catalyst Trusteeship Limited – Respondent-1 Renaissance Indus Infra Private Limited Respondent-2 at National Company Law Appellate Tribunal (NCLAT) dated 23 May, 2023.*

Facts of the Case

- M/s Renaissance Indus Infra Private Limited the Corporate Debtor (hereinafter referred as the CD) and Altico Capital India Limited (hereinafter referred to as Altico) entered and executed term sheet for a loan amount of ₹ 650,00,00,000/- (Rupees Six Hundred and Fifty crores) on 11 June 2018.
- In terms of the above Debt Term Sheet, executed between Altico and CD, Altico had agreed to subscribe to the Non-Convertible Debentures (NCDs) amounting to ₹ 390,00,00,000/- (Rupees Three hundred and Ninty crores) pursuant to which, an amount of ₹ 280,00,00,000/- (Rupees two hundred and eighty crores) had been disbursed.
- On 21 June 2018, the Debenture Trustee Appointment Agreement was executed where Vistra ITCL (India) Limited was appointed as the Debenture Trustee (hereinafter referred as Debenture Trustee).
- Further, a Debenture Trustee Document (DTD) was executed on 26 June 2018 between the CD, Promoters (Mr. Mayur Suckak and Ms. Dipti Suchak) and Debenture Trustee under which 390 unlisted, secured, redeemable non-convertible debentures of ₹ 390,00,00,000/- (Rupees Three hundred and Ninty crores) were issued by the CD.
- An Assignment Agreement dated 4 March 2021 was issued by Altico in favour of - Catalyst Trusteeship Limited - Financial Creditor - Assignee (hereinafter referred to as FC).
- Altico as the debenture holder transferred all the rights under the Debentures along with all underlying security interest and rights created by the CD and the other obligations in connection with the debentures, together with the debentures to the FC.
- Pursuant to the execution of the Assignment Agreement dated 4 March 2021, the NCDs were transferred to the account of the FC.
- On 13 July 2022, the Debenture Trustee issued a demand notice to the CD to make outstanding payments due to the FC. However, CD failed to make payment.

- On failure to make payment, CD committed events of default as per DTD and therefore the FC issued an Acceleration and Enforcement Notice dated 26 July 2022. No response was given by the CD.
- The FC filed a section 7 application under the Insolvency and Bankruptcy Code, 2016 (IBC) against the CD on 29 July 2022. Notice was issued in the Company Petition.
- Along with the reply an I.A. was also filed by the CD on 26 November 2022 challenging the maintainability of the company petition.
- National Company Law Tribunal (NCLT) *vide* order dated 21 March 2023 admitted the application filed u/s 7 of IBC against the CD on the following grounds:
  — *The Inter Creditor Agreement dated 26 June 2018, the finance parties were intended to collectively mean (a) Debenture Trust Deed (b) Debenture Holders' and (c) any agent of the Debenture Trustee as may be appointed by the Debenture Trustee from time to time. Further Clause 5.6 of the Agreement further clearly stated that all or any of the finance parties would be entitled to bring a suit or other legal proceedings or to take or to instruct the Debenture Trust Deed to take any steps for enforcement of the security created in its or their respective favor for the realization of its respective security interests created under the Debenture document. This also showed that it was not necessary that only the Trustees were competent to launch the legal proceedings. Rather any of the financial parties including the Debenture Holders/assignee could initiate the proceedings for the Enforcement of the security interests created by the Debenture Documents*
- The National Company Law Tribunal (NCLT) vide order dated 21 March 2023 admitted the application filed u/s 7 of IBC against the CD.
- Aggrieved by the order, an Appeal had been filed by the Suspended Promoter & Director of the CD.

Question before the NCLAT: Is the Catalyst Trusteeship Limited ie., the Financial Creditor/Assignment Holder entitled to file an application u/s 7 of the IBC or only the Debenture Trustees, i.e. Vistra ITCL India Limited could file such an application.

Arguments of the Appellant

- As per the DTD as well as the Enforcement Notice, proceedings against the CD can be initiated only by the Debenture Trustee.
- The FC in its reply suppressed various vital documents.
- The DTD read with Inter-Creditor Agreement clearly provided that it was only the Debenture Trustee who was legally entitled to take any action or declare default against the CD either by itself or jointly with the Debenture Holder.
- The FC invoked Enforcement Notice dated 26 July 2022 which notice was contrary to the terms of the Inter-Creditor Agreement. The FC/ Assignee has no locus standi to invoke proceedings u/s 7 of IBC without the prior consent of other lenders.
- The appellant also highlighted the clauses of the DTD Inter-Creditor

Agreement which depicted that the assignment holder had no locus standi in initiating proceedings against the CD which NCLT failed to appreciate.

Arguments of the Respondent

- It was submitted that the Appellant had not disputed the debt and default committed by the CD.
- CD failed to issue any reply to the Demand Notice or the Acceleration and Enforcement Notice.
- The appointment of the Debenture Trustee does not detract or in any manner prejudice the rights of the Debenture Holders to take legal action.
- Notice of payment default dated 13 July 2022 had been issued by the Debenture Trustee on the instructions of FC. Hence, the CD cannot raise any grievance regarding the locus standi of the FC.
- The CD had no privity to the Inter-Creditor Agreement. The other creditor i.e., Clearwater Capital Singapore Fund V Private Limited had also filed its own section 7 application against the CD.
- As per the clauses of the Inter-Creditor Agreement, the rights of each Creditor to avail necessary legal proceedings had been preserved.
- Assignment Agreement categorically records that all rights, entitlements, and claims of the original Debenture Holder have been transferred to the Assignment Holder.
- In the appeal filed by the Appellant, they had also made a statement that they propose to give a fresh offer to the assignment holder for settlement, but no steps were taken by the Appellant in that regard.
- Debt and default being admitted; the NCLT has rightly admitted the Section 7 application under IBC.

