UPDATES

Monthly Tax Updates

May 2022

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Key Focus Areas Covered in this Update:

This update covers key judicial developments in the month of May 2022 relating to direct tax, service tax, GST, central excise and procedural matters.

1 Direct Tax

1.1 Supreme Court upholds the validity of 90,000 reassessment notices issued between 1 April 2021 to 30 June 2021; deemed as show-cause notices under Section 148A of the IT Act

The Supreme Court, in *UOI v Ashish Agarwal,* has upheld the validity of reassessment notices issued between the period 1 April 2021 and 30 June 2021 under the old provisions of Section 148 of the Income Tax Act, 1961 (**IT Act**). While modifying the orders of various High Courts, the Supreme Court held that notices issued under the erstwhile Section 148 shall be deemed as show-cause notices in terms of Section 148A(b) as substituted by the Finance Act, 2021 (**FA 2021**).

The decision has come as a relief to the tax department as more than 90,000 reassessment notices issued under the erstwhile reassessment provisions have been held to be valid.

The Government, through FA 2021, revamped the reassessment provisions from 1 April 2021 and made changes to the procedure governing the issuance of reassessment notices. Section 148A was inserted in the IT Act mandating procedural safeguards to be necessarily followed by the tax officers before issuing notice under Section 148.

Parallelly, the Central Government, deriving powers from the Taxation and Other Laws (Relaxation and Amendment of Certain Provisions) Act, 2020, vide explanations to Notification No. 20/2021 and Notification No. 38/2021 (**collectively, the Notifications**) stipulated that the old, unamended provisions of reassessment shall continue to apply to reassessment proceedings initiated till 30 June 2021.

Relying on the Notifications for extension of time (and notwithstanding the new reassessment regime), the tax department issued more than 90,000 reassessment notices to taxpayers across India under the erstwhile provisions of Section 148 between 1 April 2021 to 30 June 2021. The validity of such notices was challenged by many taxpayers before various High Courts.

The High Courts of Allahabad, Delhi, Bombay, Rajasthan, Madras, and Calcutta quashed such reassessment notices.

On petitions filed by the tax department, the Supreme Court, while discussing the new reassessment regime, observed that the intention of the substituted provisions is to streamline and simplify the procedure. The Supreme Court concurred with the finding of the High Courts that the notices should have been issued under the substituted provisions as amended by FA 2021. However, it went on to observe that quashing all such notices would frustrate the purpose of reassessment proceedings. Accordingly, the Supreme Court upheld the validity of the notices and directed that the reassessment notices issued under the erstwhile reassessment provisions shall be deemed as show-cause notices under Section 148A of the IT Act.

While the decision attempts to balance the ‘rights’ of the taxpayers and the tax department, it undermines the fact that the tax department, as an authority of the State, does not have ‘rights’ and instead, it is the taxpayers who have such exercisable rights against a State Authority. The effect of this judgement on the continuation of reassessment proceedings may be outweighed by its effect on tax jurisprudence in India.

Further, on 11 May 2022, the Central Board of Direct Taxes (**CBDT**) issued Instruction No. 1 of 2022 clarifying that for assessment years (**AYs**) 2013-14, 2014-15, and 2015-16, fresh notice under Section 148 of the IT Act can be issued with the approval of the specified authority. However, if the income escaping assessment amounts to or is likely to amount to less than Rs. 50 lacs, then no notice can be issued. Whereas, for the AY 2016-17 and 2017-18, fresh notice under Section 148 of the IT Act can be issued with the approval of the specified authority.

However, the CBDT Instruction appears to be in direct contradiction to the Proviso to the amended Section 149(1) of the IT Act, which provides that no notice under the amended Section 148 shall be issued for any AY beginning on or before 1 April 2021, if such notice could not have been issued under the erstwhile Section 149(1)(b) of the IT Act. Accordingly, no notice under Section 148 of the IT Act could have been issued for AY 2013-14 to 2015-16 since the time limit for issuance of notice under erstwhile Section 149(1)(b) had expired.

Thus, it would be interesting to see how the courts will deal with this and it would not be right to say that the controversy surrounding the provisions of Section 148 of the IT Act has finally settled.

1.2 Income Tax Appellate Tribunal holds that third-party shareholders (not relatives) renouncing their 'right shares' would attract the provisions of Section 56(2)(vii)(c) of the IT Act in the hands of the recipient

Recently, the Income Tax Appellate Tribunal (**ITAT**), in *Shri Jigar Jashwantlal Shah v ACIT* (**Shah Ruling**), held that renunciation of rights by an unrelated third party in favour of the taxpayer leads to disproportionate allocation, thereby invoking Section 56(2)(vii)(c) of the IT Act.

