Monthly Tax Updates

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Key Focus Areas Covered in this Update:

1 Direct Tax

This update covers key regulatory and judicial developments in the month of June 2022 relating to direct tax, customs and service tax and the recommendations of the GST Council.

1.1 Guidelines on tax withholding on benefits/perquisites arising from business or profession

Under the newly introduced section 194R of the Income Tax Act, 1961 (**IT Act**), any person responsible for providing to a resident, any benefit or perquisite arising from a business or the exercise of a profession by such resident, must ensure that tax has been deducted at the rate of 10% of the value of such benefit or perquisite. The benefit or perquisite may or may not be convertible to money. This provision was introduced through the Finance Act, 2022 (**FA 2022**) and came into effect on 1 July 2022.

On 16 June 2022, the Central Board of Direct Taxes (**CBDT**) notified guidelines to clarify certain ambiguities surrounding this provision. We have analysed some of the important clarifications below.

a. ***Taxability for the recipient need not be tested:*** The person providing the benefit or perquisite is not required to check if such benefit is taxable in the hands of the recipient and is only required to ensure that tax has been deducted.

b. ***Provision also applies to cash benefits:*** In addition to benefits provided in kind, the provision would also apply to benefits paid in cash.

c. ***Capital assets also covered*****:** Capital assets such as car, land, etc., would also be covered within the ambit of this provision.

d. ***Provision not applicable to sales/cash discount and rebates*****:** Tax would not have to be withheld on sales discount, cash discount and rebates allowed to customers. However, this relaxation would not apply in respect of free samples, which would be covered within the ambit of the provision.

e. ***Actual user of benefits or perquisites irrelevant*****:** Tax would have to be withheld so long as the benefit is provided in substance to a person/entity that is engaged in business/professional activities, even if the actual user of the benefit is a relative/director of the entity or any other associated person who individually may not be carrying on a business or a profession.

f. ***Excluded entities:*** The provision would not apply if the benefit or perquisite is provided to a government entity, such as a government hospital, not carrying on business or profession.

g. ***Valuation*****:** For the purposes of tax withholding, the benefit will be valued on fair market value basis except in the following cases:

   i. *Benefit/perquisite purchased by the provider:* Valuation would be based on the purchase price.

   ii. *Benefit/perquisite manufactured by the provider*: Valuation would be based on the price charged to customers.

   GST will not be included in the valuation of the benefit.

h. ***Reimbursement of out-of-pocket expenses:*** Applicability of section 194R would depend on the manner in which the out-of-pocket expenses are invoiced. In case of a contract for provision of services, if the invoice for out-of-pocket expenses is issued in the name of the client but paid by the service provider and thereafter reimbursed by the client, then such reimbursement would not be treated as a benefit/perquisite for the purposes of this provision. However, if the invoice for out-of-pocket expenses has been issued in the name of the service provider and has been paid/reimbursed by the client, tax withholding will be required.

i. ***Applicability to dealer/business conferences*****:** Expenditure incurred on a dealer/business conference would not be considered as a benefit/perquisite if the conference is held with the primary objective of educating dealers or customers. However, such conferences must not be in the nature of incentives/benefits to dealers who have achieved certain targets. Further, any expenses attributable to family members or leisure trips would constitute benefits for the purposes of the provision and would require tax withholding.

1.2 Clarification on tax withholding on virtual digital assets

Under section 194S of the IT Act, any person responsible for paying to a resident any sum as consideration for the transfer of a virtual digital asset (**VDA**) is required to deduct tax at the rate of 1%. This provision was introduced through FA 2022 and came into effect on 1 July 2022.

The CBDT has issued circulars and notifications to clarify various aspects of this provision, as follows.

a. ***Liability to deduct tax when the transfer of the VDA is undertaken through an exchange and the VDA is owned by a person other than the exchange:*** Tax should be deducted only by the exchange while making

the payment to the seller (i.e., the owner of the VDA being transferred). In a case where the payment between the seller and the exchange is through a broker, the onus to deduct tax would be on the exchange as well as the broker. The broker may deduct tax subject to a written agreement with the exchange.

b. ***Liability to deduct tax when the transfer of the VDA is through an exchange and the VDA is owned by the exchange:*** In this case, since the exchange itself would be the seller, the primary responsibility to deduct tax would be that of the buyer (or the broker engaged by the buyer). However, in case the buyer is unsure of the ownership of the VDA by the exchange, it may enter into an agreement with the exchange requiring the exchange to pay tax on a quarterly basis.