Held

- NCLAT after looking into the different clauses of the Debenture Trust Document and Inter-Creditor Agreement, made clear that the Financial Creditor was fully entitled to issue Acceleration Notice.
- The argument of the Appellant that action must be taken by the Debenture Trustee loses its significance.
- Also highlighted the fact that other creditor i.e. Clearwater Capital Singapore Fund V Private having already initiated action under Section 7 of IBC, both the creditors are unanimous in taking action against the CD.
- The submission of the Appellant that there was no majority opinion of the Financial Creditor to take action under the Debenture Trust Document against the CD loses its significance. Furthermore, Clause 9.8 begins with the words "*Notwithstanding anything to the contrary contained in this Deed....*". Clause 9.8, thus has an overriding effect which reserves rights in lender to take all action and seek remedy as available.
- **NCLAT held that the locus standi of a debenture holder to file a section 7 application could not be challenged based on the independent right available to debenture trustees to initiate such proceedings.**
- The Appeal was thus dismissed.

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FEMA – Update and Analysis

CA Hardik Mehta CA Tanvi Vora

In this article, we have discussed rules and regulations under Foreign Exchange Management Act, 1999 for Acquisition or Transfer of Employee Stock Options.

ESOP (Employee stock option plan) refers to an employee benefit plan which offers employees an economic and/or ownership interest in the organization Employee stock option plans are issued as share options with the right to convert into equity shares at a later date subject to vesting and other terms, phantom stock pay outs or bonuses, and the employer has the sole discretion in deciding who could avail of these options. However, Employee stock option plans are just options that could be purchased at a specified price before the exercise date.

Under an ESOS, a company grants options (right without any obligation) to acquire a certain number of shares in the company or its holding/subsidiary company generally at a predetermined price (exercise price) within a pre-determined period (exercise period) to its employees. The option to acquire shares can be exercised once the conditions are fulfilled, referred to as 'vesting conditions'. Such vesting conditions may be continued employment for a defined time or performance based or both. Upon vesting, the employee gets an unfettered right to 'exercise' the vested options by payment of the exercise price. On exercise, the shares are allotted/transferred to the employees who may sell them subject to lock-in period, if any, specified under the scheme.

Employee Benefit Scheme or Share Based Employee Benefits means any compensation or incentive given to the directors or employees of any entity which gives such directors or employees ownership interest through ESOP or any similar scheme.

Sweat Equity Shares "Sweat Equity Shares" means such equity shares as are issued by the Company to its Directors or Employees at a discount or for consideration, other than cash, for providing their know-how or making available rights in the nature of intellectual property rights or value additions, by whatever name called.

Acquisition or transfer of ESOPs or sweat equity shares can be inbound i.e. PROI acquiring shares of an Indian Company or outbound i.e. PRII acquiring shares of a foreign entity. These have been dealt with in Rule 8 of Foreign Exchange Management (Non-debt Instruments) Rules, 2019, dated October 17, 2019 and Schedule III of Foreign Exchange Management (Overseas Investment) Rules, 2022 dated August 22, 2022 respectively.

We have provided below an overview and analysis on the provisions and highlighted

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some of the issues and challenges that may be faced:

A. Issue of Employee Stock Options, Sweat Equity Shares and Share Based Employee Benefits to persons resident outside India

An Indian company can issue employee stock option, sweat equity shares and shares based employment benefits to the following persons resident outside India:

i) Employees of Indian company

ii) Directors of Indian company

iii) Employees or directors of holding company

iv) Employees or directors of overseas JV or WOS

v) Employees or directors of its subsidiaries

This is permitted under NDI Rules, 2019 subject to the following conditions:

a. The ESOP is drawn either in terms of regulations issued under the SEBI Act, 1992 or the Companies (Share Capital and Debentures) Rules, 2014 notified by the Central Government under the Companies Act 2013;

b. The "employee's stock option"/"sweat equity shares" are in compliance with the sectoral cap applicable to the said company;

c. Issue of "employee's stock option"/"sweat equity shares" in a company where investment by a person resident outside India is under the approval route requires prior Government approval;

d. Issue of "employee's stock option"/"sweat equity shares" to a citizen of Bangladesh/Pakistan requires prior Government approval.

Issue of "sweat equity shares" to a person resident outside India was permitted with effect from June 11, 2015.

RBI also foresaw the possibility of an individual being a resident in India when ESOPs were issued and have a different residential status vis-à-vis when the ESOP is exercised. RBI has provided that in such a case, the individual shall hold the equity instruments received on exercising the option on a non-repatriation basis.

Reporting Requirements

Reporting in relation to ESOPs is to be undertaken at two separate points in time.

a. At the time of issue of ESOPs:

An Indian company issuing ESOPs to eligible PROIs (listed above) is required to file Form ESOP within 30 days from the date of issue of option. Form ESOP is to be filed on the FIRMS portal of the RBI.

At the time of filing, the Indian company is required to provide the ESOP scheme, Letter of Grant or Offer mentioning the name of the employee, the no. of shares and the exercise price and the valuation report.

b. At the time of exercise of ESOP:

The Indian company needs to file Form FC-GPR as and when the ESOPs are exercised. If the ESOPs are linked to ADR/GDR, Form DRR may be filed upon exercise of such ESOPs. Details of the Form ESOP filed is required to be provided at the time of filing Form FCGPR.

