TRILEGAL

Monthly Tax Updates

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1 Direct Tax

This update covers key judicial developments and important notifications in the month of April 2022 relating to direct tax, tax on lotteries, GST, service tax and entry tax.

1.1 Supreme Court upholds the validity of assessment made in the case of a non-existent amalgamating entity

The Supreme Court in *PCIT v Mahagun Realtors (P) Ltd.* (**Mahagun Ruling**) upheld the validity of an assessment order made in the case of a non-existent entity, Mahagun Realtors (P) Ltd. (**MRPL**), which had merged into Mahagun India Private Limited (**MIPL**) by an order of the Delhi High Court dated 10 September 2007.

This ruling seemingly unsettles a prior ruling of the Supreme Court in *PCIT v Maruti Suzuki India Limited* (**Maruti Suzuki Ruling**) which held that once an amalgamating company ceases to exist, it cannot be regarded as a

'person' under the income tax law. Therefore, the Revenue can neither initiate a tax proceeding nor pass an order against such an entity.

However, the facts in the Mahagun Ruling are slightly different to those in the Maruti Suzuki Ruling. In the Maruti Suzuki Ruling, the assessee had disclosed the fact of its amalgamation to the jurisdictional Assessing Officer (AO) even before the case being selected for scrutiny. In the Mahagun Ruling, MRPL (i.e., the amalgamating company) consistently held itself out as the assessee before tax officers and courts even after its amalgamation.

As mentioned above, MRPL amalgamated with MIPL by virtue of an order of the Delhi High Court dated 10 September 2007. The order provided that the amalgamation would take effect from 1 April 2006. A search and seizure operation was undertaken against the Mahagun group (including MIPL and MRPL) on 27 August 2008. The directors of both companies were questioned during these proceedings. Even at this stage, the directors did not disclose to the Revenue that MRPL had merged into MIPL and had ceased to exist. Further, in response to notices issued after the search and seizure operation, MRPL filed a return of income in its own name and with its own PAN number. The return of income did not disclose that the company had undergone a merger and had ceased to exist, despite a specific disclosure requirement. Consequently, the AO passed an assessment order in the name of '*Mahagun Realtors (P) Ltd., represented by Mahagun India Private Limited*'. The assessee also filed an appeal before the Commissioner of Income Tax (Appeals) in a similar manner.

It is at the stage of the second appeal before the Income Tax Appellate Tribunal (ITAT) that the assessee filed an additional ground contending that the entire proceeding was a nullity as the assessment order was made against a non-existent entity, which is impermissible under the income tax law. The ITAT agreed with the assessee and set aside the assessment order. Further, relying on the Maruti Suzuki Ruling, the Delhi High Court dismissed the appeal filed by the Revenue against the order of the ITAT.

However, the Supreme Court disagreed with the ruling of the Delhi High Court. It held that the Maruti Suzuki Ruling could not be relied on in the present case as it is distinguishable on facts. The assessee, in that case, had disclosed to the Revenue that the company had ceased to exist. On the other hand, MRPL had consistently held itself out as the assessee before various forums even after its amalgamation.

The Court concluded that the terms of the amalgamation and the facts of each case would determine if the corporate death of an assessee (upon amalgamation) would invalidate an assessment order.

Interestingly, the Finance Act, 2022 has already introduced provisions governing the conduct of tax proceedings in case of amalgamating companies. The law now provides that in the event of a business reorganisation (including amalgamation), assessment or other proceedings pending or completed on the predecessor entity shall be deemed to have been made on the successor entity. These amendments took effect from 1 April 2022.

While these amendments should provide much-needed certainty in the future, it appears that the law concerning past years has been thrown wide open after the Mahagun Ruling.

1.2 ITAT holds that the circular issued by the Central Board of Direct Taxes in relation to the Most Favoured Nation clause is neither binding nor retrospective

In an important development, the ITAT in *GRI Renewable Industries S.L. v ACIT* (GRI Ruling) held that the circular dated 3 February 2022 (Circular) issued by the Central Board of Direct Taxes (CBDT), clarifying the applicability of the Most Favoured Nation Clause (MFN Clause) found in Double Taxation Avoidance Agreements (DTAA) between India and certain other member-countries of the Organisation for Economic Co-

operation and Development (**OECD**), (i) cannot be applied retrospectively, and (ii) transgresses the boundaries of income tax law by laying down additional requirements for the applicability of the MFN Clause.

The MFN Clause provides that if after the entry into force of the DTAA containing the clause (**Existing Treaty**), India concludes a DTAA with another OECD member-country (**Subsequent Treaty**), and such Subsequent Treaty provides a more beneficial tax treatment to specified kinds of income, then similar tax benefits would also be extended under the Existing Treaty.

