UPDATES

Monthly Tax Updates

November 2022

Partner: *Himanshu Sinha,* ***Counsels****: Aditi Goyal and Shashank Shekhar,* ***Senior Associates****: Bhuwan Dhoopar and Tushar Joshi,* ***Associates****: Ekansh Saigal and Samyak Jain*

This update covers:

This update covers key judicial developments in the month of November 2022 relating to direct tax, central excise, goods and services tax and value added tax.

1 Direct Tax

1.1 Supreme Court holds employer to be in default for failure to withhold taxes on leave travel concession paid to employees for circuitous journeys involving foreign travel

On 4 November 2022, the Supreme Court in the case of *State Bank of India v ACIT* rejected the assessee-employer's plea that it had made a '*bonafide mistake*' in not withholding income tax on the leave travel concession (**LTC**) paid to its employees for circuitous journeys that involved travel to foreign countries as well.

Under the provisions of (Indian) Income Tax Act, 1961 (**ITA**), LTC received by an employee is tax exempt up to certain prescribed limits, so long as it is availed for travel to any place within India. During the year under consideration, employees of the assessee had raised several claims of travel expenses. While the expenses pertained to journeys within India, certain employees had also travelled to foreign countries before arriving at their ultimate destination in India (for example, Delhi-Madurai-Colombo-Singapore-Colombo-Delhi).

The tax authorities held that such circuitous journeys would not qualify for an LTC exemption since the employees had travelled to foreign destinations. LTC is only tax exempt in case of travel within India.

Accordingly, the tax authorities passed orders holding the assessee-employer liable for its failure to withhold tax on the LTC paid to the individuals concerned.

On the other hand, the assessee-employer contended that the ITA does not specifically bar foreign travel so long as the journey begins and ends in India, and the employees are only reimbursed for the shortest route of travel between two places in India.

On reference, the Supreme Court upheld the orders of the High Court of Delhi as well as the Income Tax Appellate Tribunal (**ITAT**) and ruled in favour of the tax authorities. The Supreme Court held that LTC must be availed by an employee within the limitations prescribed under the ITA to qualify as 'exempt income'. The limitations prescribed are two-fold:

a. LTC must be paid for domestic travel only; and

b. the amount reimbursed must be for the shortest route of travel between two points in India.

The Supreme Court remarked that the assessee-employer could not claim ignorance of the travel plans of its employees as all the relevant facts had been presented to it during the settlement of the LTC bills. In its ruling, the Court rejected the plea of '*bonafide mistake*' advanced by the assessee-employer since it was in possession of all facts to correctly compute the estimated income of its employees for the purposes of tax withholding and had failed to observe "*the elephant in the room"*.

This ruling affirms the settled principle that to qualify as exempt income, LTC must be claimed for domestic travel. Further, an employer is duty-bound to arrive at a good faith estimate of its employees' taxable salary income for the purposes of tax withholding, based on all the information available with it.

1.2 Bangalore ITAT rejects invocation of 'colourable device' argument on sale of shares taxed in trust's hands

On 11 November 2022, the Bangalore bench of the ITAT in the case of *M/s United Breweries Limited v DCIT* rejected additions made by the tax authorities in the hands of the assessee company for capital gains income earned by a trust in which the assessee company was both the settlor and beneficiary.

In the present case, the High Court of Madras sanctioned a composite scheme of amalgamation and allowed the amalgamation of certain group companies with the assessee company, which was the ultimate transferee under the scheme. The assessee company directly/indirectly held shares in all the transferor companies and was therefore required to issue shares to itself (as the shareholder of the transferor companies) pursuant to the scheme of amalgamation. Since a company cannot hold its own shares, the only option available to the assessee company was to either cancel such shares after allotment, or to parcel the shares to another group entity. Since the cancellation of the shares would have eroded its capital base, the assessee company chose to allot shares to a trust that was set up pursuant to the restructuring. The objective of the formation of the trust was to hold shares for the benefit of the assessee company. On the disposal of the shares, the sale proceeds were to be remitted to the assessee company. Thereafter, the trust was to stand discharged and terminated in accordance with provisions of the trust deed. Therefore, the assessee company was both the settlor as well as the beneficiary of the trust.

In the subject year, the trust sold all the shares held by it in the open market and remitted the net sale proceeds to the assessee company. The trust disclosed the resulting capital gains income in its tax return. Such income was claimed to be tax-exempt, since at the relevant time, long term capital gains income arising from the sale of equity shares was not taxable, so long as the applicable securities transaction tax had been paid.

Since the trust had declared the capital gains income in its tax return, the assessee company did not offer to tax the proceeds received from the trust. Under the scheme of the ITA, income (other than business income) of a specific trust is chargeable to tax in the same manner and to the same extent as it would be taxed in the hands of the beneficiary. Although the computation of tax is in respect of each beneficiary, the tax is collected from the trust. Once the tax has been recovered from the trust, the same income cannot be taxed in the hands of the beneficiary.