The number of ESOPs at time of issue and number of equity instruments at the time of exercise may not necessarily match since the option to exercise is at the discretion of the eligible employee or director or in case of vesting conditions, the options could also have lapsed.

B. Acquisition of shares or interest under Employee Stock Ownership Plan or Employee Benefits Scheme or sweat equity shares

A resident individual has been permitted to acquire (without limit) shares of an overseas entity under ESOP or EBS or Sweat Equity Shares, provided he is an employee or a director of:

i) an office in India or branch of an overseas entity or

ii) a subsidiary in India of an overseas entity or

iii) of an Indian entity in which the overseas entity has direct or indirect equity holding

The issue of ESOP or EBS should be offered by the issuing overseas entity globally on a uniform basis.

The conditions clearly indicate that the person receiving the sweat equity shares should be an employee or director of one the entities listed above. Therefore, it should be remembered that shares issued to a non – employee or a non – director, often as advisory shares is not permitted under FEMA.

As explained above, the Rules relating to ESOPs is covered under the new OI framework, specifically under Schedule III of FEM (OI) Rules, 2022. It provides that shares or interest acquired by the resident individuals by way of sweat equity shares or under Employee Stock Ownership Plan (ESOP)/Employee Benefits Scheme up to 10% of the paid-up capital/stock, whether listed or unlisted, of the foreign entity and without control shall qualify as Overseas Portfolio Investment and not ODI. However, in case the investment is more than 10%, it would qualify as ODI and reporting under Form ODI would apply accordingly.

AD banks have been permitted to allow remittances towards acquisition of the shares/interest in an overseas entity under the scheme offered directly by the issuing entity or indirectly through a Special Purpose Vehicle (SPV)/SDS. Though there is no limit on the amount of remittance made towards acquisition of shares/interest under ESOP/ Employee Benefits Scheme or acquisition of sweat equity shares, such remittances shall be counted towards the LRS limit of the person concerned.

RBI has also permitted foreign entities to repurchase the shares issued to residents in India under any ESOP Scheme provided (i) the shares were issued in accordance with the rules/regulations framed under FEMA, 1999, (ii) the shares are being repurchased in terms of the initial offer document, and (iii) necessary reporting is done through the AD bank.

Reporting requirements

The responsibility of reporting of ESOPs alongwith relevant documentation is not applicable to the resident individuals but is instead passed on to the office or entity in India.

a. The reporting shall be done by the office in India or branch of an overseas entity or a subsidiary in India of an overseas entity has direct or Indirect equity

holding where the resident individual is an employee or director.

b. While making any OPI or transferring such OPI shall report such investment or transfer of investment within 60 days from the end of the half-year in which such investment or transfer is made as of September or March end.

In case of delay in reporting, Late Payment Fee would be payable. RBI has provided a matrix for calculation of LSF as follows:

Sr. No.	***Type of Reporting delays***	***LSF Amount (INR)***
1	Form 001 Part-II/ APR, FCGPR (B), FLA Returns, Form OPI, evidence of investment or any other return which does not capture flows or any other periodical reporting	7500
2	FC-GPR, FCTRS, Form ESOP, Form LLP(I), Form LLP(ll), Form CN, Form DI, Form InVi, Form ODl-Part I, Form 001-Part 111, Form FC, Form ECB, Form ECB-2, Revised Form ECB or any other return which captures flows or returns which capture reporting of non-fund transact ions or any other transactional reporting	[7500 + (0.025% x A x n)]

"n" is the number of years of delay in submission rounded-upwards to the nearest month and expressed up to 2 decimal points.

"A" is the amount involved in the delayed reporting.

Maximum LSF amount will be limited to 100 per cent of 'A' and will be rounded upwards to the nearest hundred.

The facility for opting for LSF is available up to three years from the due date of reporting/ submission.

"To turn the mind inside, stop it from going outside, and then to concentrate all its powers, and throw them upon the mind itself, in order that it may know its own nature, so that it will analyse itself, as it were, is indeed very hard work. Yet that is the only way to anything like a scientific approach towards the subject. Now,"

— *Swami Vivekananda*

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Best of The Rest

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REVANASIDDAPPA & ANR. VS MALLIKARJUN & ORS. - ORDER DT. 01/09/2023 PASSED IN CIVIL APPEAL NO 2844 OF 2011 [SUPREME COURT]

The Hindu Succession Act 1956 ("HSA 1956") – The Hindu Marriage Act 1955 ("HMA 1955") – the provisions of the HSA 1956 have to be harmonized with the mandate in section 16(3) of the HMA 1955 which indicates that a child who is conferred with legitimacy under sub-sections (1) and (2) will not be entitled to rights in or to the property of any person other than the parents - The property of the parent, where the parent had an interest in the property of a joint hindu family governed under the mitakshara law has to be ascertained in terms of the explanation to sub-section (3) of section 6 of HSA.

Facts

The Apex Court was concerned with the correctness of the decisions in ***Jinia Keotin vs. Kumar Sitaram Manjhi [(2003) 1 SCC 730]***, subsequently followed in ***Neelamma vs. Sarojamma [(2006) 9 SCC 612],*** and ***Bharatha Matha vs. R Vijaya Renganathan [(2010) 11 SCC 483]*** as it was doubted by a two judge Bench in ***Revanasiddappa vs. Mallikarjun [(2011) 11 SCC 1]***.