Section 56(2)(vii)(c) provided that where an individual or Hindu Undivided Family receives any property other than immovable property for a consideration that is less than the aggregate fair market value (**FMV**) by more than Rs. 50,000, the difference between aggregate FMV and the consideration shall be chargeable to tax.

In the Shah Ruling, the assessee was allotted right shares by three ways: (a) shares allotted in proportion to existing shareholding; (b) shares allotted on renouncement of right by relatives; and (c) shares allotted on renouncement of right by third-party, unrelated shareholders. The tax department, invoking Section 56(2)(vii)(c) of the IT Act, added the difference between the aggregate FMV and the issue price of the shares to the income of the assessee. On appeal, the Commissioner of Income Tax (Appeals) gave part relief and deleted the addition on account of shares allotted to the assessee on a proportionate basis. However, addition on account of shares renounced by relatives and third parties was sustained.

When the matter reached before the ITAT, the assessee contended that there is a difference between 'issuance' of a share to a subscriber and 'purchase' of a share from an existing shareholder. It was argued that only the latter would fall within the ambit of Section 56(2)(vii)(c). However, the ITAT held that Section 56(2)(vii)(c) uses the term 'receives', which cannot be restricted to receipt by way of 'transfer' alone. Thus, the ITAT held that the issuance of shares would fall within the ambit of Section 56(2)(vii)(c).

Regarding the first two categories, the ITAT held that Section 56(2)(vii)(c) would not apply. However, for the third category wherein the shares were renounced by third-party shareholders, the ITAT observed that specific renunciation of right had been made by the third-party shareholders, which led the assessee to acquire a higher shareholding qua the other shareholders. Accordingly, the ITAT held that since such additional shares were allotted to the assessee allowing him to gain a controlling interest in the company, Section 56(2)(vii)(c) of the IT Act will be applicable.

1.3 Following the withdrawal of retrospective taxability of gains from indirect transfer of assets, the tax department withdraws pending appeals before the Supreme Court in the case of Sanofi Aventis Amerique Du Nord

On 6 May 2022, the tax department, putting to rest the controversy around the retrospective taxability of gains arising from the transfer of assets located in India through the transfer of the shares of a foreign company (**indirect transfer of assets**), withdrew its appeals filed before the Supreme Court in the case of *Sanofi Aventis Amerique Du Nord*.

The issue of taxability of indirect transfer of assets has been the subject matter of protracted litigation. The Finance Act, 2012 (**FA 2012**) amended the provisions of Section 9(1)(i) of the IT Act to provide that the gains arising from the sale of shares of a foreign company are taxable in India, if such shares, directly or indirectly, derive value substantially from the assets located in India. Such amendment was made with retrospective effect from 1 April 1962.

Such retrospective amendment made by the FA 2012 invited criticism from the international community and various representations were made to the Government to withdraw the retrospective operation of the amendment.

To address the above, the Taxation Laws (Amendment) Act, 2021 (**Amendment Act**) was introduced by the Government in 2021 to settle the dispute of non-taxability of indirect transfer of assets prior to FA 2012. Through the Amendment Act, the Government withdrew the retrospective applicability of the amendments made to Section 9(1)(i) of the IT Act by FA 2012.

The Government notified Rules 11UE and 11UF of the Income Tax Rules, 1962 which provided the conditions and manner to be followed by the assessee to settle the disputes.

In view of the Amendment Act and fulfilment of the prescribed conditions by Sanofi Aventis Amerique Du Nord, the tax department has withdrawn the appeals pending before the Supreme Court.

This is a welcome step taken by the Government towards reducing tax litigation and settling disputes. Further, it will also help boost India's cooperative stand on retrospective laws, thereby helping to attract foreign investment to the country.

2 Service Tax

2.1 Supreme Court holds that the secondment of employees by overseas entities to their Indian counterparts is exigible to service tax

The Supreme Court, in *Commissioner of Customs, Central Excise and Service Tax, Bangalore v Northern Operating Systems*, has held that service tax is leviable on the secondment of employees by an overseas entity to its Indian group entity since the latter becomes a service recipient required to discharge service tax on a reverse charge basis.

The Tax Department had approached the Supreme Court against the decisions of the Customs Excise and Service Tax Appellate Tribunal (**CESTAT**), holding that the secondment of employees by foreign group entities to their Indian counterparts is not subject to service tax. These decisions were based on the ground that such seconded employees qualify as employees of the Indian entities.