c. ***Liability to deduct tax when the consideration is in kind or in the form of another VDA:*** Under the provision, the person responsible for paying consideration is required to ensure that tax has been paid. Therefore, in this case, the buyer will release the consideration in kind after the seller provides proof of payment of tax. In a transaction wherein the parties exchange VDAs, each party would need to ensure that the other has deposited the applicable tax. If an exchange is involved, the exchange may carry out tax withholding based on a written agreement. In case tax has been deducted in kind (i.e., in the form of a VDA), such VDA may be converted into cash by following the procedure set out in the circular.

d. ***Interplay between sections 194Q and 194S:*** The CBDT has not clarified if VDAs would be considered as '*goods*' for the purposes of the IT Act. However, it has clarified that once tax has been deducted under this provision, tax would not need to be deducted under section 194Q, which pertains to purchase of goods.

e. ***Consideration for tax withholding:*** Tax may be withheld on the '*net*' consideration after excluding GST and service charges.

f. ***Tax withholding where payment is made through payment gateways:*** If the buyer has withheld tax, the payment gateway will not be required to carry out tax withholding. The payment gateway should obtain an undertaking from the buyer in this respect.

g. ***Exclusion of certain cards, vouchers etc. from the definition of VDAs:*** The following have been excluded from the definition of VDAs:

   i. Gift cards or vouchers that may be used to obtain goods/services or a discount on goods/services;

   ii. Mileage points, reward points or loyalty cards, given without direct monetary consideration under an award, reward, benefit, loyalty, incentive, rebate or promotional program that may be used or redeemed only to obtain goods/services or a discount on goods/services;

   iii. Subscription to websites or platforms or applications;

   iv. Non-fungible tokens whose transfer results in the transfer of ownership of an underlying tangible asset, with such transfer of ownership being legally enforceable.

1.3 Karnataka High Court grants relief to Flipkart on salary reimbursements to Walmart

On 24 June 2022, the Karnataka High Court allowed the writ petition filed by Flipkart Internet Pvt. Ltd. (**Flipkart**) against the rejection of its application for the issuance of a '*nil*' withholding tax certificate for payments to be made to Walmart Inc. (**Walmart**) for the reimbursement of salaries of seconded employees.

In this case, Walmart had seconded certain employees to Flipkart, which was required to make payments to Walmart to reimburse the salaries payable by Walmart to these employees. Flipkart filed an application seeking the issuance of a '*nil*' withholding tax certificate which was rejected by the tax authorities on the basis that the amounts under consideration did not constitute reimbursement of salaries as there was no employer-employee relationship between Flipkart and the seconded employees. The seconded employees continued to be on the rolls of Walmart, which had provided technical services to Flipkart through these employees. The tax department relied on the recent ruling in *C.C., C.E., & S.T.-Bangalore (Adjudication), etc. v M/s Northern Operating Systems Pvt. Ltd.* (**Northern Operating Systems Ruling**), in which the Supreme Court had upheld the service tax demand in a secondment arrangement on the basis that a secondment arrangement involves the provision of services by the original employer to the host entity since the seconded employees continue to be employed by the original employer. (To refer to our update on the Northern Operating Systems Ruling, click here.)

In Flipkart's case, the High Court provided relief to Flipkart and held that it was not liable to withhold tax on the reimbursement of salaries due to the following reasons:

a. For a payment to be subject to withholding tax in India, it must be chargeable to income tax in India.

b. Under the provisions of the India-US tax treaty, mere provision of services is not sufficient for the service fee to be taxable in India. For service fees to be taxed in India, technical services must be '*made available*' to the recipient of the service (**Make Available Test**).

c. The Make Available Test envisages that the recipient of services must be able to independently apply the technical knowledge in the future, without recourse to the service provider.

d. In the present case, the Make Available Test was not satisfied. Accordingly, the payments by Flipkart to Walmart would not be taxable in India and would also not be subject to withholding tax.

e. The fact that the seconded employees retained their employment with Walmart which could terminate them after the period of secondment would not alter the relationship between them and Flipkart. Flipkart had issued appointment letters to the seconded employees and had the power to terminate their employment during the period of secondment. The seconded employees reported to Flipkart. Therefore, for the purposes of the secondment arrangement, Flipkart was the employer entity and the amounts payable by it to Walmart constituted reimbursement of salaries.

The court distinguished the Northern Operating Systems Ruling by holding that it was rendered in the context of service tax and the question in that case was whether the supply of manpower was a taxable service under the service tax laws. However, in Flipkart's case, the question was whether any services were '*made available*' by Walmart to Flipkart.