In Jinia Keotin case, a two judge Bench held that merely because the children born out of a void and illegal marriage have been specifically safeguarded under Section 16, they ought not to be treated on par with children born from a lawful marriage for the purpose of inheritance of the ancestral property of the parents. The Apex Court held that in view of the express mandate of the legislature in Section 16(3), a child born from a void marriage or a voidable marriage in respect of which a decree of nullity has been passed would have no right to inheritance in respect of ancestral or coparcenary property. The decision in Jinia Keotin was followed by two judge benches in ***Neelamma vs. Sarojamma (supra)*** and later in ***Bharatha Matha vs. R Vijaya Renganathan (supra)***. After adverting to the two earlier decisions, the Apex Court had held that "a child born of void or voidable marriage is not entitled to claim inheritance in ancestral coparcenary property but is entitled only to claim a share in self-acquired properties." The correctness of these orders were referred to the larger bench in the present case.

Issue Involved

1. Whether the legislative intent is to confer legitimacy on a child covered by Section 16 in a manner that makes them coparceners, and thus entitled to initiate or get a share in the partition - actual or notional?

2. At what point does a specific property transition into becoming the property of the parent. For, it is solely within such

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property that children endowed with legislative legitimacy hold entitlement, in accordance with Section 16(3)?

Held

The Court concluded in the following terms:

"(i) *In terms of sub-section (1) of Section 16, a child of a marriage which is null and void under Section 11 is statutorily conferred with legitimacy irrespective of whether (i) such a child is born before or after the commencement of Amending Act 1976; (ii) a decree of nullity is granted in respect of that marriage under the Act and the marriage is held to be void otherwise than on a petition under the enactment;*

(ii) *In terms of sub-section (2) of Section 16 where a voidable marriage has been annulled by a decree of nullity under Section 12, a child 'begotten or conceived' before the decree has been made, is deemed to be their legitimate child notwithstanding the decree, if the child would have been legitimate to the parties to the marriage if a decree of dissolution had been passed instead of a decree of nullity;*

(iii) *While conferring legitimacy in terms of sub-section (1) on a child born from a void marriage and under sub-section (2) to a child born from a voidable marriage which has been annulled, the legislature has stipulated in sub- section (3) of Section 16 that such a child will have rights to or in the property of the parents and not in the property of any other person;*

(iv) *While construing the provisions of Section 3(1)(j) of the HSA 1956 including the proviso, the legitimacy which is conferred by Section 16 of the HMA 1955 on a child born from a void or, as the case may be, voidable marriage has to be read into the provisions of the HSA 1956. In other words, a child who is legitimate under sub-section (1) or sub-section (2) of Section 16 of the HMA would, for the purposes of Section 3(1)(j) of the HSA 1956, fall within the ambit of the explanation 'related by legitimate kinship' and cannot be regarded as an 'illegitimate child' for the purposes of the proviso;*

(v) *Section 6 of the HSA 1956 continues to recognize the institution of a joint Hindu family governed by the Mitakshara law and the concepts of a coparcener, the acquisition of an interest as a coparcener by birth and rights in coparcenary property. By the substitution of Section 6, equal rights have been granted to daughters, in the same manner as sons as indicated by sub-section (1) of Section 6;*

(vi) *Section 6 of the HSA 1956 provides for the devolution of interest in coparcenary property. Prior to the substitution of Section 6 with effect from 9 September 2005 by the Amending Act of 2005, Section 6 stipulated the devolution of interest in a Mitakshara coparcenary property of a male Hindu by survivorship on the surviving members of the coparcenary. The exception to devolution by survivorship was where the deceased had left surviving a female relative specified in Class I of the Schedule or a male relative in Class I claiming through a female relative, in which event the interest of the deceased in a Mitakshara coparcenary property would devolve by testamentary or intestate succession and not by survivorship. In terms of sub-section (3) of Section 6 as amended, on a Hindu dying after the commencement of the Amending Act of 2005 his interest in the property of a Joint Hindu family governed by the Mitakshara law will devolve by testamentary or intestate*

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succession, as the case may be, under the enactment and not by survivorship. As a consequence of the substitution of Section 6, the rule of devolution by testamentary or intestate succession of the interest of a deceased Hindu in the property of a Joint Hindu family governed by Mitakshara law has been made the norm;

(vii) *Section 8 of the HSA 1956 provides general rules of succession for the devolution of the property of a male Hindu dying intestate. Section 10 provides for the distribution of the property among heirs of Class I of the Schedule. Section 15 stipulates the general rules of succession in the case of female Hindus dying intestate. Section 16 provides for the order of succession and the distribution among heirs of a female Hindu;*

(viii) *While providing for the devolution of the interest of a Hindu in the property of a Joint Hindu family governed by Mitakshara law, dying after the commencement of the Amending Act of 2005 by testamentary or intestate succession, Section 6(3) lays down a legal fiction namely that 'the coparcenary property shall be deemed to have been divided as if a partition had taken place'. According to the Explanation, the interest of a Hindu Mitakshara coparcener is deemed to be the share in the property that would have been allotted to him if a partition of the property has taken place immediately before his death irrespective of whether or not he is entitled to claim partition;*

(ix) *For the purpose of ascertaining the interest of a deceased Hindu Mitakshara coparcener, the law mandates the assumption of a state of affairs immediately prior to the death of the coparcener namely, a partition of the coparcenary property between the deceased and other members of the coparcenary. Once the share of the deceased in property that would have been allotted to him if a partition had taken place immediately before his death is ascertained, his heirs including the children who have been conferred with legitimacy under Section 16 of the HMA 1955, will be entitled to their share in the property which would have been allotted to the deceased upon the notional partition, if it had taken place; and*

(x) *The provisions of the HSA 1956 have to be harmonized with the mandate in Section 16(3) of the HMA 1955 which indicates that a child who is conferred with legitimacy under sub-sections (1) and (2) will not be entitled to rights in or to the property of any person other than the parents. The property of the parent, where the parent had an interest in the property of a Joint Hindu family governed under the Mitakshara law has to be ascertained in terms of the Explanation to sub-section (3), as interpreted above.*