In appeal, the Supreme Court held that the control exercised by the Indian entity over the seconded employees is not determinative of whether such seconded employees would be the employees of the Indian entity. For this proposition, the Supreme Court relied on its earlier decisions in the cases of *DC Dewan Mohideen Sahib and Sons*, *Silver Jubilee Tailoring House,* and *Sushilaben Indaravan*. The Court concluded that to determine the relationship between the entity and the seconded employees, the substance of the arrangement would have to be analysed over the form in which the agreement may be drafted.

The Court analysed the agreements between the respondent and its foreign group entity and observed that the nature of the business of the overseas group companies is to secure contracts, the performance of which requires highly trained and skilled personnel. It observed that since the foreign group entity outsources a portion of the performance of the contract to the Indian entity, the Indian entity requires the skill and know-how of the seconded employees to be able to perform its portion of the contract. The Court further held that the seconded employees could not be said to be the employees of the Indian entities as they return to their overseas employer or are deployed on some other secondment upon the cessation of the term of secondment with the Indian entity. On the basis of these observations, the Supreme Court held that the employees seconded by the foreign group entity of the respondent were not the employees of the respondent and that the respondent had received the supply of skilled manpower from its overseas group entity.

This is a departure from the settled position that secondment of employees from overseas entities to its Indian group entities does not amount to provision of service. In any case, the negative list regime under service tax specifically excluded provision of service by an employee to its employer in the course of or in relation to employment.

This decision is likely to have a wide implication on various global businesses where such arrangements are commonplace. The impact of this decision is also likely to percolate into the Goods and Services Tax regime owing to the similarity of provisions on this aspect. It is important for the taxpayers to analyse whether the nature of previous/existing arrangements between the Indian entities and the foreign counterparts was similar to that in the case of *Northern Operating Systems*. Similarly, going forward, the taxpayers would have to review the terms of the arrangements with the foreign group companies as well as the seconded employees in light of the service tax implication on them.

3 Goods and Services Tax

3.1 Gujarat High Court holds that the mandatory deeming fiction of 1/3rd deduction for the value of land in under-construction projects is ultra vires the provisions of the CGST Act as well as violative of Article 14; reads the fiction down to be optional in the hands of the taxpayer

The Gujarat High Court, in *Munjal Manishbhai Bhatt v Union of India*, has held that the mandatory deeming fiction of 1/3rd value towards land in under-construction projects is *ultra vires* the provisions of the Central Goods and Service Tax Act, 2017 (**CGST Act**) as well as violative of Article 14 of the Constitution of India. Such mandatory fiction has been created under paragraph 2 of Notification No. 11/2017- Central Tax (Rate) dated 28 June 2017 (**Notification No. 11/2017**).

The High Court reinforced the position that a deeming fiction can only be applied when the actual value of the transaction is not ascertainable. On this basis, the Court held that the mandatory application of the deeming fiction of 1/3rd of total agreement value towards land even when the actual value of the land is ascertainable is clearly contrary to the provisions and the scheme of the CGST Act. The High Court further held that the deeming fiction leads to discriminatory and arbitrary consequences and is thus violative of the Constitution. Further, the Court held that the deeming fiction by way of delegated legislation has led to a situation where the measure of the tax imposed has no nexus with the charge of tax which is on the supply of construction service.

The Court accordingly read down paragraph 2 of Notification No. 11/2017 to the effect that the deeming fiction of 1/3rd value towards land will not be mandatory and will be optional at the hands of the taxpayer/developer where the actual value of land is not ascertainable.

This decision is significant as the fiction created by Notification No. 11/2017 made a significant departure from the erstwhile taxation regimes and could have potentially led to protracted litigation.

3.2 Madras High Court holds that procedural infractions cannot debar legitimate claims of refund in case of export

The Madras High Court in, *Abi Technologies v Assistant Commissioner of Customs, Tuticorin*, has set aside the orders rejecting the refund claims filed by the petitioner on the ground of improper details in the monthly returns.

The High Court acknowledged that the principle of refund of tax/duty paid on exports has been a long recognised one. The Court further held that the procedure prescribed to claim refund is not intended to defeat the legitimate export incentives if the taxpayer is able to satisfy the legitimacy of payment of Integrated Goods and Services Tax and the export of goods. This judgement upholds the settled proposition of law that such rules are enacted to enable the intent of the legislature and not to act as a hindrance to the same.