In this case, the tax authorities added the capital gains income to the taxable income of the assessee company despite the fact that the trust had already offered the income to tax in its return of income (although such income had been claimed to be tax exempt). The tax authorities also alleged that the trust had been set up as a colourable device to avoid payment of tax on the capital gains income.

In its ruling, the ITAT held that the capital gains income from the transfer of shares had been offered to tax in the hands of the trust. By including such income in the assessee company's taxable income, the tax authorities had sought to tax the same income twice, which is impermissible. Since the arrangement had been effected pursuant to a scheme of amalgamation approved by the jurisdictional High Court, it could not be held to be a colourable device. More importantly, there would not be any taxable capital gains under both alternatives (i.e., cancellation of shares or settling the shares under the trust). Therefore, there was no question of holding that the arrangement was a colourable mechanism.

This ruling is welcome and affirms the settled principle that there can be no double taxation – i.e., the same income cannot be taxed twice. Once the income has been offered to tax in the hands of trust, the distribution thereof cannot be taxed in the hands of beneficiary.

2 Central Excise

2.1 Supreme Court holds that the price ordinarily charged from unrelated parties can be applied to related party purchases to calculate assessable value

The Supreme Court in *Commissioner of Central Excise & Service Tax, Rohtak v Merino Panel Product Ltd.* held that while determining the assessable value for goods sold partly to related parties and partly to unrelated parties, the price charged to unrelated parties should be considered the assessable value for the sales made to related parties as well.

The assessee in this case was engaged in the manufacture of decorative laminates and other like materials which were sold by it to unrelated as well as related parties. The allegation of the tax department was that goods sold to related parties were undervalued as against those sold to unrelated parties which resulted in a shortfall in the collection of excise duty.

Section 4(1)(a) of the Central Excise Act, 1944 (**Excise Act**) provides that excise duty is chargeable on the transaction value when goods are sold to unrelated parties and where price is the sole consideration.

Section 4(1)(a) of the Excise Act further provides that in other cases, the value on which excise duty is chargeable shall be value determined in accordance with the Central Excise Valuation (Determination of Price of Excisable Goods) Rules, 2000 (**CEVR**). Rule 11 of the CEVR is the residuary rule which provides that if the value of any excisable goods cannot be determined under any other Rule of the CEVR, the value shall be determined using reasonable means consistent with the principles and general provisions of CEVR and Section 4(1) of the Excise Act.

The Central Board of Excise and Customs (**CBEC**) had issued a circular dated 1 July 2002 which provided that there is no specific rule of valuation for a situation where goods are sold partly to unrelated parties and partly to related parties. It was further clarified that the transaction value in respect of sales to unrelated parties cannot be adopted for sales to related parties since as per Section 4(1) of the Excise Act, the transaction value is to be determined for each case of removal from the factory. It was also clarified that recourse would have to be made to Rule 11 of the CEVR to determine the taxable value in respect of the sales made to related parties.

In this regard, the Supreme Court relied upon its decision in the case of *SACI Allied Products Ltd., U.P. v Commissioner of Central Excise, Meerut,* in which it had ruled that the amount charged from independent buyers can form the benchmark to calculate the appropriate assessable value of the goods sold to the related parties. Following the ratio of *SACI Allied Products,* the Supreme Court held that the presumption under Section 4(1)(a) of the Excise Act is that the sale price charged to an independent party by an assessee is the proper valuation to be used for determining excise duty. It was further held that in case of sales made to related as well as unrelated parties, Rule 11 of the CEVR obliges the tax officials to use *'reasonable means'* consistent with the principles under Section 4(1) of the Excise Act to arrive at the appropriate value.

The Court accordingly held that the price charged from independent parties for the sale of excisable goods can be used as a benchmark for determination of excise duty for transactions with related parties as well, when such a price is readily available. The Supreme Court further held that circular dated 1 July 2002 is not contrary to any statutory provisions pertaining to the valuation of goods for the purpose of charging excise duty.

Further, since the tax officials themselves appeared to be unclear on the correct method of valuation of the goods, the Court held that it will not be appropriate to levy interest and penalty upon the assessee.

This decision of the Supreme Court has crystallised the law regarding the valuation of sales made to related as well as unrelated parties simultaneously.

3 Goods and Services Tax

3.1 Jharkhand High Court holds that proceedings initiated under the Goods and Services Tax laws for alleged contravention of erstwhile laws is without jurisdiction

The Jharkhand High Court in *Usha Martin Limited v Additional Commissioner, Central GST and Excise, Jamshedpur* held that the authorities empowered under the Goods and Services Tax (**GST**) laws do not have the jurisdiction to determine the admissibility of the Central Value Added Tax (**CENVAT**) credit transitioned by an assessee to the GST regime.

The petitioner in this case was engaged in the business of manufacturing iron and steel products. Upon introduction of GST, the petitioner registered under the Central Goods and Services Tax Act, 2017 (**CGST Act**) and carried forward the CENVAT credit availed by it in the erstwhile regime into the GST Regime, by filing GST TRAN-1.