In the GRI Ruling, the assessee was a tax resident of Spain (a member of the OECD). It filed a tax return in India, declaring income in the nature of fees for technical services and royalty. The India-Spain DTAA provides for a tax rate of 20% for such income. Relying on the MFN Clause in the India-Spain DTAA and the DTAA signed between India and the Portuguese Republic (**India-Portugal DTAA**), the assessee contended that it was eligible to avail a lower tax rate of 10%. The assessee's reasoning was that the Portuguese Republic was also a member of the OECD, and the India-Portugal DTAA (with the lower tax rate of 10%) was signed by India after the DTAA with Spain came into effect. Therefore, by virtue of the MFN Clause in the India-Spain DTAA, the lower rate of 10% would automatically apply under the India-Spain DTAA as well. The Revenue rejected this contention and applied the higher rates of tax provided under the domestic law. The Revenue held that in the absence of a notification importing the lower rate of tax under the India-Portugal DTAA into the India-Spain DTAA, the MFN Clause would not apply.

However, during the appellate proceedings, the ITAT disagreed with the Revenue and concluded that once a DTAA between India and a partner country is notified, all integral parts of the DTAA automatically get notified. Therefore, there is no requirement to issue notifications under the MFN Clause separately. Accordingly, the ITAT observed that the MFN Clause would apply and the assessee was eligible to avail of the lower rate of tax provided in the India-Portugal DTAA.

Further, the ITAT observed that in the Circular, the CBDT had laid down the following conditions which must be fulfilled for benefits under the MFN Clause to be available:

a. The Subsequent Treaty must be entered into by India during the operation of the Existing Treaty.

b. The country with which India concludes the Subsequent Treaty must be a member of the OECD both when the Subsequent Treaty is concluded and when the MFN clause is sought to be applied.

c. In the Subsequent Treaty, India must have limited its taxing rights (either in terms of the rate or scope of taxation).

d. A separate notification is issued by India, importing the benefits of the Subsequent Treaty into the Existing Treaty.

According to the ITAT, some of these requirements are in excess of those envisaged under India's domestic law. The ITAT observed that it is settled law that a circular issued by the CBDT is binding on the Revenue and not on taxpayers or the Tribunal / other appellate authorities. Further, a circular that transgresses the boundaries of the domestic law cannot bind the ITAT.

The ITAT also observed that a circular which imposes an additional detrimental stipulation (of issuing a notification, in the present case) cannot be applied retrospectively to the detriment of the taxpayers. Consequently, since the present case pertained to an assessment year prior to the issuance of the Circular, the ITAT held that additional stipulations contained in the Circular cannot be applied in the present case.

The ITAT has provided relief to taxpayers by ruling that the Circular would not apply to past assessment years. However, it has still not conclusively ruled on the applicability of the Circular to assessment years after its issuance. It remains to be seen how courts/tribunals rule on this aspect.

2 Taxes on Lotteries

2.1 Supreme Court: State Legislatures are competent to impose tax on lotteries

The Supreme Court in *State of Karnataka & Anr. v State of Meghalaya & Anr.* has held that State Legislatures are competent to legislate and impose tax on lotteries under Entry 62 of List II of the Seventh Schedule to the Constitution of India.

The States of Karnataka and Kerala had approached the Supreme Court against the judgements of the respective High Courts, whereby States were held to have no competence to enact laws on taxing lotteries. Accordingly, the High Courts declared the laws enacted by the state legislatures for taxing lotteries as unconstitutional and invalid.

In appeal, the Supreme Court held that lotteries are a species of betting and gambling. Further, Entry 62 of List II of Seventh Schedule is a specific Entry and gives States the power to tax all activities which are in the nature of betting and gambling including lotteries, irrespective of whether they are conducted or organised by the Government of India or the State Government or is authorized by the State or is conducted by an agency or instrumentality of a State Government or Central Government or any private player.

This decision is likely to have a wider implication on the lottery industry as the Supreme Court has now settled the controversy on the power of the State Legislatures to enact laws for taxing lotteries. This will also create an additional stream of revenue for the States for whom taxing petrol and petroleum products and liquor has been the most prominent source of revenue post-GST.

3 Goods and Services Tax

3.1 Kerala High Court quashes detention order passed in respect of goods in transit; holds no provision under GST Act to detain goods if price quoted in invoice is lower than MRP of goods

The Kerala High Court in *Alfa Group Ltd. v Assistant State Tax Officer, State of Jharkhand* has held that the value quoted in the invoice being lower than the Maximum Retail Price (MRP) of the goods, is not a valid ground for detention of goods in transit.