This is a welcome decision and comes as a relief to companies implementing secondment arrangements. Importantly, in its ruling, the court has distinguished the decision of the Supreme Court in Northern Operating Systems. However, in doing so, the court has relied on the '*Make Available Test*' in the India-US tax treaty. It remains to be seen how the Northern Operating Systems Ruling is dealt with by the courts in the context of treaties that do not contain the '*Make Available Test*'.

2 Customs

2.1 Madras High Court upholds the validity of Show Cause Notices issued by the Directorate of Revenue Intelligence as proper officers u/s 28 of the Customs Act

The Madras High Court, in a batch of writ petitions titled *M/s N.C. Alexander v Commissioner of Customs,* has ruled that the officers of the Directorate of Revenue Intelligence (**DRI**) have the power to issue show cause notices under section 28 of the Customs Act, 1962 (**Customs Act**). section 28 empowers the proper officer to send notices for recovery of dues not levied or short-levied or erroneously refunded.

Earlier, on the issue of DRI officers being proper officers, the Supreme Court in *Canon India Pvt. Ltd. v Commissioner of Customs,* had held that DRI officers are not proper officers under section 28 as recovery proceedings are in the nature of review and only the officer who passed the original assessment order can re-open assessment under section 28.

However, the Madras High Court observed that sweeping changes have been brought to the Customs Act by the Finance Act, 2022 after which there is no doubt regarding the status of DRI officers as proper officers for the purpose of issuance of show cause notices.

The Court further observed that from 8 April 2011, section 17 of the Customs Act, which pertains to assessment of duty, had been amended due to which assessment of Bill of Entry by a proper officer is no longer required and the importer is to self-assess the Bill of Entry. The proper officer under section 17 is now merely required to re-assess imported goods where he disagrees with the self-assessment made by an importer. The Court noted that the observation of the Supreme Court in *Canon India* was made without taking note of the amendment to section 17.

The decision of the Madras High Court assumes importance since the issue of DRI officers being proper officers for issuance of show cause notice has far reaching revenue implications. Presently, this issue is being considered by the Supreme Court by way of review of its decision in *Canon India* and also in writ petitions filed before it by the importers challenging the validity of the retrospective amendments made to the Customs Act through the Finance Act, 2022.

3 Service Tax

3.1 Credit of service tax paid on activities related to Corporate Social Responsibility disallowed

The Customs, Excise and Service Tax Appellate Tribunal (**CESTAT**), New Delhi, in *M/s Power Finance Corporation Ltd. v Commissioner (Appeal), Central Excise and Service Tax,* has disallowed the credit of service tax paid on expenses incurred towards Corporate Social Responsibility (**CSR**).

The CESTAT observed that the expenditure incurred by the assessee on CSR activities was consequent to rendering its output service. If the expenditure is incurred before the service is rendered, only then can it be construed as being towards input service. It was observed that only such services qualify as '*input service*' which are used by the service provider for providing an output service. However, CSR expenses cannot be construed as an input service for providing output service. Also, CSR was not included in the '*inclusive part*' of the definition of '*input service*' under the CENVAT Credit Rules, 2004. Accordingly, credit of service tax paid on CSR activities was denied.

CSR, being a legal responsibility, is undertaken by various companies. However, in light of this decision, credit of service tax paid on activities undertaken as part of the CSR initiative will not be available to companies. It will be interesting to see how this issue is judicially interpreted under the Goods and Services Tax (**GST**) regime as credit on input tax is available under GST when the input and input services are used or intended to be used in the course or furtherance of business.

3.2 CESTAT allows refund of service tax rejected previously on the ground of assessee being an intermediary

The CESTAT, Mumbai, in *M/s Anglo Eastern Maritime Services Pvt. Ltd. v Commissioner of CGST,* has allowed the refund of Central Value Added Tax (**CENVAT**) credit which was rejected on the ground that the exporter of service was an intermediary.

The assessee was providing ship management services involving crew management to its foreign associate company. Deeming this as export of service, the assessee had filed for refund of accumulated CENVAT credit which was rejected by the tax department on the ground that the assessee was an intermediary and therefore, under the relevant rules, the place of provision of service would be treated as India.

Analysing the definition of intermediary under the relevant rules and the agreement between the parties, the CESTAT observed that the assessee's role was restricted to providing crew management services on principal-to-principal basis. Further, from the terms of the agreement it could be clearly concluded that there was no agency between the parties.

The CESTAT accordingly held that the assessee was not an intermediary since it only provided trained manpower to overseas customer who, in turn, recruited them and engaged them in ships owned by others through a separate agreement.