55. *Before concluding, it would be necessary to clarify that the reference to the three Judge Bench in this batch of cases is confined to Joint Hindu families governed by Mitakshara law. This Court has, therefore, dwelt on the interpretation of the provisions of the HSA 1956 in relation to Joint Hindu families of that class."*

DHANRAJ N. ASAWANI vs. AMARJEETSINGH MOHINDERSINGH BASI & ORS. – ORDER DT 25/07/2023 PASSED IN CR. APPEAL NO. 2093 OF 2023 WITH SLP (CRIMINAL) NO. 2246 OF 2022 [SUPREME COURT]

Section 4 of the Code of Criminal Procedure vis a vis Section 81(5B) of The Maharashtra

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Co-operative Societies Act, 1960 ("1960 Act") -) Section 81(5B) does not contain any express or implied bar against any person from setting the criminal law in motion - once the criminal law is set into motion, it is the duty of the police to investigate into the alleged offence. This process cannot be interdicted by relying upon the provisions of sub-section (5B) of Section 80 of the 1960 Act which cast a duty on the auditor to lodge a first information report.

Facts

The 1st Respondent was the CEO of Seva Vikas Co-operative Bank, and the 2nd Respondent was the former Chairperson of the bank. Complaints were lodged by various individuals, members, shareholders, and depositors of the bank alleging acts of cheating and misappropriation of funds by the bank's management. The Economic Offences Wing (EOW) registered FIRs based on these complaints and conducted investigations.

During the investigation, the EOW conducted a test audit and issued communications seeking information about the bank's affairs. An inspection report was prepared by the Joint Registrar (Audit) based on the audit of the bank's accounts (as was sought by the EOW through the Commissioner for Co-operation and Registrar of Co-operative Societies Maharashtra). The forensic report prepared by the Joint Registrar (Audit) allegedly indicated financial irregularities by the bank's office bearers. Based on this inspection report, the appellant (who is a shareholder of the co-operative society and erstwhile director) lodged FIR against the Respondents, alleging various offenses punishable under the Indian Penal Code at Police Station Pimpri, Chinchwad.

The 1st and 2nd Respondents moved the Bombay High Court ("HC") seeking the quashing of the FIR. The High Court allowed the petition by its impugned judgment dated 16/11/2021. The HC held that Section 81(5B) of the 1960 Act contains special provisions for the submission of a special report and the obtaining of the permission of the Registrar before the lodging of an FIR. It held that these provisions would be rendered otiose if the general provisions in the Code of Criminal Procedure 19734 ("CrPC") were to apply and hence, the latter must yield to the special procedure which has been prescribed under the 1960 Act. The HC held that where the allegations in regard to the commission of offences are solely based on an audit which has been conducted u/s 81 of the 1960 Act, the peremptory procedure prescribed in Section 81(5B) must be scrupulously followed. The HC concluded that the FIR was based on the report of the auditor who was appointed u/s 81(3)(c) and hence, it was not open to the appellant to fall back on the general principle that the criminal law can be set in motion by any individual upon which the police are duty bound to register an FIR absent a statutory prohibition. Hence, the present SLP/ Cr. Appeal.

Issues Involved

Whether the HC erred in quashing of the FIR [lodged by the Appellant on the basis of a Report of the auditor who was appointed u/s 81(3)(c)] on the ground that it was not open to the appellant to fall back on the general principle that the criminal law can be set in motion by any individual upon which the police are duty bound to register an FIR absent a statutory prohibition?

Held

The Supreme Court allowed the appeal and set aside the HC's judgment. The Court's findings and observations include:

1. The special provisions of Section 81(5B) of the 1960 Act, which required auditors and Registrars to report financial irregularities and file FIRs, did not by express or implied implication bar any person other than auditors

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and Registrars from reporting such irregularities to the police.

2. The Court emphasized that the initiation of criminal proceedings is not solely limited to auditors or Registrars but can be set into motion by any individual who comes across information about an offense.

3. The Court distinguished the case from precedents where specific provisions of special laws excluded the application of general procedures under the CrPC.

4. The Court held that there was no statutory bar against the appellant lodging the FIR based on the audit report.

5. The Court clarified that the proceedings challenging the order of the Minister regarding the audit report will have no bearing on whether the investigation by the police on the FIR which has been filed by the appellant should be allowed to proceed.

Overall, the Supreme Court's decision underscores that the special provisions of the 1960 Act did not preclude any person, including the appellant, from setting the criminal law in motion by reporting financial

M/S LARSEN AIR CONDITIONING AND REFRIGRATION COMPANY vs. UNION OF INDIA & ORS. – ORDER DT 11/08/2023 PASSED IN CIVIL APPEAL NO(S). 3798 OF 2023 [SUPREME COURT]

Arbitration And Conciliation Act 1996 – section 31(7)(b) - the statutory rate of interest itself is contemplated at 18% per annum, which is applicable unless provided otherwise in the Award - Therefore, there was little to no reason, for the High Court to have interfered with the arbitrator's finding on interest accrued and payable.

Arbitration And Conciliation Act 1996 - In appeal, Section 37 of the Act grants narrower scope to the appellate court to review the findings in an award, if it has been upheld, or substantially upheld under Section 34

Facts

Aggrieved by the impugned judgment of the Allahabad High Court (**"HC"**), the appellant has approached this court with a simple question of law, as to whether the High Court erred in modifying the arbitral award to the extent of reducing the interest, from compound interest of 18% to 9% simple interest per annum.

