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Dear Readers,

In this edition, we have analysed the recent judgment of Supreme Court in Abhisar Buildwell Private Limited. This is a welcome judgment keeping since it highlights that completed assessment cannot be opened in absence of incriminating material during the search. There was a great confusion as to the powers of Assessing Officer under Section 153A with respect to re-opening of completed assessments especially in a situation where there was no incriminating material. The Supreme Court blessed the rationale of Delhi High Court in Kabul Chawla.

The next article is on the analysis of Bombay High Court decision in Dharmendra M Jani, wherein the High Court held that the State does not have competence to tax the services provided by intermediary. The High Court turned down the Revenue's contention that the provisions of IGST Act should be lifted and read in the context of State GST Acts. This judgment will be appealed by the Revenue, undoubtedly and we have to wait and see how the top court interprets.

We have also collated certain important judgments under direct tax and indirect tax laws, provided our comments wherever necessary.

I hope that you will have good time reading this edition and please do share your feedback.

Thanking You,

Suresh Babu S
Founder & Chairman

GST

THE TWIST TO THE INTERMEDIARY STORY - DELHI HC IN DHARMENDRA JANI

Contributed by CA Sri Harsha

The Bombay High Court in Dharmendra M Jani[1] has held that was seized with the validity of taxation of supplies of intermediary in the constitutional scheme pertaining to GST laws. The taxation of intermediary supplies has started with the advent of place of supply provisions under the service tax regime. Though there is some clarity now, as to the scope of the intermediary, the current challenge goes to the root of the issue. Till now the courts, under the earlier regime, were occupied with the dealing as to what would be the scope of 'intermediary', but never got an opportunity to deal with the validity of the levy on the said supply. The Bombay High Court under the GST regime was seized with this question. In this article, we shall deal with the challenges faced with respect to the taxation of 'intermediary' and how the High Court answered them.

The Issue:

The whole challenge before the Bombay High Court is, whether it is permissible under the constitution to charge tax on a supply which is essentially an export service, but by a deeming fiction made it is a domestic supply? Before discussing the outcome of the verdict, it would be appropriate to understand the core issue.

From the facts narrated before the High Court, one of the petitioners is engaged in providing marketing and promotion services to its customers located outside India. The overseas customers to whom services are provided by the petitioner are inter alia engaged in manufacturing and sale of goods. The petitioner provides services only to its foreign principal and receives consideration in convertible foreign exchange. The services provided by petitioner fructifies, if an Indian purchaser (importer) directly places a purchase order on such overseas customer of petitioner, for supply of goods. Such transaction is enabled as a result of the service so provided by the petitioner to his foreign principal. The goods are directly shipped by the foreign supplier to the Indian purchaser. On arrival of goods in India, they are cleared by the Indian purchaser directly from the port. The Indian purchaser makes payment to foreign supplier. On receipt of such payment from the Indian purchaser, the petitioner would be entitled for commission.

Section 13(8)(b) of IGST Act[2] states that the place of supply of an intermediary services as the location of supplier. Since, in the instant case, the location of supplier is in India, the services of intermediary does not qualify as 'export of services' and accordingly becomes taxable, though essentially all the other conditions for 'export of services' stands satisfied. This artificial/deeming place of supply of intermediary services is challenged before the High Court.

[1] 2023 (5) Centax 201 (Bom)/[2023] 149 taxmann.com 317 (Bom)
[2] Integrated Goods and Services Tax Act, 2017

Summary of Arguments by Petitioner& Revenue:

Issue	Stand of Petitioner	Stand of Revenue
Export of Service	• The main contention of the petitioner that, the services provided by them are essentially 'export of services'. They satisfy all the conditions mentioned therein and stands qualified to be called as 'zero rated supplies'. • However, the legislature in arbitrary and discretionary manner, introduced the deeming place of supply for the intermediary services as the location of intermediary. • It was argued that the general rule for determination of place of supply is the location of recipient of services. However, this general rule was violated with respect to the intermediary supplies. • A deeming fiction is created in the nature of Section 13(8)(b), whereby the place of supply is stated to be the location of Intermediary, thus making it taxable. • Accordingly, it was argued that the levy of tax on export of services is in ultra vires Article 246A read with Article 269A and 286 of Constitution of India. • It was argued that Article 286(1) states that no state can impose or authorise imposition of tax on supply of goods or services, where supply takes place in course of export of goods or services or both. Hence, in any case, the state cannot levy tax on supplies which are in the course of export. Since, intermediary is ideally an export of service, the state cannot be authorised	• Revenue argued that the value addition of service provided by an intermediary is at the place where the intermediary is located. • Taxing such services as provided by Indian service providers to foreign companies, incentivises the foreign companies to start manufacturing in India to offset the liability against the tax on goods cleared domestically or get refund of taxes on goods exported from India and hence taxing such services in India is in consonance with 'Make in India' programme. • Sinceplace of supply of intermediary is in India and not outside India, said supply does not satisfy conditions mentioned for 'export of service' and thereby does not become export and the same cannot be a reason to say that it has violated Article 269A. • Revenue argued that essentially all services provided by intermediary involve soliciting purchase orders, promotion and marketing. All such services are provided in India though the recipient is outside India. Hence, they cannot be called as export of services. • The challenge of the petitioner is premised on the plea that the petitioner is being taxed for a services rendered outside India which is unconstitutional. The Revenue argued that such an action is permissible in light of Article 245(2) of Constitution, which provides that no law made by

	to tax the same as a local supply. This would be in violation of Article 286(1). • It was further argued that, though Article 286(2) has given the power to parliament to formulate the place of supply dealing with export of goods or services, they do not vest such wide power to nullify, what is stated in Article 286(1). • Petitioner argued that the import and export haven been treated as 'inter-state' supplies in terms of Section 7 of IGST Act. However, Section 13(8)(b) deems intermediary, which is ideally an export (inter-state) as 'intra-state' and hence in violation of charging section of IGST Act, Section 5 which levies tax only on inter-state supplies.	Parliament shall be deemed to be invalid on ground that it would have an extra-territorial operation. • Revenue argued that the Court's approach in determining the constitutional validity of statutory provision is, as to see whether there exists a legislative power and once such power is found to be present, then the next step would be to ascertain whether the enacted provisions impinges upon any rights enshrined in Part III of Constitution. • Revenue stated that the Constitutional provisions clearly mandate that the powers are vested with Parliament to frame laws relating to GST which are wide and untrammelled. The Parliament is also empowered to formulate the principles for determining the place of supply. • Article 269A(5) authorises Parliament to frame the law in respect of two aspects, firstly, to formulate the principles for determining the place of supply and secondly, when the supply of goods or services or both takes place in the course of inter-state trade or commerce. • Accordingly, Article 269A(5) empowers the Parliament by authorising it to make law on what is inter-state supply as also to determine what is not an inter-state supply i.e., intra-state supply. Hence, there cannot be said that there exists no power to Parliament to determine or formulate as to what amounts to inter-state and intra-state supplies.