Given that the concept of intermediary under GST is similar to the one under service tax and in the past, the tax department has interpreted the definition of intermediary very broadly, this judgement will help resolve the controversy where the arrangement between the parties is on principal-to-principal basis and does not involve agency.

4 Goods and Services Tax

4.1 Recommendations made by the GST Council in its 47th Meeting

The GST Council (**Council**), in its 47th meeting held on 28-29 June 2022, has made several recommendations in relation to the applicable rates on the supply of goods and services and also in relation to GST Laws and procedure. Some of the significant recommendations made by the Council are:

a. ***Waiver of mandatory registration of supplier supplying through e-commerce operations:*** The Council has given an in-principal approval for waiver of the requirement of mandatory registration of suppliers making supply of goods through E-Commerce Operators (**ECOs**). This relaxation will be subject to the following two conditions:

   i. the aggregate turnover of the supplier on all India basis does not exceed the amount specified under section 22(1) of the Central Goods and Services Tax Act, 2017 (**CGST Act**) and notifications issued thereunder. (While the threshold turnover is INR 20 lacs under section 22(1), there are a few exceptions listed in the provisos to the section.)

ii. the supplier is not making any inter-State taxable supply.

With certain supplies made through ECOs already made taxable at the hand of such ECOs, this waiver would incentivise micro/small scale suppliers which lack the necessary understanding and infrastructure for GST compliance to provide their goods through ECOs. However, clarity will be required with respect to inter-State supplies made by such small-scale suppliers. The Council has also recommended that composition taxpayers be allowed to make intra-State supply through ECOs on the same lines. Composition Scheme allows small taxpayers to pay GST at a fixed rate of turnover.

b. ***Revised formula for calculating refund of unutilised Input Tax Credit:*** The Council has recommended that the formula for calculation of refund of unutilised Input Tax Credit (**ITC**) on account of inverted duty structure provided under Rule 89 of the Central Goods and Service Tax Rules, 2017 (**CGST Rules**) be amended. Inverted duty structure refers to accumulation of ITC where the rate of tax on inputs is higher than the rate of applicable tax on the outward supply. Accordingly, necessary amendments have also been made to Rule 89 of CGST Rules.

The formula in its earlier form made a presumption that the output tax payable on supplies was entirely discharged from the ITC accumulated on account of input goods and there was no utilisation of the ITC on input services. This anomaly was acknowledged by the Supreme Court in its judgement in *VKC Footsteps.* The Court had accordingly urged the GST Council to reconsider the formula and take a policy decision regarding the same.

The Council, therefore, suggested that the formula be revised to take into account the utilisation of ITC in respect of input goods and input services for payment of output tax on inverted rated supplies in the same ratio in which ITC has been availed on input goods and input services during the said tax period. This suggestion has also now been implemented by suitable notification amending the CGST Rules.

Such a change in Rule 89 would help in reducing the accumulation of ITC availed on input services in cases of inverted duty structure.

c. ***Recrediting of erroneously refunded amounts:*** In cases where taxpayers are erroneously granted refund on account of:

i. accumulated ITC, or

ii. integrated GST (**IGST**) paid on zero rated supply of goods or services (in contravention of Rule 96(10)),

the Council recommended that if such taxpayer deposits the entire amount of such erroneous refund (along with applicable interest and penalty), the electronic credit ledger of the taxpayer would be re-credited by an amount equal to such erroneous refund. A new Form GST PMT-03A will be introduced for this purpose. This suggestion has been given effect by way of appropriate amendment to the CGST Rules.

This provides a formal process to the taxpayers for getting re-credit of the amount erroneously refunded and bringing the money back into the system, which was earlier absent. While the recommendation to impose interest on the sanctioned refund appears reasonable, the requirement of payment of penalty may not be equitable in all cases.

d. ***Extension of exemption on IGST on import of goods under various schemes:*** The Council has recommended that the present exemption of IGST on import of goods under Advance Authorisation/Export Promotion Capital Goods/Export Oriented Units scheme be continued. Further, it has also been recommended that the CGST Rules be amended to provide that there is no requirement of

reversal of ITC for the exempted supply of Duty Credit Scrips by the exporters. Relevant customs notifications have also been issued in this respect.

These recommendations and subsequent notifications are likely to continue to incentivise taxpayers to export goods and services from India by way of eliminating issues of cash flow caused by the imposition of IGST on imports made under the aforementioned schemes.

e. ***Clarification on calculation of limitation period for filing claims for refund:*** The Council has recommended that the time period from 1 March 2020 to 28 February 2022 is to be excluded from calculation of the limitation period for filing refund claim by an applicant under sections 54 and 55 of the CGST Act. Similar exclusion has also been recommended for issuance of demand/order in respect of erroneous refunds under section 73 of the CGST Act. The recommendation has also been implemented by way of issuance of a notification.