Partly allowing the appeal, the HC had disapproved the reasoning in the award on Claim No. 6; it held that the sum of ₹ 3 lakhs awarded towards compensation for loss caused due to non-issue of tender document and paralysing business could not have been granted. The HC held that it could not be said that the proceedings (in the present case) were under the Arbitration Act, 1940, and therefore, the rate of interest granted should not be 18%. The HC referred to this court's judgments in ***K. Marappan vs. Superintending Engineer TBPHLC Circle Anantapur [(2019) 5 SCR 152], M/s Raveechee & Co. vs. Union of India [(2018) 5 SCR 138] and Ambica Construction vs. Union of India [(2017) 14 SCC 323]*** while deciding this question of pendente lite interest; it was held that the bar to award interest on the amounts payable under the contract would not be sufficient to deny the payment of interest pendente lite.

The HC proceeded to reduce the rate of interest from 18% (as ordered by the arbitrator), to 9% per annum. The remaining amount was directed to be deposited by the appellants as expeditiously as possible, with the interest accrued, not later than 12 weeks from the date of the judgment.

On other grounds, it was held that there was no scope for interference in the arbitral award. Contentions of parties. The ground pressed by the appellant in the present proceedings related to the modification of the rate of interest (relating to award in Claim No. 9), and the scope of the appeal was limited to this question.

Issue Involved

Whether the HC erred in modifying the arbitral award to the extent of reducing the interest, from compound interest of 18% to 9% simple interest per annum?

Held

The Court held that the impugned judgment warranted interference and accordingly, set aside the same to the extent the rate of interest for past, pendente lite and future interest was modified. Accordingly, the 18% per annum rate of interest, as awarded by the arbitrator on 21.01.1999 (in Claim No. 9) was reinstated. The Court came to this conclusion in view of the following findings/ observations:

1. Section 31(7)(b) of the 1996 Act, was amended by Act 3 of 2016, w.e.f. 23.10.2015. The pre-amended provision, empowers the arbitrator to award both pre-award and post-award interest, and specifies that the awarded sum would carry an interest of 18% per annum, unless provided otherwise, from the date of award till the date of payment.

2. The court placed reliance on the judgment in the case of ***Shahi & Associates vs. State of UP & Ors. [(2019) 11 SCR 640],*** wherein this court, in light of Section 31(7), upheld 18% per annum as rate of interest, as justifiable.

3. In the present case, as the arbitration commenced in 1997, i.e., after the Act of 1996 came into force on 22.08.1996, the arbitrator, and the award passed by them, would be subject to this Act of 1996. Under the enactment, i.e. Section 31(7), the statutory rate of interest itself is contemplated at 18% per annum, which is applicable unless provided otherwise in the Award. Therefore, there is little to no reason, for the HC to have interfered with the arbitrator's finding on interest accrued and payable. Reference was made to cases of this Court wherein the scope of interference by the court has been well defined and delineated such as- ***Associate Builders vs. Delhi Development Authority [(2014) 13 SCR 895], Ssangyong Engineering Construction Co. Ltd vs. National Highways Authority of India (NHAI) [(2019) 7 SCR 522]*** and ***Delhi Airport Metro Express Pvt. Ltd. vs. Delhi Metro Rail Corporation Ltd. [(2021) 5 SCR 984].***

4. The Court observed that there is limited and extremely circumscribed jurisdiction of the court u/s 34 of the Act, permitting the court to interfere with an award, sans the grounds of patent illegality, i.e., that "illegality must go to the root of the matter and cannot be of a trivial nature"; and that the tribunal "must decide in accordance with the terms of the contract, but if an arbitrator construes a term of the contract in a reasonable manner, it will not mean that the award can be set aside on this ground" [ref: ***Associate Builders (supra)***]. The other ground would be denial of natural justice.]

5. In appeal, Section 37 of the Act grants narrower scope to the appellate court to review the findings in an award, if it has been upheld, or substantially upheld under Section 34 ***[Project Director, National Highways No. 45E and 220 National Highways Authority of India vs. M. Hakeem [(2021) 5 SCR 368]***

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MAHANT PRASAD RAM TRIPATHI VS. STATE OF UTTAR PRADESH THROUGH THE CENTRAL BUREAU OF INVESTIGATION (CBI) – ORDER DT 23/08/2023 PASSED IN CRIMINAL REVISION NO. 935 of 2023 [ALLAHABAD HIGH COURT, LUCKNOW BENCH]

Indian Evidence Act, 1872 – relevancy and admissibility of evidence - telephone conversation between two accused persons cannot be excluded from evidence on the ground that it had been obtained illegally.

Code of Criminal Procedure, 1973 – Section 227 – Discharge Application - the Court has to form a definite opinion, upon consideration of the record of the case and the documents submitted therewith, that there is not sufficient ground for proceeding against the accused.

Facts

(i) One Haider Ali @ Mantu had filed a complaint against one Shashi Mohan, Member, Fatehgarh Cantonment Board, on the basis whereof Case No. RC0062015A0009 u/s 7 of Prevention of Corruption Act, 1988 was registered by the Central Bureau of Investigation on 09.05.2015. The complainant had alleged that Shashi Mohan had demanded Rs. 1,56,000/- as bribe on behalf of the applicant Mahant Prasad Tripathi, who was the C.E.O. of Cantonment Board Fatehgarh, for payment of certain bills, at the rate of 6% of the bill amount.

(ii) The C.B.I. has recorded a telephonic communication between two accused persons on a digital voice recorder, wherein the co-accused told the applicant on phone that 'Haider had come and he has paid the amount of 6%', which was acknowledged by the applicant by merely saying 'yes' and when the co-accused Shashi Mohan tried to carry the conversation forward, the applicant forbade him to talk on the issue and asked him to talk in the office.