Violation of Destination Based Principle	• The petitioner argued that Section 13(8)(b) cannot be understood and applied dehors the fundamental principles underlying the goods and service tax, namely the destination based taxation. • Petitioners argued that the services of intermediary are consumed by the foreign supplier and taxing them in India artificially violates the destination based taxation on which the whole GST laws rest. This is an apparent violation of the judgment of Supreme Court in All India Federation of Tax Practitioners [3].	• Revenue argued that intermediary is a distinct category of service provider and is treated as such by law, since the case of intermediary services there would be two contracts/transactions involved. • First contract is between intermediary and his foreign principal and secondly, a contract between the principal and his purchaser. In the present case, the question is not the second transaction but the first transaction which is a transaction of rendering services in India by intermediary. • The reason for distinct treatment for an intermediary is that the intermediary is acting between two persons the main service provider and service recipient. The intermediary provides services to both persons, though he may have a contractual agreement with only one or both of them. Hence, Revenue argued that it may not feasible to prescribe one person as recipient of intermediary services, so as to apply a general rule.
Double/Triple Taxation	• Petitioner argued that any provision which leads to double taxation needs to be struck down and the taxation of intermediary fails on this count too. • Petitioner argued that the intermediary services by virtue of Section 13(8)(b) is taxable in India. The same service is taxable in foreign country in the hands of foreign supplier under reverse charge, thereby becoming expense in the hands of foreign supplier. The said expense would be included in the cost of goods sold to Indian buyers and thus, the same would be again imported into India. Hence, this is a case of double and triple taxation.	• Revenue countered that there is no double taxation as narrated by the Petitioner. • Revenue argued that there are two distinctly identifiable supplies involved; firstly a supply of goods by foreign supplier to Indian importer and secondly, supply of services by intermediary to foreign supplier. • The above two supplies are distinct and charged to tax under the respective statutes namely for import the Customs Act and for the commission, IGST Act.

[3] 2007 (7) STR 625

		• It was also submitted that the argument that tax paid by foreign supplier on intermediary services gets loaded into the cost of machinery on which the Indian importer pays customs duty and IGST (at the time of import) and hence there is a double taxation is neutralised by allowing the importer the credit of taxes paid (to extent of IGST). • Hence, it was argued that there is no double taxation as canvassed by petitioners.

Analysis by High Court:

The Court after hearing the arguments of both the parties framed the question as to, whether Section 13(8)(b) is ultra vires of Constitution and provisions of IGST Act? The Court then proceeded to examine the Constitutional Scheme qua the GST laws.

The Court after setting out for the examination of Article 246A, Article 269A and Article 286 has summarised its observations in Para 58 of the judgment. The Court stated that by virtue of Article 286(1)(b), the State does not have any power to tax a transaction which is in course of inter-state trade or commerce. The Court recognised that the power to formulate the principles for determining the place of supply and when supply of goods or services or both takes place in the course of inter-state trade or commerce is given to Parliament vide Article 269A(5) read with Article 286(1).

The Court then proceeded to examine the contentions of Petitioner as to whether factually the transaction carried on by petitioner is an export of service or inter-state supply or intra-state supply?

The Court held that the contention of the petitioners that as the recipient of their services, being a foreign party, the trade in question undertaken by the petitioners would neither amount to 'inter-state' or 'intra-state', since they are in the nature of export of service is found to be reasonable. The Court held that it is only by virtue of Section 7(5)(a) of IGST Act, the transaction of petitioners, that is location of supplier is in India and the place of supply being outside India, is deemed to be inter-state supply but not on actual and factual grounds. The Court accordingly concluded that since the services provided by petitioners are in fact export of services as the recipient of service is the foreign principal, the destination/consumption of services takes place in the foreign land and completely satisfies the test of export of services as laid down in Section 2(6) of IGST Act and also there is no contra indication that 'factually' it can be regarded as either inter-state or intra-state.

The Court then proceeded to examine, the next contention of the petitioner that, as to whether by virtue of Section 13(8)(b), the state legislature is competent enough to tax a transaction which is otherwise an export? The Court stated that as discussed above, by virtue of Section 7(5)(a), the export of service done by petitioners is treated as inter-state supply. But, how is the State Legislature empowered to levy tax on such inter-state supplies, since, the taxing rights qua State Legislature is restricted only to intra-state supplies.

The Court stated that the petitioners argued that once by virtue of Section 13(8)(b), the place of supply of intermediary is stated to be location of supplier, then in light of Section 8(2) read with Section 12, the supply shall become intra-state supply. Once it becomes an intra-state supply, then by virtue of definition in Section 2(65) of CGST Act[4] dealing with 'intra-state supply', by legal effect incorporates the entire Section 8 and Section 12 of IGST Act into the CGST Act, thereby allowing the State Legislatures to levy tax on such supplies made by petitioners. In essence, the petitioner contended that transaction of export of service by virtue of legal fictions is converted first to inter-state supply and then to intra-state supply, so that State Legislature were given power to tax the same is against the Article 246A, Article 269A and Article 286.

The Court founded stated that there exists polarity which is brought about insofar as taxing export of services provided by intermediaries, as a consequence of an interplay of enactments namely IGST Act and then CGST Act and MGST Act [5]. The Court also stated that export of services for a commission to be received by petitioners fructify only after the goods are supplied by foreign supplier to Indian importers.

Thus, applying the destination principle, the amount by way of commission, to be paid to the petitioners are already subsumed in the transaction which the foreign principal may have with its customer on which the Indian importer is already being taxed and once such supply has already been taxed at the hands of Indian importer, it does not fit into any acceptable parameters that export of services between the intermediaries and foreign principal which is an independent transaction, by any analogy, can be remotely considered to be a part of transaction between the foreign supplier and the Indian importer, in light of destination based principle on which GST law is founded. Accordingly, the Court concluded that such a theory as canvassed by Revenue that the intermediary service has to be seen not only with respect to foreign supplier but also Indian importer would not only lead to double taxation but also to an implausible and illogical effect, in recognising two independent transactions to be one transaction for purposes of CGST and MGST Act. The Court stated that if the contention of Revenue is accepted then the definition of 'export of service' and Section 16 of IGST Act would be nullified and rendered meaningless.

The Court also stated that there is another apparent dichotomy, because on one hand, the transaction provided by intermediary is stated to be inter-state by virtue of Section 7(5)(a) of IGST and on the other hand, by virtue of Section 13(8)(b), the place of supply of intermediary is stated to be location of supplier and thereby an intra-state supply. Hence, the Court proceeded to apply the concept of validation-oriented approach to decide the fate of Section 13(8)(b).

