CASC BULLETIN

THE CHARTERED ACCOUNTANTS STUDY CIRCLE

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EDITORIAL

Dear Colleagues,

On behalf of the CASC, we pay our respects to the departed soul of our member, Shri.S.Rajaratanam, an eminent tax personality, a member (retd.) of the ITAT and more than that a friend, philosopher and guide of The Chartered Accountants Study Circle (CASC). For years together, he has been an immense source of strength to CASC, be it by way his active participation at our meetings or be it sharing his intellect by way of contributing articles to our CASC Bulletin. We express our sincere condolences to his family. We at CASC pray the Almighty for this noble soul to attain moksha. Om Shanthi.

Dear Colleagues,

For all the problems that our clients face in their life, be it medical problems, be it family related problems, be it psychological problems, be it a problem of choice in decision making, be it zeroing down on career options for themselves or their children, be it facing the stressful Covid-19 situation – our Clients approach Us. WHY? It's a very Big Question Mark. But then we are only Accounting Professionals. We are neither Sooth Sayers nor Counsellors nor Advisors nor Mentors nor a One-Stop Solution Providers for problems other than financial matters. But, the fact remains that Clients look up to us, Trust & Confide in us and Look upon us as their Springboard for Stress Release. My dear Colleagues, we are placed in such an enviable (!) position.

This unforeseen pandemic, that we are a part of, has affected the lives of everyone of us in this world. On the exterior surface, we may all seem to be calm, composed and normal, but underneath, well within, the tensions have redefined our normal (alas abnormal).

All businesses have been affected to varying degrees. By bringing businesses around the world almost to a halt, the pandemic has increased pressure on all small and big businessmen with operations shut and with no backup plans. Apart from worrying about the safety of their families

and loved ones, entrepreneurs and business leaders have additional stress regarding the company and the staff's survival in times of no revenue. All of this can take a toll on their mental health.

Research points out to a strong association between mental health problems and financial difficulties. In some cases. People who suffer financial stress can develop mental health problems and vice versa.

'Mental illness' is a diagnosable illness that affects a person's thinking, emotional state of behaviour, and disrupts the person's ability to work of carry out other daily activities and engage in satisfying personal relationships.

Clients invariably approach their auditors when they are under stress. We need to understand the signs & effects of mental illness to interact with and support clients suffering from mental illness.

Specific signs that could indicate that our clients may be experiencing mental health problems include changes in usual behaviour, displaying unusual behaviour, lack of clarity of thought, not attending appointments, not returning phone calls, not keeping proper records, not meeting repayment schedules and avoiding discussions with bankers and financial institutions.

Certain other behavioural problems include, Not getting things done, Erratic behaviour, Withdrawing from Others, Reduced participation in work or other usual activities, Inability to concentrate, Indecisiveness, Difficulty with memory, Loss of confidence, Conflict with peers, family or friends, Excessive fear or Worry, etc.,

As an auditor, in the role of a counsellor, we have to help our clients to develop their own understanding of the situation they are in. We should enable our clients to explore aspects of their own life and feeling, by talking openly & freely. We should help our clients to see things more clearly, possibly from a different point of view. This can enable our clients to focus on feelings, experiences, behaviour, with a goal of facilitating positive change.

Please carefully note that **counselling is not** giving advice, being judgemental, attempting to sort out problems of the client, expecting or encouraging a client to behave as the counsellor *(we)* would behave if confronted with a similar

problem in our own life, getting emotionally involved with client or looking at a client's problem from our own perspective, based on our value system.

Courage is the pre-requisite that allows the client to build confidence and courage serves the client even if confidence deserts him. ***Nelson Mandela once said "…….courage is not the absence of fear but the triumph over it."***

We definitely need to have concerns about the well-being of our clients who are experiencing stress. We need to understand the demands placed on us by our clients. We need to equip ourselves with knowledge & skills required to respond appropriately to clients experiencing mental health problems. We need to have sensitive conversations with them. To our clients, a friendly prod, to move things along, to challenge, to listen and provide an understanding ear, is what we can do.