The respondent, an authority constituted and empowered under the CGST Act, issued a show cause notice (**SCN**) to the petitioner alleging that the petitioner was not entitled to avail the CENVAT credit transitioned by it as the availment of the said CENVAT credit was in contravention of the Excise Act, and Finance Act, 1994 (**Finance Act**) read with Cenvat Credit Rules, 2004 (**CCR**).

Aggrieved by the SCN, the petitioner filed a writ petition before the Jharkhand High Court solely on the question of legality and jurisdiction of the respondent to initiate a proceeding under Section 73(1) of the CGST Act for transition of CENVAT Credit, which was allegedly inadmissible under the Excise Act and Finance Act read with CCR.

In this regard, the Court analysed Section 73 of the CGST Act and held that under the said Section, a proceeding can be initiated for:

a. non-payment of any tax; or

b. short payment of such tax; or

c. erroneous refund of such tax; or

d. wrongly availing or utilising the Input Tax Credit (**ITC**) available under the CGST Act.

The High Court further held that Section 73 does not deal with CENVAT credit.

Thereafter, the Jharkhand High Court examined whether a registered person could transition inadmissible CENVAT credit from the erstwhile regime to the GST regime under Section 140 of the CGST Act without any check or proceeding against him. In relation to this question, the Court analysed Section 174 of the CGST Act (which provides for the repeal and saving of erstwhile statutes pertaining to the taxes which have been subsumed by GST laws) and held that the repeal and saving clause (e) under Section 174(1) of the CGST Act allowed legal proceedings to be instituted under the erstwhile laws in respect of transactions effected in the past in accordance with the provisions of the applicable law in effect at that time.

The Court held that the duty of the constitutional courts is to interpret the law and to ensure that there is certainty about the law not only in the minds of the law enforcement agencies but also for the common person. If proceedings for transition of CENVAT credit that is alleged to be inadmissible are permitted to be carried under the CGST Act as well as the erstwhile laws, it may lead to uncertainty not only in the minds of the ordinary citizen but also in the minds of the tax authorities. In view of the same, the High Court held that demand proceedings pertaining to erstwhile laws cannot be initiated under the CGST Act.

This decision of the Jharkhand High Court is a step in the right direction. It provides clarity of jurisdiction in cases where proceedings have been initiated for contraventions under erstwhile laws that have been repealed by the CGST Act.

4 Value Added Tax

4.1 Andhra Pradesh High Court holds that the extension of the period of limitation granted by the Supreme Court due to the pandemic applies to orders passed by statutory authorities

The Andhra Pradesh High Court, in *Prabhu Chaitanya Enterprises v Commercial Tax Officer,* has held that the benefit of extension of the period of limitation granted by the Supreme Court through a *suo moto* writ petition (following the disruption due to the Covid-19 pandemic) is available to statutory authorities as well for passing orders similar to the extension granted to assessees for filing their petitions, applications, suits, appeals, etc. The Supreme Court had extended the period of limitation in all proceedings before the courts and tribunals by excluding the period from 15 March 2020 to 28 February 2022 for the purposes of calculating limitation period.

The petitioner, in this case, had claimed exemption under Section 5(3) of the Central Sales Tax Act, 1956 (**CST Act**) on the basis of *'H forms'* issued by the buyers. *'H Form'* is issued under the CST Act when the inter-state buyer is an exporter and buys the goods for the purpose of export. If the exporter buyer (who belong to another state) issues *'H form'*, the selling dealer is not required to charge or pay any CST on the transaction. The exemption was granted to the petitioner after verification of the documents supporting the claim in 2017.

Five years later, an order was passed by the respondent which withdrew the exemption granted to the petitioner in 2017, on the basis of a finding that *'H forms'* submitted by the petitioner in support of its claim for exemption were bogus and were not issued by competent officers under the CST Act.

Aggrieved by the said decision, the petitioner approached the High Court on the ground that the order was barred by limitation and was in violation of the principles of natural justice as no opportunity was granted to the petitioner to present its case.

On the issue of limitation, the High Court relied on an earlier decision of a division bench of the same court in the case of *V-Guard Industries Limited* where it was held that the extension of period of limitation (as directed by the Supreme Court due to the pandemic) is applicable to orders passed by statutory authorities as well.

Relying on the ratio of the *V-Guard Industries* case, the High Court observed that the State is also a litigant, and if orders could not be passed within the time prescribed due to the prevailing pandemic, they should not be barred by limitation. It was further observed that the possibility of State authorities falling sick and not able to discharge their functions due to the pandemic cannot also be ruled out. Such a situation cannot be taken advantage of by tax evaders or defaulters, more so, when the corresponding relief had been extended to assessees or their representatives during the pandemic.

In view of the above, the High Court held that the period of limitation, as extended by the Supreme Court, applies to orders to be passed by statutory authorities as well, as the State is also a litigant and thus should be able to raise disputes to protect against revenue loss due to actions of defaulters/tax evaders.

By way of this decision, the Andhra Pradesh High Court has ensured that the benefit of the extension of period of limitation available to litigants in courts is available to statutory authorities as well, while passing orders. It remains to be seen whether the same position will be adopted by other High Courts as well.