The High Court quashed the detention order observing that there is no provision under the Central Goods and Service Tax Act, 2017 (CGST Act) which mandates that goods cannot be sold at prices below the declared MRP. The High Court observed that the statutory scheme of CGST Act facilitates free movement of goods. The Court observed that the tax department officials cannot resort to arbitrary and unwarranted detention of goods in transit, eroding public confidence in tax administration. Regarding the allegation of incorrect classification on the invoice, the Court observed that since the alleged change in classification did not change the rate of tax as adopted by the assessee, such alleged misclassification does not become a ground for detention of the goods.

This decision is significant as the tax officers in the past have detained goods on minor inconstancies in the invoice, which do not warrant detention of goods as such under the CGST Act. This judgment of the High Court should prevent arbitrary detention by tax officers and enable hassle-free movement of goods.

3.2 Karnataka HC upholds simultaneous levy of GST, Excise and National Calamity Contingency Duty on tobacco and tobacco products

The Karnataka High Court in *VS Products v Union of India* has upheld simultaneous levies of Goods and Service Tax, Basic Excise Duty and National Calamity Contingency Duty (**NCCD**) on tobacco and tobacco products.

The High Court held that powers granted to Parliament to levy tax on matters enumerated in List I under Article 246 and the power to levy GST under Article 246A of the Constitution of India are mutually exclusive and can be applied simultaneously. The Court further observed that the legislature enjoys a wide latitude to decide on the methodology of revenue generation and courts must tread carefully while dealing with legislation based on fiscal policy. On the issue of levy of NCCD, the High Court held that even though the NCCD is a surcharge by way of duty of excise, its validity is traceable to Article 271 of the Constitution and has nothing to do with the validity or leviability of the duty of excise itself.

This decision of the Karnataka High Court will come as a setback for the taxpayers involved in the manufacture and trade of tobacco-related products as parallel levy of taxes translate into higher prices.

4 Service Tax

4.1 Gujarat High Court holds that period of limitation for filing a refund claim of service tax paid on services used for export of goods shall begin from the date when the ship or aircraft carrying the goods leaves India

The Gujarat High Court in *Thankys Exports Pvt. Ltd. v Union of India* has held that the Clause 3(g) of Notification No. 41/2012-ST dated 29 June 2012 (**Limitation Clause**) along with the Explanation provided thereunder is *ultra vires* Section 83 of the Finance Act, 1994 (**Finance Act**) read with Section 11B of the Central Excise Act, 1944 (**Excise Act**).

The Limitation Clause provides that the time limit for claiming refund of service tax paid on specified services used for export of goods shall begin from the date the Customs officer makes an order permitting clearance and loading of the said goods for exportation. The High Court held that the said clause is in direct contravention to Section 11B of the Excise Act, which provides that the period of limitation will commence from the date when the ship leaves India. By holding the Limitation Clause as *ultra vires* Section 11B of the Excise Act, the High Court has re-affirmed the legal position that in case of conflict between the statutory provision and the delegated legislation, the former would prevail.

This decision would provide clarity to the taxpayers who had filed service tax refund claims in the pre-GST period but are pending. The taxpayers can adduce evidence to establish that the refund claim was filed before the date on which the ship carrying the goods left India.

5 Entry Tax

5.1 West Bengal Taxation Tribunal holds that State cannot legislate on entry tax law post 101st Constitutional Amendment Act

The West Bengal Taxation Tribunal (**Tribunal**) in *Tata Steel and Ors. v The State of West Bengal* has held that the provisions of the West Bengal Finance Act, 2017 (**WB Finance Act 2017**), which amended the West Bengal

Tax on Entry of Goods into Local Area Act, 2012 (**WB Entry Tax Act**) retrospectively, are *ultra vires* the Constitution by virtue of the 101st Constitutional Amendment Act.

A single bench of the Calcutta High Court earlier struck down the WB Entry Tax Act. Thereafter, the state of West Bengal attempted to revive it retrospectively through the WB Finance Act 2017.

The Tribunal held Sections 5 and 6 of the WB Finance Act 2017 (which amended the WB Entry Tax Act retrospectively and validated the said Act) to be unconstitutional. It held that the State was deprived of its powers to legislate or amend on matters related to entry tax by virtue of the 101st Constitutional Amendment Act which omitted Entry 52 of the State List under the Seventh Schedule of the Constitution. The said Entry provided the power to the States to impose taxes on the entry of goods into a local area for consumption.

The Tribunal held that since such power itself was taken away from the states once and for all, an amendment to the statute providing for the imposition of the said tax cannot be made thereafter.