Believe me Colleagues, You have the Power to Change Your Clients' Life!

Dear Colleagues,

We have a request from CA Vivek Rajan, author of a series of well researched articles on Direct Taxes in our CASC Bulletin. He solicits questions in order to frame a comprehensive set of FAQs & solutions on the topic " Implications of Finance Act 2020 on Charitable Organisations". The objective of this attempt is to enable better in-depth understanding, documenting open ended aspects, and to make representations to the Authorities. Request you to send the FAQ's to admin@casconline.org with a copy to the author at vvr@vvrcas.com

Best Regards

P.Ramasamy

Homage to Shri. S. Rajaratnam

Sri. S. Rajaratnam

Sri. S. Rajaratnam, IRS(Retd.) was born in 1928 and passed away at Chennai on 18th July, 2020.

Hailing from a remote corner of Tamilnadu, having multiple qualifications as a Lawyer, Cost Accountant and IRS, he was simplicity personified.

He had a glittering career with the Income-tax Department for nearly three decades, with deputation to the Sales Tax Department and to the Sri Lankan Tax Department in between. During his tenure as CIT (A) and as a member of the ITAT, his orders were absolutely fair, never biased in favour of Revenue, and were "Speaking Orders", clearly emphasising on law as enunciated and interpretation as warranted with a balanced mind.

He was so upright that most influential political big wigs were uncomfortable with his judgement and pronouncements.

From the time he opted for VRS from the ITAT, he was an integral part of the Society of Auditors, and many members felt that he would have attended/ participated in the highest number of meetings and programs conducted by that well established organisation.

He has written innumerable books and treatises on Income-tax, International Taxation and many allied Laws and most of them have been best sellers.

He was easily accessible to CAs and Advocates and thousands of professionals benefited from his sincere opinions, guidance and encouragement.

His contribution to YMIA, of which he was a well accepted President for a few years, Hindustan Chamber of Commerce, where he was in the Council of Management for nearly 25 years, Rajaji Centre for Public Affairs, where he was a Trustee from its inception and many other public bodies where he was active, has been immeasurable and noteworthy.

CASC owes a debt of gratitude to his active participation in many of its Conferences, Seminars and Meetings and the enormous support lent by him in education and learning related activities. The number of his Articles for the CASC Magazine , speak volumes of his willingness to share his vast knowledge with the younger generation of professionals and students.

We offer our condolences to the members of his family and wish and pray that his Aathma attains Shanthi.

CA. G. Subramanian
Founder Committee Member - CASC

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ANNOUNCEMENTS

1. The copies of the material used by the speakers and provided to CASC for distribution, for the regular meetings held twice in a month is available on the website and is freely downloadable.
2. Earlier issues of the bulletin are also available on the website in the "News" column.

The soft copy of this bulletin will be hosted on the website shortly.

READER'S ATTENTION

You may please send your Feedback Contributions / Queries on Direct Taxes, Indirect Taxes, Company Law, FEMA, Accounting and Auditing Standards, Allied Laws or any other subject of professional interest to ***admin@casconline.org***

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Opportunity: Writ petition is of the year 2011; The learned Government Advocate appearing for the respondents submits that the impugned order is liable to be sustained as the petitioner has not clearly explained the transaction and authorities acting under the provisions of the TNVAT Act, 2006 have passed a fair order. The Court observed that though the quantity in both the sets of invoices are identical i.e. 36.594 cbm, there was several disputed questions of facts, which were not placed before the 2nd respondent by the petitioner. Stating so, amongst others, Court opined that a fair chance may be given to the petitioner to place the same before the 2nd respondent for the latter to pass an appropriate order in accordance with law after hearing the petitioner and the impugned order is quashed and stated that the petitioner may file all documents and a detailed written submission before the 2nd respondent. Such details may be filed within a period of 30 days of this order. The 2nd respondent shall pass appropriate orders on merits in accordance with law, through video conferencing, if the situations so warrant on account of continuance of Covid19 pandemic. **M/s.Krishna Timber & Plywood, Vs 1.State of Tamilnadu, 2.The Joint Commissioner (CT), Coimbatore – 18. W.P.No.5470 of 2011 dated : 19.05.2020**