[4]Central Goods and Services Tax Act, 2017

[5]Maharashtra Goods and Services Tax Act, 2017

The Court stated that the provisions of IGST Act should only be used for determining the taxation of inter-state supplies but in anyway cannot be used to extend to the CGST Act and MGST Act. The Court stated that it is difficult to conceive as to why the IGST Act would take within its ambit any intra-state supply, when the IGST Act itself is a legislation, which concerns GST to be levied on inter-state trade and not on intra-state. The Court stated that the fiction which is created by Section 13(8)(b) would be required to be confined only to provisions of IGST Act, as there is no scope for the fiction travelling beyond the provisions of IGST Act to the CGST Act and MGST Act, as neither Constitution would permit taxing of an export of service under said enactments nor these legislations would accept taxing such transactions. Accordingly, the Court held that the provisions of Section 13(8)(b) should be confined only to IGST Act and cannot travel to CGST Act and MGST Act.

Remarks:

From a detailed perusal of the judgment, it would be evident that the judgment proceeded ignoring the deeming fiction created for the intermediary services. A service can be called as export of service only when it satisfies all the conditions mentioned in Section 2(6) of IGST Act. One of the condition is that the place of supply shall be outside India. If the place of supply is not outside India, then it cannot be called as export of service. The determination of place of supply is guided by Section 12 and Section 13. Section 13 deals with a situation, where the location of supplier or location of recipient is outside India. In the context of intermediary, since the location of recipient is outside India, the determination of place of supply should be done in accordance with Section 13. Once you enter the provisions of Section 13, Section 13(8)(b) states that the place of supply of intermediary is deemed to be location of supplier.

Once such deeming fiction is created and thereby the place of supply is deemed to be location of supplier, it is not clear as to how the Court proceeded to treat the said service as 'export of service' based only on the reasoning that the recipient is outside India. It is settled law that the deeming fiction has to be interpreted to reach a logical conclusion. If that is done, then the place of supply for intermediary service is not outside India and cannot be called as 'export of service'. Once it is not called as 'export of service', then it cannot be a zero rated supply and subjected to tax in India. Without analysing this aspect, it appears that the Court has proceeded with an assumption that intermediary services is an export of service and thereby struck down the levy of CGST and MGST, stating that the State Legislatures are not empowered to tax such export of services. In my view, there would be another round of litigation before the Supreme Court, wherein this judgment would be subjected to a detailed scrutiny and the outcome would be significantly different from the current judgment.

This article is contributed by CA Sri Harsha. The author can be reached at harsha@sbsandco.com

DIRECT TAX

EFFECT OF INCRIMINATING MATERIAL ON FATE OF COMPLETED ASSESSMENTS - SUPREME COURT IN ABHISAR BUILDWELL PRIVATE LIMITED

Contributed by CA Sri Harsha & CA Narendra

Effect of Incriminating Material on Fate of Completed Assessments - Supreme Court in Abhisar Buildwell Private Limited[1]

The Honorable Supreme Court in Abhisar Buildwell Private Limited has set to rest the long-drawn controversy on the fate of assessment of completed/unabated assessments, where no incriminating material was found during the course of a search under Section 132 or requisition under Section 132A of IT Act[2] .

Issue before the Supreme Court:

Section 153A of the IT Act states that once the search is initiated under section 132 or requisition is made under section 132A, the AO shall assess or reassess the total income of 6 years immediately preceding the year of search/requisition. Further, second proviso to section 153A states that assessment or reassessment, if any, relating to above mentioned period pending as on the date of initiation of the search/requisition shall abate.

The crux of the matter before the two-judge bench of the Supreme Court was, whether the interpretation canvassed by Revenue that the AO[3] gets power to assess the 'total income' of an assessment year for which assessment is already completed (as on the date of search) even in absence of availability of incriminating material during the course of search?

Which means that, whether AO can assess or reassess the total income of any of the year covered above, for which the assessment is already completed under section 143(3), in the absence of incriminating material for the respective year. The same was countered by the assessee that the completed assessments cannot be assessed in guise of power under Section 153A.

Decision of the High Court:

The lead judgment in favor of assessee was the Delhi High Court in Kabul Chawla [4]and Gujarat High Court in Saumya Constructions [5]. The only judgment that was in favor of revenue is by Allahabad High Court in Mehndipur Balaji[6] .

The Hon'ble Delhi High Court in the case of Kabul Chawla (supra) has held that though section 153A does not state addition should be made strictly based on evidence found during the search or other information available with the AO, it does not mean that assessment can be arbitrarily made without any relevance to the seized material. As far the pending assessments (which are abated consequent to

[1]2023 (4) TMI 1056 – Supreme Court
[2]Income Tax Act, 1961
[3]Assessing Officer
[4][2016] 380 ITR 573 (Del)
[5]2016 (7) TMI 911
[6](2022) 447 ITR 517

search), the High Court has held that the jurisdiction to make the original assessment and the assessment under section 153A merges into one and the one assessment shall be made for such abated assessments. On the hand, in respect of completed assessment, the High Court has held that the AO can invoke provisions of section 153A only when incriminating material is unearthed during the course of search/requisition. The above view has been accepted by various judicial fora.

However, the Hon'ble Ahmedabad High Court in the case of Mehndipur Balaji (supra) has held that in the absence of any bar under section 153A, it cannot be said that assessment or reassessment cannot be made if the incriminating material has not been found during the search/requisition but is available with the AO during the investigation. Section 153A provides for assessment of income and not mere computation of income based on the evidence found during the search. If that interpretation is accepted, it would not be the assessment or reassessment of total income, but it would become assessment or reassessment of undisclosed income found during the search/requisition.

Decision of Supreme Court:

After referring to the above judgments, the Supreme Court rested the controversy in favor of assessee. It approved the Delhi High Court's decision in Kabul Chawla (supra). The reasoning adopted by the Supreme Court in approving the above decision and settling the issue in favor of the assessee is detailed hereunder.

The Revenue's contention was that the AO is in his power to issue a notice asking the assessee to file the return of income for six previous years relevant to the assessment year during which search is conducted. The AO draws such power from Section 153A. The said section has four provisos, where the first and second proviso are interpreted in this judgment.

The first proviso provides that the AO shall assess or reassess total income in respect of each assessment year falling within such six assessment years. Whereas the second proviso provides that the assessment or reassessment, if any, relating to any assessment year falling within the six assessment years are pending on the date of initiation of search, they shall abate. The sub-section (2) of Section 153A states that, if the proceeding initiated or assessment or reassessment made under Section 153A(1) gets annulled, then the proceedings which are abated by virtue of second proviso gets revived. Further, if such annulment is set aside by the appropriate forum, then the revived assessments or reassessments gets abated.

The Revenue's contention was that in light of the above scheme, specifically by virtue of first proviso, the AO is empowered to assess or reassess total income for each of the assessment year falling within the six assessment years. The Revenue contended that there is nothing in the language of Section 153A or Section 132 which states that the assessment could take place only if there is enough incriminating material which was found during the course of search.