(iii) The applicant had sought his discharge under Section 227 of Cr.P.C. on the ground that the telephonic conversation recorded on the digital voice recorder was not admissible in evidence, but the learned trial court has rejected the application.

(iv) Accordingly, revision under Section 397/401 Cr.P.C. was filed by the revisionist challenging the validity of the said order dated 25.05.2023, passed by the learned Special Judge, C.B.I. Court No.4, Lucknow, rejecting the application for discharge.

Issue Involved

Whether the Special Judge, CBI erred by rejecting the application for discharge under Section 227 of Cr.P.C. on the ground that the telephonic conversation recorded on the digital voice recorder was admissible in evidence?

Held

The court rejected the Revision Application and confirmed the order of the Special Judge, CBI in view of the following observations and findings:

(i) The case of ***People's Union for Civil Liberties (PUCL) vs. Union of India and another: (1997) 1 SCC 301*** as relied upon by the Revisionist was held to be not applicable to the facts of the present case as the question of admissibility of an intercepted telephonic conversation in evidence not raised before the Hon'ble Supreme Court and this question was not decided in PUCL case. Therefore, PUCL case (Supra) was not an authority for adjudging the admissibility of a telephonic conversation allegedly

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intercepted without following the due process of law.

(ii) As from the aforesaid facts, it appears that the communication between the two accused persons reached its destination and it was not stopped while it was in the process of reaching the other person, before reaching the other person. Therefore, from the plane meaning of the word 'intercept' it appears that the communication was not 'intercepted'. Thus, the provisions of law regarding interception of telephonic communication (i.e. Indian Telegraph Act and the Rules made thereunder) would not apply to the facts of the present case.

(iii) Reliance was placed on the decisions of the Hon'ble Apex Court i.e. ***State vs. N.M.T. Joy Immaculate, (2004) 5 SCC 729*** and in the case of ***State (NCT of Delhi) vs. Navjot Sandhu, (2005) 11 SCC 600*** wherein the principle laid down by the Privy council and the decision of the Constitution Bench in case of ***Pooran Mal vs. Director of Inspection (Investigation), (1974) 1 SCC 345*** were considered that "The test to be applied, both in civil and in criminal cases, in considering whether evidence is admissible is whether it is relevant to the matters in issue. If it is, it is admissible and the court is not concerned with how it was obtained."

(iv) The judgment of Delhi High Court in the case of Sanjay Pandey versus Directorate of Enforcement, 2022 SCC OnLine Del 4299 and the judgment of Andhra Pradesh High Court in ***Rayala M. Bhuvaneswari vs. Nagaphanender Rayala, AIR 2008 AP 98*** as relied upon by the Revisionist were not binding precedents as they did not take into consideration the above referred law laid down by the Hon'ble Supreme Court and, therefore, those are per incuriam judgments.

(v) Therefore, whether the telephonic conversation between the two accused persons was intercepted or not and whether it was done legally or not, would not affect the admissibility of the recorded conversation in evidence against the applicant.

(vi) Moreover, the telephonic conversation recorded in the digital voice recorder was not the solitary evidence relied upon by the prosecution and it appears that the prosecution proposes to produces other evidences as well during trial.

(vii) Reference was made to the decision of the Gayatri Prasad Prajapati vs. Directorate of Enforcement 2023 SCC OnLine All 376, wherein it was held that while deciding discharge Application u/s 227 of CrPC the Court has to form a definite opinion, upon consideration of the record of the case and the documents submitted therewith, that there is not sufficient ground for proceeding against the accused. As in the present case, no such material or ground was present from which the Court could form a definite opinion that there was no sufficient ground for proceeding against the applicant.

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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 **1st August, 2023 to 31st August, 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 4th August, 2023 are as under:

Type of Membership	No. of Members
Life Member	10
Ordinary Member	20
Student Member	09
Associate Member	02
Total	**41**

II. PAST PROGRAMMES

Sr. No.	*Date*	*Topics*	*Speakers*
		ACCOUNTING & AUDITING	
1.	12.08.2023	Preparation of Financial Statements and applicability of Accounting Standards on Non-Corporate Entities	Mrs. Padmashree Crasto
2.	17.08.2023	Schedule III & CARO 2020	CA Zubin Bilimoria

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Sr. No.	*Date*	*Topics*	*Speakers*
		BENGALURU STUDY GROUP	
1.	04.08.2023	Recent Supreme Court rulings	K. K. Chythanya, Senior Advocate
		COMMERCIAL & ALLIED LAWS	
1.	05.08.2023	Lecture Meeting on Overview of Annual Compliances for Companies under The Companies Act, 2013	CS Gaurav Pingle
2.	21.08.2023	Recent Supreme Court Judgements in IBC	CA Avil Menezes
		DELHI CHAPTER	
1.	09.08.2023	Recent Development in Pillar-II – STTR, Practical Issues & Implication on India	*Chairman & Keynote Speaker:* Mr. Akhilesh Ranjan – Ex-Member CBDT *Speaker*: CA Jitendra Jain
		DIRECT TAXES	
1.	10.08.2023	Recent Important Decisions under Direct Tax	Devendra Jain, *Advocate*
2.	18.08.2023	Issues in Tax Audit and ITR & Audit of Charities - Relevant amendments made by previous 3 Finance Acts	CA N. C. Hegde
		INDIRECT TAXES	
1.	09.08.2023	Analysis of Judgement on Time limit for claiming ITC under Section 16(4) of CGST Act, 2017 and Issues arising out of Section 16(4) of CGST Act, 2017	K. Vaitheeswaran, *Advocate*
2.	24.08.2023	Issues in Media & Entertainment Industry	*Group Leader*: CA Parth Shah *Chairman:* CA Rajat Talati
		INTERNATIONAL TAXATION	
1.	10.08.2023	FEMA from The Auditor’s Perspective	CA Hardik Mehta
2.	11.08.2023	Tax Challenges in Metaverse - Part 1	CA Sachin Sastakar