These recommendations and subsequent notification have been made in line with the decision of the Supreme Court whereby, taking *suo moto* cognisance, the Court had directed the extension of the period of limitation in all proceedings before the courts and tribunals. This amendment should clarify the position and would regularise the belated refund claims filed by taxpayers due to prevalence of the Covid-19 pandemic.

f. ***Extension of time limitation for issuance of order under section 73 of the CGST Act for FY 2017-18:*** The Council has recommended that limitation period for issuance of order in respect of demands under section 73 of the CGST Act for the Financial Year (**FY**) 2017-18 be extended till 30 September 2023. Notification implementing the above suggestion has also been issued.

As the normal period of limitation, which is to be computed from the date of filing of annual return for FY 2017-18, was nearing its expiry, this extension of time would provide an additional buffer period to the tax department to issue notices to taxpayers.

g. ***IGST Exemption on import of defence items for Defence forces*****:** The Council has also proposed an exemption from payment of IGST on the import of specified defence items by private entities/vendors when the end-users of such items are the Defence forces. Suitable notification has also been issued in this regard.

While exemption for import of defence related equipment/items by the Ministry of Defence or the Defence forces, or the Defence Public Sector Units or other Public Sector Units, for use by the Defence forces already exists, such an exemption has now also been extended to private entities/vendors to strengthen the defence resources available and minimise the tax costs related to procurement.

h. ***Clarification on concessional GST rate for Electric Vehicles*****:** The Council has recommended that a clarification be issued on concessional GST rate of 5% on electric vehicles (**EVs**). It recommends that EVs, whether or not fitted with a battery pack, are eligible for the concessional GST rate of 5%. Presently, there was confusion regarding the treatment of EVs since such EVs were taxable at 5% while their Lithium-ion batteries were chargeable at 18%.

Such a clarification would clear the position regarding the applicable rate of GST for taxpayers engaged in the supply of EVs even when supplied without battery packs.

i. ***Clarification on the taxability of renting of motor vehicles for transport of passengers to a body corporate for a specific time period under reverse charge mechanism*****:** A clarification providing that renting of motor vehicles for transport of passengers to a body corporate for a specific time period is

taxable in the hands of the body corporate under reverse charge mechanism has also been recommended by the Council.

j. ***Recommendation to give Goods Transport Agencies the option to pay GST at 5% under forward charge:*** It has further been recommended that Goods Transport Agencies (**GTAs**) be given an option to pay GST at 5% (without ITC) or 12% (with ITC) under forward charge. The GTAs opting to avail such an option would have to intimate the same to the concerned departmental authority at the beginning of the financial year. Relevant notification in this respect has also been issued.

   Earlier, the GTAs who opted to pay GST under the forward charge mechanism did not have the option to pay GST at the rate of 5% (without ITC) and had to pay GST at the rate of 12% (with ITC) on all their consignments. While in cases where the GTAs opted to not pay GST under forward charge, the registered service recipients were liable to pay GST at the rate of 5% under reverse charge. Further, in the latter scenario, the GTAs were not allowed to avail ITC of the GST charged on goods and services used by them in supplying the GTA service.

   With this amendment, GTAs will now be able to pay GST either at 5% (without ITC) or 12% (with ITC) on their consignments under forward charge. Further, the option of not paying GST under forward charge will continue to remain available to the GTAs, in which case GST on GTA services will continue to be chargeable in the hands of the service recipient under reverse charge mechanism.

k. ***Rationalisation of rates to remove inverted duty structure:*** In addition to the above, the GST Council has also recommended changes in the applicable rates of GST for supplies of various goods and services as follows:

   i. The applicable rates in respect of supply of various goods and services have been proposed to be increased in order to remove the existing distortions on account of the inverted duty structure. These goods include ink, cutlery, pumps for handling water, machinery used in milling industry, milk and dairy machinery, lights and fixtures, solar water heater, leather, etc.

   ii. The applicable rates in respect of services such as job work in relation to manufacture of leather items and processing of leather, works contract supplied to the government and governmental institutions for various purposes, works contract for roads, bridges, railways, metro, etc., have also been proposed to be increased.

l. ***Denial of refund of accumulated ITC on edible oils and coal:*** The Council has recommended that the refund of accumulated ITC not be allowed on edible oils and coal in order to remove the existing distortions on account of the inverted duty structure.