When there is nothing to mean the above, the restriction of power of AO to reassess the completed assessment is not in accordance with the law. Hence, the Revenue argued that, whether or not, there was incriminating material found during the course of search, the AO has power to reassess the total income even for those assessment year for which assessments were already completed as on the date of search. The Revenue also argued that Section 153A opens with a non-obstinate clause and all other sections

should give way to Section 153A. Hence, the Revenue's argument that AO is statutorily mandated to issue notice asking the assessee to file returns for six assessment years and pass necessary orders after considering the total income. The AO would assume power, even if for some assessment years, the assessment is completed. The Revenue's argument was based on usage of 'reassessment' and 'total income' in the first proviso.

The assessee countered the above stating that the usage of expression 'reassessment' in the first proviso is to deal with undisclosed income that comes up during the course of search. In absence of any incriminating material, the AO cannot in guise of Section 153A reassess the total income.

Further, the assessee argued that second proviso in clear terms stipulate that only pending assessments gets abated. In absence of any specific language used in the second proviso (qua completed assessments) which expressly dealt with abatement of pending proceedings, the AO does not have any right to disturb the completed assessments. The assessee further argued that there were strict prescriptions for re-opening the assessment under Section 147 read with Section 148 and the same cannot be by-passed in light of Section 153A.

Finally, the assessee argued that the revenue's argument that 'total income' has to be assessed and if there is no incriminating material also, the AO can reassess because the expression used is 'total income' and not undisclosed income does not have any base. For the reason, that prior to the current scheme of Section 153A, there was a different scheme, which taxed the 'undisclosed income' at a special rate. Hence, prior to the current scheme, the AO has to identify the undisclosed income unearthed during the search and bring the same to tax at a special rate. Now, that the above scheme is dispensed, the legislature has used the expression 'total income' instead of 'undisclosed income' and the same cannot be interpreted as canvassed by Revenue. The assessee argued that under the current scheme there are no different rates of taxes that are applicable and hence the usage 'total income' as against 'undisclosed income'.

The Supreme Court after hearing to both the parties have held that AO is undoubtedly has power to issue notice asking the assessee to file the returns for the six previous years falling prior to the assessment year during which search was initiated under Section 132. However, in light of second proviso and on a conspectus reading of Section 153A, the Court held that the first proviso does not give the AO power to reassess the total income in respect of the assessment year for which assessment is completed as on the date of search. The AO has power only to reassess the total income with respect to the assessment year which was already assessed only if there is incriminating material found during the course of search.

The Supreme Court upheld the Delhi High Court's view in Kabul Chawla (supra) wherein it was held that though the expression 'incriminating material' is neither found in Section 153A or Section 132, the same has to be inferred while reading Section 153A keeping in mind the whole point as to why search is conducted under Section 132.

The Supreme Court accordingly held that the AO is not empowered to disturb the completed assessments as on the date of initiation of search, in cases, where there is no incriminating material found during the course of search. However, the Supreme Court also stated that AO has power to issue notices under Section 148 to re-open the assessment under Section 147, if such notice can be issued within the time limits specified under the Act.

Effect of other material available (in addition to the incriminating material):

As stated above, the Hon'ble Supreme Court has held that AO can assess or reassess the total income of the year only if the incriminating material is found during the search. However, the Supreme Court has held that *'in case any incriminating material is found/unearthed, even, in case of unabated/completed assessments, the AO would assume the jurisdiction to assess or reassess the 'total income' taking into consideration the incriminating material unearthed during the search and the other material available with the AO including the income declared in the returns.*'Which means that once the assessment under section 153A is made, AO is empowered to utilize any other information available with the AO whether or not such material is found during the search/requisition.

The above judgment of the Supreme Court can be understood by reading the below table:

S No	Position	Incriminatig Material Found during the Course of Search	Remedy Available to the AO	Basis for assessment
1	Assessments **completed** for AY's falling six years prior the previous year in which search was initiated.	No	AO cannot invoke the provisions of section 153A. However, AO is empowered to invoke provisions of section 147.	Information available with the AO post search.
2		Yes	AO can invoke the provisions of section 153A.	Incriminating material found during the search/requisition and any other information available.
3	Assessments **pending** for AY's falling with six years prior the previous year in which search was initiated	No	AO can invoke the provisions of section 153A.	Information available with the AO.
1		Yes	AO can invoke the provisions of section 153A.	Incriminating material found during the search/requisition and any other information available.

Miscellaneous Application before the Supreme Court:

As stated above, the Supreme Court has opined that, in a case where no incriminating material is found, AO is empowered to re-open the assessment under section 147 subject to satisfaction of conditions specified under section 147/148. In this regard, the revenue has filed a MA[7] before the Supreme Court to obtain more clarification on re-opening of assessment under section 147 (to convert 153A notices into 147 notices). The Supreme Court has completed the hearing and reserved the order.

[7]Miscellaneous Application.

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SUMMARY OF JUDGEMENT

SUMMARY OF GST DECISIONS

Contributed by Team SBS

1. Supreme Court in Edelweiss Finance Services Limited[1] - No Service Tax on Corporate Guarantee Services provided to Group Companies in absence of flow of 'consideration':

In a brief order, the Supreme Court has turned down the appeal preferred by Revenue against the order of CESTAT [2], where in it was held that there cannot be any service tax in absence of consideration for the services provided by respondent of corporate guarantee services to its group companies.

The facts of the issue are that Edelweiss Finance Services Limited (Edelweiss) was engaged in provision of banking and other financial services. A show cause notice was issued demanding service tax to the tune of Rs 97 Crores (approx.) for the corporate guarantee services provided to its affiliates within and outside India. For the services provided to affiliates outside India, Edelweiss has received consideration to the tune of Rs 3 Crores (approx..) and the balance is demand for the services provided to domestic affiliates. The adjudicating authority has turned down the demand by stating that for services provided to overseas affiliates, the same will be export of services. For the domestic services, the 'corporate guarantee' services is not covered under the ambit of Section 65(12) (for the period prior to 01.07.12) and since there is no 'consideration' (for the period post 01.07.12), the notice was set aside.

The Revenue has approached the Tribunal seeking set aside of the order. The Tribunal by placing reliance on the decision of DLF Cyber City Developers Limited [3] has held that the corporate guarantee services do not fall under the ambit of Section 65(12) and also since no consideration is received from affiliates, the levy fails. The Tribunal accordingly held that there cannot be any tax in absence of consideration flow from the affiliates to Edelweiss.

The Revenue approached the Supreme Court against the above order. The Supreme Court passed a brief order stating that in absence of consideration, there cannot be any tax. The Court also stated that Revenue has not shown any finding to demonstrate that issuance of corporate guarantee services to group companies without consideration is a taxable service and accordingly turned down the appeal.