CA. V.V. SAMPATHKUMAR

Imported Goods: The goods were taxed at higher rate of sales tax (TNGST Act, 1959) at 20% compared to the goods indigenously made. The vires of Entry 14(vi) of Part D of the First Schedule to the TNGST Act, 1959, Entry 8 Part G of the First Schedule and Entry 9 of Eleventh Schedule respectively prescribing 20% rate of sales tax on the sales of goods imported at Delhi and Mumbai and stock transferred and sold in Chennai were challenged as a violative of Articles 14, 301 and 304 of the Constitution of India and therefore void and unenforceable. The Division Bench of this Court upheld the provision. One of the criteria of distinction for levying higher rate of tax is whether the goods imported from the other country lose its identity as foreign goods or not. In the given case, the goods are television sets, audio systems, handy cameras, handsets of cellular phones, cars, medium density fibre boards, etc., and even after their import, they did not lose their respective identity. In the case of sugar,

even after the sugar is imported, it is not sold in the market as imported sugar and it is possible for the trader to mix the imported sugar with the indigenous manufactured sugar as well. Distinguishing the ruling in Indian Sugar & General Industry Export Import Corporation Ltd., v. Commercial Tax Officer and others (2002) Vol.127 STC 339) this court held that the imposition of higher rate of sales tax for imported goods would in no way amount to restriction of trade under Part XIII of the Constitution of India. **M/s. Tai Industries Limited, Vs. 1.The State of Tamilnadu, Commercial Taxes Department, 2.The Commercial Tax Officer, Saligramam Assessment Circle W.P.No.35865 of 2004 dated 19.05.2020**

Copies of Documents: Proceedings dated 31.12.2010 for the assessment year 2001-02.was subject matter of a writ petition in W.P.No.14296 of 2011. The Court, by its order dated 25.08.2011 set aside the said order 31.12.2010 and remitted the case back to the respondent with a direction to furnish the copies of the documents sought for by the petitioner by letter dated 13.12.2010 within a period of 3 weeks from the date of receipt of a copy of that order and on receipt of the same, the petitioner was directed to furnish their reply for the 1st respondent to pass appropriate orders. Though certain documents were provided by the Assessing authority, the further documents sought for were not provided in spite of remainders by the petitioners. Stating so, the impugned proceedings in CST 223991/2001-2002 dated 26.04.2013, is set aside and directed the petitioner to appear before the 1st respondent on 30.06.2020 to collect the documents specified in letter dated 02.11.2011. The petitioner shall thereafter file a fresh reply to notice within a period of 30 days. The respondent shall thereafter pass appropriate orders in accordance with law after hearing the petitioner within a period of three months thereafter through videoconferencing, if situations so warrants on account of continuance of Covid19 pandemic. **M/s.Dekshinamoorthi & Co.,vs 1.The Commercial Tax Officer, Thiruvarur 2. The Assistant Commissioner (CT), Avarampalayam Assessment Circle, Coimbatore W.P.No.34822 of 2016 dated 19.05.2020**

Refund: The petitioner is a dealer of Motor Vehicles who had claimed a refund of excess Input Tax Credit in terms of Sections 19(17) & 19(18) of the TNVAT Act, 2006 read with Rule 10(10)(a) & (b) and Rule 11 of the TNVAT Rules, 2007. The petitioner filed a refund claim on 09.11.2011 and requested the respondent to refund a sum of Rs.46,03,026/- being accumulated Input Tax Credit for the Assessment Years from 2006-2007 up to 2009-2010. The Court extracted the following passage from the decision of the Hon'ble Supreme Court in Unichem