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Sr. No.	*Date*	*Topics*	*Speakers*
3.	28.08.2023	Tax Challenges in Metaverse - Part 2	CA Sachin Sastakar
4.	The International Taxation Committee had planned a webinar series on "Online Transfer Pricing Master Class 2023". The session-wise detail of the program is as under:		
a	19.08.2023	Key Note on Transfer Pricing & Recent Developments	CA Vispi T. Patel
b.		Form No. 3CEB and Guidance on Local File Documentation with sharing of practical experience	CA Akshay Kenkre
c.	24.08.2023	Benchmarking – Indian & foreign databases along with Economic Adjustments	CA Vijay Ramachandran
d.	25.08.2023	Master File Documentation and CbCR – Practical – Issues	CA Eric Mehta
e.	26.08.2023	Applicability of TP (Deemed International Transactions, Domestic Transactions and Business Restructuring)	CA Bhavesh Dedhia CA Anjul Mota
f.	31.08.2023	Procedural and practical aspects in TP	Harsh Shah, *Advocate*
g.		Recent Important TP Judicial Rulings: Domestic and Global	CA Rajan Vora CA Nikhil Tiwari
h.	01.09.2023	Transfer Pricing for Start-ups	CA Munjal Almoula
i.	02.09.2023	Impact of Pillar 2 on TP with global development	CA Radhakishan Rawal
j.		APAs and MAPs	Mr. Sobhan Kar, Former IRS Commissioner (APA Director)
k.	09.09.2023	Panel Discussion on Key transfer pricing controversies	*Moderator*: CA Vispi T. Patel *Panelist*: Shri Amit Shukla (Hon'ble ITAT Judicial member), CA Vijay Iyer CA Geeta Karnik CA Karishma Phatarphekar

Sr. No.	*Date*	*Topics*	*Speakers*
IT CONNECT			
1.	29.08.2023	Generative AI in Legal drafting	Mr. Suhas Baliga - Principal at Innove Law
MEMBERSHIP & PR			
1.	22.08.2023	Invisible Leadership	Dr. Shubha Vilas Das
STUDENT			
1.	The Student Committee had planned a webinar series on "Tax Audit – Student Perspective". The session-wise detail of the program is as under:		
a.	08.08.2023	Key Note Address on overview of tax audit, impact of Auditing Standards for carrying out Tax Audit, etc.	CA Pradip Kapasi
b		Detailed discussion on relevant provision of Income Tax Act and clause by clause analysis of Tax Audit Report	CA Devangi Patel
c	09.08.2023	Continuation of analysis of remaining clauses of Tax Audit Report and detailed discussion on Basics of Form 3CD, documentation, uploading and filing of Tax Audit Report	CA Devangi Patel
2.	19.08.2023	Udaan - Episode 5	Vikram Nankani, Senior *Advocate*
STUDY CIRCLE & STUDY GROUP			
1.	08.08.2023	Select issues with reference to taxation of transaction in immovable property	CA Jagdish Punjabi Ritu Punjabi, *Advocate*
2.	28.08.2023	Issues in Tax Audit in FAQ format	*Group Leader:* CA V. Ramnath *Moderator:* CA Mahendra Sanghvi

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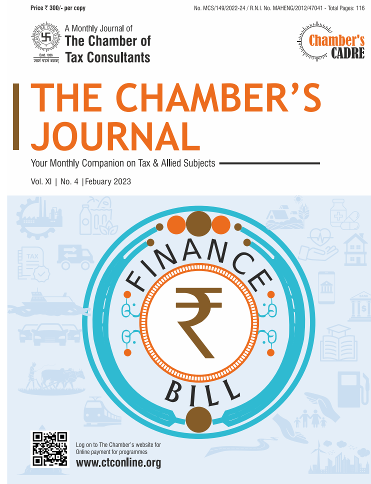
JANUARY 2023



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JUNE 2023

JULY 2023

AUGUST 2023

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GST
Acts | Rules | Forms | Notifications

As Amended by the
CGST (Amdt.) Act 2023 | IGST (Amdt.) Act 2023 | Updated Till 24th August 2023

Coverage	GST Acts	GST Acts with Rules	GST Acts with Rules & Forms	GST Acts with Rules/ Forms & Notifications
	₹525	₹795	₹1,295	₹1,995
GST Acts				
CGST Act	✓	✓	✓	✓
IGST Act	✓	✓	✓	✓
UTGST Act	✓	✓	✓	✓
GST (Compensation to States Act)	✓	✓	✓	✓
GST Rules				
CGST Rules	✗	✓	✓	✓
IGST Rules	✗	✓	✓	✓
UTGST Rules	✗	✗	✓	✓
Other Rules	✗	✗	✓	✓
GST Forms	✗	✗	✓	✓
GST Notifications	✗	✗	✗	✓
CGST Notifications	✗	✗	✗	✓
IGST Notifications	✗	✗	✗	✓
CGST, IGST & Compensation Cess (Rate) Notifications	✗	✗	✗	✓
Allied Laws referred to in the Section	✓	✓	✓	✓
GST Law Guide	✓	✓	✓	✓

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