Our Comments:

A brief judgment but much needed one. The concluding remarks that revenue could not show that the service is taxable despite there is no consideration sets a tone in favour of Revenue under the GST era. We all know that, certain activities or transactions are deemed to be supply even without consideration as listed in Schedule I of CT Act. A similar provision is absent in the service tax era based on which Edelweiss succeeded in the above case. However, the same would not be the situation under GST era unless Schedule I is challenged. This is important because at the heart of the 'supply',

[1](2023) 5 Centax 58 (SC)
[2](2023) 5 Centax 57 (Tri-Bom)
[3]2019 (28) GSTL 478 (Tri-Chan)

there is a contract and a contract without a consideration is not a valid contract. Hence, it become important as to how courts start interpreting the Schedule I. If they uphold that Schedule I is permissible, that is, there shall be a supply, even in absence of 'consideration', then the Revenue is in better position in light of the above judgment.

2. **Supreme Court in Gujarat Industrial Development Corporation[4] - Amounts collected, whether under Statutory Function, so that they do not fall under the ambit of service tax – Remands to CESTAT for limited consideration in light of its recent decision in Krishi Upaj Mandi Samiti[5]**

The Ahmedabad CESTAT has set aside the order wherein the service tax was confirmed on the maintenance charges collected by Gujarat Industrial Development Corporation (GIDC). The CESTAT has reached the above decision in light of the judgment of Honourable Bombay High Court in Maharashtra Industrial Development Corporation (MIDC) [6] and other judgments. Aggrieved by the above order, the Revenue has appealed before the Supreme Court.

The Supreme Court after hearing the submissions, remanded the matter to CESTAT for a limited consideration qua taxability based on its recent decision in Krishi Upaj Mandi Samiti.

Our Comments:

The Supreme Court in Kirshi Upaj Mandi Samiti was dealing with taxability of rents collected by the agricultural marketing committees. The Samiti argued that such rents are collected in terms of statutory functions and accordingly the same shall not be subjected to service tax in terms of Circular 89/7/2006, wherein it was clarified that mandatory activities performed will amount to discharge of statutory functions and hence cannot be called service for consideration. However, the Supreme Court after referring to Section 9(2) of the Rajasthan Agricultural Produce Markets Act, 1961 has stated that the said sub-section uses 'may' instead of 'shall'. In light of such usage, granting of rent cannot be called as statutory function because it is not mandatory.

The leading judgment providing immunity from service tax qua sovereign functions is the Bombay High Court's judgment in MIDC (supra). In the said judgment, the Bombay High Court held that maintenance, management and repair facilities provided by MIDC are statutory in nature and cannot be brought to tax.

Based on the above judgment, the CESTAT of Ahmedabad has held that similar functions provided by GIDC are also not taxable. Now, the twist to the story is that Supreme Court remanding the case to CESTAT to examine in light of its decision in Krishi Upaj Mandi Samiti (supra).

Hence, from the above, it is evident that, a new test has been formulated by virtue of judgment in Krishi Upaj Mandi Samiti by Supreme Court. If the activities performed by such entity or authorities are mandatory in the nature (that is, the same should be supported by 'shall' in their respective legislations), then such activities are called sovereign in nature, else, they **'shall'** be treated as services for consideration.

[4] 2023 – VIL –40 – SC – ST
[5] 2023 – VIL – 13 – SC – ST
[6] 2018 (2) TMI 1498

3. Supreme Court in Suzlon Energy Limited[7] - Customised Designs and Drawings which are used for manufacture of Wind Turbine Generator are 'services' though the same are imported and cleared as 'goods' under the Customs Act:

In an interesting judgment, the Supreme Court has held that customised designs imported from country outside India would be called as 'services', though they have been imported and cleared as 'goods' under the Customs Act.

The facts of the matter was that Suzlon Energy Limited (SEL), an Indian company during the period June 2007 to September 2011 has imported customised designs and drawings for the manufacture of the Wind Turbine Generators (WTGs) from their subsidiaries located outside India. They have cleared the said designs and drawings as 'paper' under the Customs Act by claiming exemption from payment of customs duty. SEL was audited by the tax authorities and during the course of audit, it was observed that SEL has not paid service tax on the said design and drawing services received from its subsidiaries under reverse charge. Accordingly, show cause notices demanding service tax along with interest and penalty were issued. SEL has made replies, but the same were alleged to be not properly considered by Commissioner and passed an order against SEL. Aggrieved by the order of Commissioner, SEL preferred an appeal before CESTAT.

Before the Honourable CESTAT, it was argued that the said designs and drawings are in the nature of 'goods' and since the entire rights in intellectual property was transferred by the subsidiaries, the said rights when completely transferred assume the character of goods, there cannot be any service tax on the same. SEL argued that since the transaction of complete transfer of rights was excluded from the taxable service of 'intellectual property service', the revenue's attempt to classify such service under 'design service' is not in accordance with the law. Further, SEL placed reliance on the decision of Associated Cement Companies Limited[8] , to state that once the drawings are put on medium, they assume the character of goods and accordingly be called as goods for the purposes of customs act. Though the above judgment is in the context of the Customs Act, SEL argued that the same activity cannot be taxed as goods and services. The CESTAT after hearing the above arguments has quashed the order passed by Commissioner and gave a relief to SEL.

Aggrieved by the above order, the Revenue has approached the Honourable Supreme Court. The sheet anchor argument of Revenue is that any intellectual property put in a media at all time would only get classified as 'goods' and never as 'services' is not a correct statement of law. The Revenue argued that the dominant nature test to be applied if the situation does not fall under the instances mentioned under Article 366(29A) of Constitution. By applying the said test, if the result is that the parties had 'service' in mind, then the same cannot be called as 'goods' though the same is put in a medium. In the instant case, the Revenue argued that though the designs and drawings are put on medium, they still can be called as 'services', since the intention between the subsidiaries and SEL is to provide/render a service but not a sale of goods. Since the designs and drawings are tailor made/customised, there are bright chances to call such as 'services'.

[7](2023) 5 Centax 152 (SC)
[8]2001 (128) ELT 21 (SC)

SEL argued that though the designs are customised, the same can be still called as goods. SEL placed reliance on the decision of Hindustan Shipyard Limited[9] to state that if the thing to be delivered has any individual existence before the delivery as the sole property of the party who is to deliver it, then it can be called as sale. Then, SEL relied on Associated Cement Companies Limited (supra) and Tata Consultancy Services[10] to state that once intellectual property is put on medium, the same assumes the character of goods and cannot be taxed as again as services.

The Supreme Court after hearing the arguments stated that the designs which were imported from subsidiaries on 'paper' were taxable as services by virtue of Circular 15/2011 – Cus dated 18.03.2011. However, SEL has not paid tax under reverse charge and cleared the same as 'paper' under the customs act. The Supreme Court found that the decision of CESTAT that since the custom authority has considered the same as 'goods', the same cannot be again subjected to service tax as erroneous. The Court made reference to BSNL[11] and held that there can be two different taxes/levies based on the aspect theory. Since the same is not considered by the CESTAT, the Court quashed the impugned order. However, since the CESTAT has not gone into the fact as to whether such design services would fall under the taxable service of 'design service' and validity of invocation of extended period of limitation, the matter was remanded for adjudicating only on such two aspects. However, the issue of levy of service tax on 'engineering, design and drawing services' is concerned, the Court has stated that it has decided in favour of revenue and against assessee.