Laboratories Ltd. Vs. CCE, (2002) 7 SCC 145 "12.For the aforementioned reasons, we are of the view that denial of benefit of the notification to the appellant was unfair. There can be no doubt that the authorities functioning under the Act must, as are in duty bound, protect the interest of the Revenue by levying and collecting the duty in accordance with law — no less and also no more. It is no part of their duty to deprive an assessee of the benefit available to him in law with a view to augment the quantum of duty for the benefit of the Revenue. They must act reasonably and fairly" and stated that the above passage squarely applies to the facts of the present case. Stating so the impugned order passed by the respondent was quashed with consequential direction to refund the amount lying unutilised after adjustment at the beginning of each financial year. **Tvl.M.R.Motor Company, Salem – 636 001.Vs.The Assistant Commissioner (CT), (FAC), Salem Town (South) Circle. W.P.No.31044 of 2013 dated 19.05.2020**

Goods Detention: The Check post officer detained the goods at the Check Post and demanded for payment of Value Added Tax and compounding fee for release of the goods. The goods in question were directly dispatched by the manufacturer to the Petitioner's site in Tirunelveli for being installed along with the other wind energy equipment at a later point time. The petitioner had not affected any sale of the goods when the goods was detained by the 1st respondent at the Paranoor Check Post near Chengalpattu. It is at a later stage, a sale would have taken place by the petitioner to its customer. The detention of the goods on the assumption that the petitioner had already effected sale and that no tax was paid when the goods were in transit was is purely based on the assumption, presumption and conjecture. As and when the petitioner affects sale, the petitioner would be liable to pay tax. Therefore, the detention of the goods on the assumption that the petitioner had already effected sale and that no tax was paid when the goods were in transit was is purely based on the assumption, presumption and conjecture. As and when the petitioner effects sale, the petitioner would be liable to pay tax. Stating so and other observations the there was an error in assumption of jurisdiction by the Check Post officer on the ground that the goods had not suffered tax as the manufacturer had indeed charged tax in the invoice raised on the petitioner. In the light of the above , the Court modified the impugned proceeding by restricting the compounding fee Rs.2000/-under Section 72(1)(b) of the TNVAT Act, 2006 and the respondents were directed to refund the excess amount paid by the petitioner to towards compounding / composition amount. As far as the tax is concerned, same can be adjusted towards the tax

liability of the petitioner. **Vestas Wind Technology India Private Limited vs The Commercial Tax Officer, Enforcement, Roving Squad, Chengalpet, W.P.Nos.28470 of 2013 Dated 19.05.2020**

Transit sales: In A & G Projects and Technologies Ltd v. State of Karnataka [2009] 2 SCC 326 , the Supreme court held that once the first transaction in the interstate sale has suffered CST, subsequent sales effected by transfer of documents during transit is exempt provided conditions prescribed u/s 6(2) are satisfied. The Supreme court observed as such: "16. Analysing Section 6(2), it is clear that sub-section (2) has been introduced in Section 6 in order to avoid cascading effect of multiple taxation. A subsequent sale falling under sub-section (2), which satisfies the conditions mentioned in the proviso thereto, is exempt from tax as the first sale has been subjected to tax under sub-section (1) of Section 6 of the CST Act, 1956. Thus, in order to attract Section 6(2), it is essential that the sale concerned must be a subsequent inter-State sale effected by transfer of documents of title to the goods during the movement of the goods from one State to another and it must be preceded by a prior inter-State sale. It is only then that Section 6(2) may be attracted in order to make such subsequent sale exempt from levy of sales tax. However, the proviso to sub-section (2) of Section 6 prescribes further conditions and it is only on fulfilment of those conditions that the subsequent sale stands exempted. If those conditions are not satisfied, then notwithstanding the fact that the sale is a subsequent sale, the exemption would not be admissible to such subsequent sales. This is the scheme of Section 6 of the CST Act, 1956" Thus, the argument of the petitioner that there was an E-1 transaction cannot be countenanced in the facts of the present case. **Vega Cotton, Karaikal. vs. 1.The Check Post Officer, DCTO, Hosur 2.The Deputy Commercial Tax Officer (CT), Karaikal Assessment Circle, W.P.Nos.22802 to 22804 of 2013 Dated 19.05.2020**