This decision will come as a welcome relief to the exporters who are not able to claim refund of the duty paid due to procedural inconsistencies while filing details in their returns. Further, this decision follows the long-standing principle of incentivising exports in India.

4 Central Excise

4.1 Jammu and Kashmir High Court holds that the amount of Education Cess and Secondary and Higher Education Cess refunded to taxpayers cannot be recovered on the basis of a change in opinion of the Supreme Court without any appeal filed by the tax department in the regular course

The Jammu and Kashmir High Court, in a batch of appeals titled *Commissioner of CGST and Central Excise, Jammu v Narbada Industries*, has held that the amount of cesses refunded to taxpayers pursuant to the decision of the Supreme Court in the case of *SRD Nutrients P. Ltd.* are not recoverable by the tax department.

The Supreme Court, in the case of *SRD Nutrients P. Ltd.,* had earlier held that Education Cess and Secondary and Higher Education Cess levied on the excise duty partakes the character of excise duty itself. By virtue of this decision, the cesses paid by taxpayers were directed to be refunded by the appellate tribunals, which were consequently sanctioned by the tax department. The decision in the case of *SRD Nutrients* was thereafter overruled by the Supreme Court in the case of *Unicorn Industries v Union of India*.

Subsequently, the tax department, on the basis of the decision of the Supreme Court in *Unicorn Industries v Union of India,* initiated multiple proceedings seeking to recover the cesses already refunded to taxpayers. In this regard, the Jammu and Kashmir High Court held that the cesses already refunded did not become recoverable due to the change in opinion of the Supreme Court when the tax department had not filed any appeal against the orders passed by the appellate tribunals directing the refund of cesses paid by taxpayers. The High Court observed that if such recovery is permitted, it will open a pandora's box and the *lis* between the parties which had attained finality will never come to an end and would be against public policy.

Further, on the question of whether the appeals filed by the tax department were barred by limitation, the High Court held that a change in opinion of the Supreme Court is not a sufficient cause to entertain delay in filing of appeals. The Court further held that sufficient cause for not filing the appeal needs to be demonstrated for the time period within which the appeal is supposed to be filed and any event after the passage of such period cannot become a cause for the delay.

This judgement will come as a relief to the taxpayers who had received the refund of cesses in line with the decision of the Supreme Court in the case of *SRD Nutrients P. Ltd.*

5 Miscellaneous

5.1 Supreme Court holds that High Courts are competent to determine whether a taxpayer would be eligible to claim exemption under a particular provision/notification

The Supreme Court, in the case of *Asean Cableship PTE Ltd. v Commissioner of Customs*, has held that a High Court is competent to adjudge on the eligibility of a taxpayer to claim exemption under a provision/notification which provides for such exemption.

While addressing the submission raised by the respondent that the question of eligibility of exemption is linked to the determination of the rate of tax payable, the Supreme Court held that the dispute concerning exemption and the dispute concerning applicable rate are different, distinct, and mutually exclusive. The Court held that while determining the eligibility of exemption on the basis of satisfaction of a particular condition, it has to be analysed separately if any question relating to the rate applicable, classification of goods, valuation of goods, or coverage of the goods under the relevant exemption notification is involved in the given case. If the answer to the above questions is in the negative, then the question of eligibility of exemption under a provision/notification does not *ipso facto* become a question relating to the rate of duty.

The decision of the Supreme Court has come as an aberration to the plethora of judicial precedents providing that only the Supreme Court has the jurisdiction to decide upon issues relating to the availment of exemption under a provision/statute. The decision might lead to confusion and litigation on the maintainability of appeals before the High Courts in matters relating to exemption since it relates to the question of rate of duty under Section 130E of the Customs Act, 1962.

5.2 Guwahati High Court holds that the managing director of a company should be summoned only as a last resort and not as a matter of practice

While deciding on the legality of the practice of tax department officials to directly issue summons to the managing directors of companies, the Guwahati High Court, in *Century Plyboards (India) Ltd. and Anr.,* held that the summoning of the managing director or director should be undertaken only as a last resort in cases where assessees are not cooperating, or the investigations are to be completed expeditiously. The High Court directed that summons should be issued to the authorised representatives of the company. The Court further directed that the board of directors of the company should authorise a competent person for the purpose and further summons be issued only to such authorised person.

Earlier, the Central Board of Excise and Customs had also issued a circular to the same effect. This decision should help in curbing the prevalent practice on the part of tax officials to directly issue summons to the managing directors or directors in the course of an investigation.