Our Comments:

The Supreme Court has referred to the aspect theory which was confirmed by BSNL (supra). In BSNL, the issue that arose before the Supreme Court was, whether the sale of SIM cards to mobile subscribers is taxable as goods or services? The states proceeded to include the activation charges in the cost of SIM card. The same was challenged stating that on activation charges, service tax was already being paid and accordingly the same value cannot be again subjected to sales tax. The Supreme Court in BSNL has held that whether SIM card is 'goods' or 'services' has to be determined based on the intention of the parties. If the parties intend to that the SIM card would be a separate object ofsale, it would be open to the sales tax authorities to tax it as sale of goods. However, if the sale of SIM card is merely incidental to service being provided, it would not be assessable to tax The Supreme Court stated that the dominant nature test would be relevant even after insertion of Article 366(29A) for transactions which are not covered by such article. The Supreme Court in BSNL reiterated the doctrine of aspect theory which was discussed in Federation of Hotel & Restaurant Association of India[12] to state that 'subjects which in one aspect and for one purpose fall within the power of a particular legislature may in another aspect and for another purpose fall within another legislative power. They might be overlapping ; but the overlapping must be in law. The same transaction may involve two or more taxable events in its different aspects. But the fact that there is overlapping does not detract from the distinctiveness of the aspects'.

[9](2000) 6 SCC 579
[10](2005) 1 SCC 308
[11]2006 (2) STR 161 (SC)
[12](1989) 3 SCC 634

Adopting the above doctrine, the Supreme Court in the instant case has held that designs imported may be 'goods' for the purposes of Customs Act and can be still called as 'services' for the purposes of Finance Act, 1994. Post this decision, it would be very tough for the assessee to argue that there should not be any service tax because such items were 'goods' based on the assessment as per Customs Act.

4. Supreme Court in Jamna Auto Industries Limited[13] - Non Compete Fee received prior to 01st July 2012 cannot be said to be falling under the 'support services of business or commerce':

In a brief order the Supreme Court has turned down the order of CESTAT, wherein it was held that service tax was payable on non-compete fee received by the appellant for the period prior to 01st July 2012 under the head 'support services of business or commerce'. The Supreme Court held that such amounts were taxable under Section 66E(5) with effect from 01st July 2012 and since the instant case, the same were received prior to the said date, there cannot be any tax. Accordingly, the Supreme Court has set aside the order of CESTAT.

Our Comments:

It appears that the Supreme Court is not convinced that the amounts received for not carrying similar business by a competitor would not be called as support services of business by whom such amount is payable. Further, since the said amounts were taxable more clearly under Section 66E(5) post 01st July 2012, the Court was not convinced the same were taxable under a more general category prior to that date. Incidentally, this judgment also helps us to understand the real ambit of Section 66E(5). The tax authorities have booked many cases under Section 66E(5), just by looking at consideration instead of service. Though Circular 178 is helping in the assessee, this judgment in a small way has helped to open the veil of Section 66E(5).

5. Madras High Court in M/s Grundfos Pumps India Private Limited[14] - No Interest on Credit Wrongly Availed if the same is not utilised before reversal:

The petitioner who was an assessee under the central excise and service tax regime has migrated to GST regime and moved the credit using the Tran-1 form. However, the credit did not appear in the electronic credit ledger. Since the credit did not appear, the petitioner on voluntary basis has availed equivalent credit in GSTR-3B return. After few days, the electronic credit ledger has shown the credit that was transitioned through Tran-1 form. Since the same appeared now in electronic credit ledger, the petitioner has reversed the credit which he has availed in GSTR-3B, before it was utilised.

The same was noticed by the audit officers and asked the petitioner to pay interest under Section 50(3) of CT Act. The said notice was challenged before the High Court stating that since the credit was not utilised, there cannot be any interest implications. The High Court has referred to the amended position of Section 50 of CT Act and held that, the Finance Act, 2022 has made an amendment with retrospective effect to mean that interest is payable only when the credit was utilised. Since, in the instant case, the credit was not utilised before the same reversed, there cannot be any interest as proposed by the notice.

[13](2023) 5 Centax 194 (SC)
[14]2023 – VIL – 214 – MAD

Our Comments:

This situation is completely unwarranted under the GST regime. Lot of water has flown under the bridge under the earlier regime. The claim of interest when the credit was not utilised is subject matter of various litigation. The Supreme Court in Ind-Swift Laboratories Limited[15] held that the interest has to be paid from the date of availment and not from the date of utilisation. The said judgment has been distinguished by Karnataka High Court in Bill Forge Private Limited[16] and held that interest is liable to be paid only when the credit is utilised. In the case of Ind-Swift, the assessee therein has irregularly availed credit based on the strength of fake invoices and have utilised them for payment of tax. However, in Bill Forge, the assessee therein has availed credit and reversed the same when it was pointed out that the same was not eligible. The said reversal was prior to utilisation of the credit. The Karnataka High Court noting the facts stated that the same is distinguishable on facts from Ind-Swift and interest does not trigger.

Despite the above jurisprudence, when the Section 50(3) of CT Act was introduced, it has used the same language which was used in erstwhile Rule 14 of Cenvat Credit Rules, 2004, paving way to opening up similar litigation under the GST regime. However, after Finance Act, 2022, the Section 50(3) has been amended with retrospective amendment to state that interest liability would apply only when the credit was availed and utilised, which was a welcome move. The High Court in right terms has quashed the notice issued proposing recovery of interest on irregular availment.

6. Delhi High Court in Mahanagar Telephone Nigam Limited [17]- No service tax on amounts received as compensation for surrender of spectrum under Section 66E(e):

The petitioner is a Government of India Enterprise engaged in provision of telecom services. The petitioner has received a compensation of Rs 458.04 Crores from Government of India on surrender of spectrum. A show cause notice was issued demanding service tax on the said amount by treating the same as consideration for agreeing or surrendering the right under Section 66E(e). Further, the notice has also alleged that there was a suppression of the amounts in ST-3 returns, thereby justifying the invocation of extended period of limitation. The petitioner has challenged the above said notice before the High Court on multiple grounds.

The petitioner argued that the transfer of spectrum was made a declared service with effective from May 2016 and hence any amount received prior to that cannot be falling under the ambit of declared services, generally and in Section 66E(e) specifically. The petitioner argued that in their assessment, the said amounts are not taxable and hence they have not shown such amounts in ST-3 returns and for this reason alone, suppression cannot be attributed.