Purchase Tax : If Petitioner had purchased turmeric from dealers who were otherwise liable to tax in in terms of Section 3(2) of the TNVAT Act, 2006 but were exempted from payment of tax under Section 15 of the TNVAT Act, 2006 as turnover is below Rs.300 Cr, the levy under Section 12 of the TNVAT Act, 2006 is not attracted if the petitioners' turnover was also below Rs 300 Crores during the year Sunrise **Foods Private Limited vs The Assistant Commissioner (CT) (FAC) Park Road Assessment Circle, Erode. W.P.No.21982 of 2016 Dated 19.05.2020**

Input Tax Credit: Input tax credit (ITC) cannot be denied to a purchasing dealer if the VAT registration of the supplier dealer who supplied the goods is cancelled retrospectively after the sale

was affected to such a purchasing dealer vide ruling in Rayan Tile Bazaar Vs. The Assistant Commissioner (CT), made in W.P.No.1569 of 2018 dated 25.01.2018. However, ITC that was availed is provisional as per section 19 (16) of the TNVAT Act, 2016. Powers are vested with the Assessing Authority to revoke the same if it appears that the credit was wrongly availed or otherwise not in order. In Rule 10 of the TNVAT Rules, 2007, an elaborate procedure has been prescribed for availing input tax credit. Goods movement documents are vital and ought to have been produced by the petitioner to substantiate the claim for input tax credit on the tax charged. Since the petitioner can establish these facts, the Court was inclined to give one final chance to the petitioner and remit the case back to the respondent to pass fresh orders preferably within a period of 3 months from date of receipt of this order. **M/ s.Bharat Steels vs The Commercial Tax Officer, Broadway Assessment Circle, W.P.Nos.21085 to 21088 of 2016 Dated : 19.05.2020**

Natural Justice: Show cause notice dated 12.12.2019 indicates that the respondent issued the show cause notice on 12.12.2019 and confirmed the said proposal also on the same day, which goes against the very basic principles of natural justice, as the petitioner / assessee was not at all given an opportunity to give their objections. An assessment cannot be made without giving an opportunity of hearing to the assessee. Observing so, this Writ Petition is allowed and the impugned order is set aside with directions. **Sree Saravana Engineering Bhavani Private Ltd., vs The Assistant Commissioner (ST), Bhavani. W.P.No.7763 of 2020 DATED: 27.05.2020**

Attachment, Encumbrance: The issue as regards the charge created on the properties, cannot be adjudicated in a writ petition filed under Article 226 of the Constitution of India and the proper remedy for the petitioner is only to approach the competent Civil Court relying upon the undertakings given by his vendor in the sale deeds. The judgment of this Court relied upon by the petitioner in the case of D.Senthil Kumar and others v. Commercial Tax Officer, Erode and another, reported in (2006) 148 STC 204 (Mad), will not apply to the facts of the present case, since in that case, the charge created on the property was subsequent to purchase of the property, but in the present case, the petitioner herein purchased the properties from the third respondent only subsequent to the attachment effected by the Department. **R.Kannan vs 1.State of Tamil Nadu, Commercial Taxes and Religious Endowment Department 2.The Assistant Commissioner, Commercial Tax, Krishnagiri. W.P.No.3932 of 2009 Dated: 26.05.2020.**

The Author is a Chennai Based Chartered Accountant in practice. He can be reached at vvsampat@yahoo.com)

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CLAIMING OF REFUND U/S 143(1) (A) AFTER THE ISSUE OF NOTICE U/S 143(2)

Whether after issue of notice u/s 143(2), rights of processing ITR under section 143(1)(a) can be enforced, by an assesse, for the purpose of issuing refund? Whether intimation is required to be sent after the issue of notice u/s 143(2)?

Vodafone Idea Ltd. *v.* ACIT [2020] 116 taxmann.com 393 (SC)

CA. G. PARI

FACTS:

1. Vodafone Idea Ltd [VIL] has filed its Return of Income [ROI] for the assessment year [AY] 2014-15 on 30.09.2014 claiming a refund of Rs. 1532.09 crores and a notice under section 143(2) was issued on 31.08.2015 for that AY. For the AY 2015-16, ROI was filed on 01.11.2015 claiming a refund of Rs.1355.51 crores and a notice under section 143(2), for that assessment, was issued on 16.03.2016. Consequent to Advance Pricing Agreement [APA] entered with CBDT under section 92CC of ITA revised return was filed for the AY 2015-16 and a modified return for the AY 2014-15, under section 92CD, was filed on 22.02.2017.

2. For the AY 2016-17, ROI was filed on 30.11.2016 claiming a refund of Rs.1128.47 crores and a notice under section 143(2), for the AY, was issued on 03.07.2017. For the AY 2017-18 ROI was filed on 25.11.2017 claiming a refund of Rs.743 crores.

3. In response to the request, by VIL, for processing of ITRs and issuing refund, revenue by referring section 143(1D) of ITA informed that processing of a return shall not be necessary, where a notice u/s 143(2) has been issued; also referred section 241A of ITA, which was inserted by the FA 2017 with effect from 01.04.2017, where any refund becomes due to the assesse and on issue of notice u/s 143(2) if the AO is of the opinion that the grant of refund may adversely affect the revenue, and having recorded reasons with previous approval of Principal Commissioner of Income tax, can withhold the refund up to the date of assessment. Pending special

audit, pending scrutiny and pending demands of amount of more than 4500 crore, would adversely affect the revenue if refunds were issued, are the reasons recorded for withholding the refund.

4. Writ petition was filed before the High Court of Delhi seeking Direction under Article 226 or 227 of the Constitution of India due to inaction on the part of Department in processing ITRs under section 143(1)(a) and issuing refund.

5. Writ has been dismissed on the premise that Section 143(1)(d) deals with two eventualities viz i) an intimation shall be deemed to be sent in a case where no sum is payable or refundable under section 143 (1) (c) and where no adjustment is made under section 143(1)(a) and ii) an intimation has not conferred any greater right to the assesse than for asking to process the refund and make over the money; however it is the AO to decide either the possibility of issue of notice u/s 143(2) or when the notice got issued to decide on the issue of refund by applying mind on the nature of the returns and the potential or likely liability that may emerge in course of assessment. Right to claim refund does not mean accrued when assessment is pending pursuant to notice u/s 143(2). Relied on the decision[1] that an intimation under Section 143 (1) is not to be considered as an assessment.

6. Aggrieved and SLP filed before Supreme Court:

ARGUMENTS of VIL [Appellants]

7. In the normal course, the return should be processed within a year and only where the AO is of the view that issuance of refund would be detrimental to collection of demands, he may invoke the provision of Section 143(1D) of the Act. Relied on the decisions of Tata Teleservices Ltd. *v.* CBDT [2016] 69 taxmann.com 226 (Delhi) and Group M. Media India (P.) Ltd. *v.* Union of India [2017] 77 taxmann.com 106 (Bombay).

8. Second Proviso to Section 143(1) provides that no intimation under section 143(1) shall be sent after the expiry of one year from the end of the financial year in which the return is made. By the reason of second proviso to section 143(1), after the expiry of one year from the end of relevant financial year the right to claim refund vested with the assesse.

[1]DCIT v Zuari Estate Development & Investment Co Ltd. 2015 (15) SCC 248 [SC]

Once the one year period in proviso to Section 143(1) ends, the return becomes final except one event i.e. issue of notice u/s 143(2).