The High Court held that on reading of Section 66E(e), it is difficult to accept that MTNL had agreed to forbade doing any act as contended by the notice; it had merely agreed to surrender allocation of an asset. The High Court stated that it did not agree to tolerate an act too. The petitioner has received

[15] 2012 (25) STR 184 (SC)
[16] 12 (26) STR 204 (Kar)
[17] 2023-VIL-216-DEL-ST

an amount spent for providing telecommunication services and for vacating the spectrum, the Government of India has decided to provide financial support. Such a support cannot be said to be a consideration for forbearance of an act or tolerating an act. Accordingly, held that the amount cannot be brought to tax under Section 66E(e). Further, the Court also found that there is no material to show that there was no deliberate intention to evade payment of tax and accordingly founded that notice issued invoking extended period is invalid.

Our Comments:

This is one of the many cases where the consideration is seen first and then service is searched for to bring under the tax net. Section 66E(e) has become the residuary clause for the tax authorities to put every possible consideration under the service tax net. Fortunately, the Courts and Tribunals have started exploring the real transactions that would fit under the ambit of Section 66E(e) and Entry 5(e) of Schedule II (in GST laws). Circular 178/10/2022 dated 3rd August 2022 has been issued to clarify that the contractual arrangement to receive consideration for refraining or tolerating or doing an act should be an independent arrangement in its own right and a person (the first person) can be said to be making a supply by way of refraining from doing something or tolerating some act or situation to another person (second person) if the first person was under an obligation to do so and then performed accordingly. Though the above Circular do not provide the complete respite, it helps the Courts/Tribunals to understand the nature of amounts that are being taxable under Section 66E(e) and to decide accordingly.

SUMMARY OF JUDGEMENT

SUMMARY OF IT DECISIONS

Contributed by Team SBS

1. **Supreme Court in ITO vs. Vikram Sujitkumar Bhatia[1] - Amendment to Section 153C made vide Finance Act, 2015 would be applicable to searches conducted under Section 132 before the date of amendment that is 01.06.15:**

In an interesting judgment, the Supreme Court has held that the amendment (by substitution) made to Section 153C through Finance Act, 2015 is applicable for the searches conducted prior to the date of substitution, that is 01.06.15.The Supreme Court stated that once the primary intention is ascertained and the object and purpose of the legislation is known, it then becomes duty of the Court to give the statute a purposeful or functional interpretation. Since the interpretation canvassed by the respondents (assessees) is frustrating the intention of the provisions of Section 153C, the same was set aside. Accordingly, the Supreme Court held that the amendment made to Section 153C vide Finance Act, 2015 shall be applicable to the searches conducted prior to the date of such amendment.

The history of the subject issue is that, pre-amended provisions of Section 153C contained the expression 'belongs or belong to' for dealing with instances where money, bullion, jewellery or other valuable article or thing or books of accounts or documents seized or requisitioned of a person other than who has been searched and provided a mechanism to proceed with assessment of such persons (non-searched persons). In Pepsico Holding Private Limited [2], the Delhi High Court has observed that on the basis of registered sale deed seized from the premises of searched person, it cannot be said that the said sale deed 'belongs to' the non-searched person. The Delhi High Court stated that there is a difference between 'belongs or belong to' and 'pertains or pertain to'. Since the legislature used the former and not the later, there cannot be any assessment based on the document belonging to non-searched person. In order to cure the above defect, vide Finance Act, 2015, the said phrase 'belongs or belong to' is substituted with 'pertains or pertain to'. Basis this amendment, the authorities can proceed to conduct an assessment on non-searched person based on the documents or other information which pertain to or pertains to such non-searched person, discovered during the search of searched person.

The above amendment was made by way of substitution. In the matter before Supreme Court, the issue was, whether the above amendment which was by way of substitution, can be applied to cases where the search was already initiated prior to such substitution. In one of the facts of the respondents before the Supreme Court, a search was conducted on various premises of H.N. Safal Group on 04.09.13. On the basis of the seized material, the AO initiated proceedings under Section 153C against another individual (who was one of the respondent before Supreme Court). The respondent stated that from the satisfaction recorded by the AO it is evident that there is no document belonging to him which was found during the search, however a hard disk was seized, which contained an excel sheet with the data of the computer of the searched person, wherein there were references to the respondent's name.

[1] TS-165-SC-2023

[2] 2014 SCC OnLine Del 4155

The respondent before the AO stated that the amendment made to Section 153Capplies prospectively and does not apply to cases where search was initiated prior to the amendment. Since, search of H.N.Safal Group was initiated prior to the amendment in Section 153C, the amendment does not apply qua him and since no incriminating material belonging to him was found, no assessment cannot be carried. The AO rejected the submissions and the individual assessee has approached the Gujarat High Court. The High Court stated that the amendment was to be applied prospectively since it creates a new classes of assessees who are sought to be brought within the sweep of Section 153C and thereby affecting the substantiative rights.

The revenue preferred an appeal before the Supreme Court, which held that considering the intention of Section 153C and the way it was amended, the amendment has held to be retrospective. Accordingly, it held that the said amendment applies to searches which are initiated before the amendment. Apart from the interpretation of retrospective application, the Supreme Court also referred to the proviso to Section 153C which deals with the date of initiation and held that the date of initiation shall be construed as the date of receiving books or documents or assets seized or requisitioned by AO having jurisdiction of non-searched person and since as on the said date, the amendment is effective, the Supreme Court stated the amended provision will apply even taking the help of proviso.

2. Supreme Court in Anil Minda[3] - Date of Panchnama prevails over the date of warrant authorization incomputing the 2-year limitation period for completing the block assessment under section 115BE.

The issue before the Apex Court pertains to the conduct of search and seizureoperation on the assessee subsequent to the issuance of two warrants dated 13.3.2001 and 26.03.2001. The first warrant was culminated on 11.4.2001, while the second warrant and panchnama were executed on the same date of 26.03.2001. Subsequently, an order of blocked assessment was passed in April 2003, two years after the aforementioned search. The assessee's contention was that the period of 2 years for completing the block assessment, as provided under section 158BE, should commence from the end of the month of the last authorization's panchnama execution which occurred in March 2001. Since the order was passed after the expiry of the time limit, the impugned assessment order is prima-facie time barred and untenable.

However, the Apex court, relying on the established precedents, interpreted that section 158BE prescribed the date of execution of last authorization as starting point for computing 2-year period. Furthermore, Explanation 2 to the aforementioned section clarifies that the date of such execution shall be on the date of execution of the panchnama. This unequivocally reflects the legislative intent of prioritizing the date of the last panchnama's execution over the date of the last authorization's procurement. Besides that, it is evident that the assessment cannot be initiated without the last panchnama's acquisition. Therefore, since the last panchnama was drawn in April 2001, the assessment order passed in April 2003 is legally valid and binding.

[3] 2023] 148 taxmann.com 407 (SC)

Our comments:

It is crucial to attribute appropriate significance to the legislative intent and the practical possibility of the action, rather than relying solely on a strict literal interpretation. The Hon'ble Supreme Court had aptly interpreted the legislature's intent and concluded that it would be defeat the sole purpose and object of Explanation 2 of section 158BE if the date of last authorization is considered as the starting point of the two-year limitation period instead of the date of last panchnama's execution.

3. **Supreme Court in US Technologies International Pvt. Ltd.& others[4] - The term 'Failure to deduct' as provided in section 271C(1)(a) does not mean to include 'failure to pay' and hence no penalty would be leviable on belated payment of the tax – Quashes Kerala HC ruling.**

The Supreme Court allowed the appeal preferred by the assessee against the order of Kerala High Court, wherein it was held that a penalty under section 271C(1)(a) shall be imposed due to failure in paying the tax deducted to the government.

The facts in a nutshell are that the assessee had deducted tax on certain payments but failed to pay the same within the time prescribed. Resultingly, interest under section 201(1A) was levied along with a penalty under section 271C. Assessee preferred appeal before the hon'ble Kerala High Court contending that penalty cannot be imposed under section 271C(1)(a)on mere reason of failure to pay, however, the High Court turned down the appeal. Aggrieved by the order, the assessee approached the Supreme Court.

It was held that Section 271C(1)(a) imposes penalty on the assessee in case of failure to deduct the tax and 271C(1)(b) imposes penalty in case of failure to pay tax as required under sections 115O and 194B which is not relevant in this case. Hence it was clear that failure to pay tax does not attract the penalty under section 271C. On top of it, section 276B provides for prosecution in case of failure to pay the tax. The same was backed up by the CBDT circular no. 551 dt 23.01.1998 which says that section 271C was introduced to impose penalty on non-deduction of tax while the existing section 276B will impose prosecution for non-payment of tax. It was also argued that the penal provisions must be strictly interpreted and are required to be read as they are. Moreover, it is to be noted that when the legislature intends to impose consequences on non-deduction/non-payment of tax, it has provided the same under sections 201(1A) and 276B. Hence, when the literature of the section 271C(1)(a) does not provide any right to impose penalty on failure to pay the tax, the revenue cannot interpret the 'failure to deduct tax' as 'failure to deduct/pay the tax'.

Our Comments:

It is a general practice to give weightage to the intention of the legislature than the literature provided in the act. However, as per the cardinal principle of interpretation of the statute and more particularly, the penal provision, the penal provisions are required to be read as they are. Nothing is to be added nor to be taken out of the penal provision. Hence, as the assessee had rightly deducted the TDS but failed to pay the tax, he shall be liable to the interest but not the penalty.

[4][TS-171-SC-2023]

4. Supreme Court in Paville Projects Pvt. Ltd.[5] – Settlement made to shareholders out of the proceeds of sale of asset as part of arbitration award for discharging the encumbrances cannot be termed as cost of improvement of the said asset and held the assessment order allowing such cost is erroneous and prejudicial to revenue.

The facts of the case in a nutshell were there was litigation between the shareholders of the company being family members. The litigation was settled through arbitration by passing an interim award for the family settlement. As a part of this settlement, the company paid the amount to the shareholders out of the proceeds of sale of Paville house. The assessee company argued that this payment is made as per the directions of the court and to end the litigation among the shareholders. Hence, the payment is termed as cost of improvement under section 55(1)(b) and considered under Capital Gain computation.

During the assessment, the AO had approved this argument. However, the Commissioner had passed a revisionary order on the ground that the assessment order is erroneous and prejudicial to the interests of the revenue. However, the Bombay High Court had quashed the revenue findings by relying on the Supreme Court decision in Malabar Industrial Co. Ltd[6] which held that when there are two possible views can be taken and the AO had done assessment by opting one view, but the commissioner is of another view, it cannot be said that there is a loss of revenue though there is a loss of tax. Aggrieved by the decision, revenue preferred appeals before Supreme Court.

The court, In the current case, held that the payment of capital gain proceeds to the share holders for discharge of encumbrances cannot be said to be cost of improvement because there was no acquisition of any interest in the asset already acquired by the assessee company from such payment. Moreover, there was no encumbrance preventing the sale of the said property and the litigation among the family members and their entitlement to the payments had nothing to do with the improvement in the property. Hence the assessment order allowing such payment as cost of improvement is not good in the eyes of the law in the first place.

The Apex Court has analyzed the decision of Malabar Industrial Co. Ltd (supra) and reiterated the wordings of the judgement which says that only when the view taken by the AO is legally plausible in the law, the order cannot be said to be prejudicial to the interests of the revenue though there is a loss of tax. There must be a grievous error in the order passed by the AO which might set a bad trend or pattern in the similar assessments, which on a broad reckoning, the Commissioner might think to be prejudicial to the interests of revenue administration.

Hence, by applying the law laid down in the case of Malabar Industrial Co. Ltd (Supra), the Supreme Court held that since the view taken by the AO in the current case is erroneous as per the law and there is a loss of tax on account of such error, the assessment order is prejudicial to the interests of the revenue. Hence, the revisionary order passed by the commissioner is held tenable.

[6][(2000) 2 SCC 718

Our Comments:

Supreme Court had upheld its interpretation given in Malabar case (Supra) as the prejudicialness to the interests of the revenue must be connected with an erroneous order passed by the AO. Every loss of revenue as a consequence of an order of an AO cannot be treated as prejudicial unless the view taken by the AO is unsustainable in law.

5. **Mumbai Tribunal in Cooperative Rabobank UA [7] - Interest income earned from ECBs by a foreign bank shall be taxable under Article 11 of Indo-Netherlands DTAA instead taxing as business profits at the rate of 40 percent.**

The assessee, being an Indian branch of a Netherland bank, engaged in lending and other business activities in India. In the course of filing the ROI for AY 2012-13, the assessee encountered practical difficulties in collating the income details earned from its group entities worldwide, resulting in non-disclosure of a certain interest income on ECBs received from the Indian entities. However, TDS was duly deducted on such income at the rate prescribed under Article 11 of Indo-Netherlands DTAA i.e., at the rate of 10%. Consequently, the assessee had forewent the corresponding TDS credit available in Form 26AS. The Ld. AO had contended that the undisclosed interest income from ECBs represents business profits accruing to the assessee and, therefore, should be taxed under Article 7 of Indo-Netherlands DTAA, which stipulates a tax rate of 40%.

The Tribunal interpreted that doctrine of lex special is applies to the present case, wherein Article 7 of the Indo-Netherlands treaty is not applicable to any income that is exclusively governed by another article of the treaty, such as Article 11(2), which exclusively deals with the taxability of interest income earned by the contracting states, stipulating that such interest income shall be chargeable in the source country at a maximum rate of 10%. Therefore, it was established that Article 11 prevails over Article 7 and applies to the interest income from ECBs. As a result, it was held that the said income would be taxable at 10% and the assessee would be eligible for the tax credit thereon available in Form 26AS.

[7] TS-152-ITAT-2023(Mum)

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