9. Reasoning for referring to section 143(1D) was also not communicated within the said period of one year. Therefore orders given u/s 143(1D) and u/s 241A were beyond by limitation without cogent reasons and justification.

10. From the perusal of section 241A, it is evident that the return has to be processed within the time prescribed u/s 143(1)(a).

11. VIL is facing precarious financial conditions with accumulated losses and mounting up of debts as on 31.03.2017.

ARGUMENTS of REVENUE:

12. On issue of notice u/s 143(2), considering the issues involved there is a prima facie likelihood of raising substantial demand by the Income Tax Department, as preceded in earlier years.

13. Section 143(1D) starts with an non-obstante clause, which overrides the provision of section 143(1), consequently, when notice u/s 143(2) has been issued it is not required to process return u/s 143(1)(a).

14. Proviso to section 143(1D), prior to the amendment with effect from 01.04.2017, provides that processing of return could be made before the assessment u/s 143(3). The non-obstante clause in section 143(1D) overrides the second proviso in section 143(1).

15. The inter-relation between sub-sections in section 143 has been ruled out by the apex court[2] as 'once regular assessment proceedings have commenced under Section 143(2) of the Income Tax Act, 1961, it is a limitation on the jurisdiction of the assessing officer to commence proceedings under Section 143(1)(a) of the Act' and revenue placed reliance on this decision.

SC DECISION:

16. The power vested under section 143(1) is merely processing of return considering any apparent inconsistencies evident on the face of the return and connected material which may call for any adjustment; whereas the nature of power to be exercised under section 143(2) is to

[2]CIT v. Gujarat Electricity Board [2003] 129 Taxman 65 (SC)

scrutinize the return, checking its veracity threadbare, after taking into account the evidence produced in order to ensure that there is no understating of income or overstating of loss or underpayment of the tax in any manner. The power under section 143(1) is summary in nature designed to carry out apparent adjustments and inconsistencies, whereas under section 143(2) is to scrutinize and cause deeper probe to arrive at the correct determination of tax liability.

17. In respect of AYs ending on 31st March 2017 or before, the requirement to process the return under section 143(1) shall stand overridden, if a notice was issued under section 143(2) and in such case it shall not be necessary to process the refund under section 143(1) of ITA.

18. Prior to 01.04.2017, section 143(1D) does not contemplate either to send intimation under section 143(1)(a) or further application of mind for keeping the processing in abeyance, when notice under section 143(2) is issued for deeper scrutiny. The notice under section 143(2) is adequate to trigger the required consequence.

19. After 01.04.2017, as per second proviso to section 143(1) read with section 241A of ITA, intimation shall be given for withholding refund within one year from the end of relevant assessment year.

BUTTRESSES or GROUNDS for the DECISION:

Scheme of section 143:

20. Section 143(1)(a) provides summary assessment permitting six types of adjustments, which are apparent and when inconsistency is evident on the face of return, where the return has been filed u/s 139 or in response to notice u/s 142(1). In case of adjustments prior intimation shall be sent to assessee for the adjustments and if response has not received within 30 days from the date of intimation, income shall be computed considering such adjustments. Section 143(1A) to (IC) provides scheme pertaining to central processing of returns.

21. Section 143(ID), inserted by the FA 2012, provides that processing of ITR shall not be necessary where notice u/s 143(2) has been issued. The Finance Act 2017, further amended section 143(1D) along with inserting section 241A with effect from 01.04.2107, where refund of any amount becomes due to the assessee

under Section 143(1) of the ITA and the AO is of the opinion that grant of refund may adversely affect the recovery of revenue, he may, for the reasons recorded in writing and with the previous approval of the Principal Commissioner or Commissioner, withhold the refund up to the date on which the assessment is made.

22. Section 143(1D) commences with, ' Notwithstanding anything contained in sub-section (1), the processing of a return shall not be necessary, where a notice has been issued to the assessee under sub-section (2)...' The phrase, 'notwithstanding anything contained in subsection (1)' is of widest amplitude engulfing the contrary provisions contained in section 143(1). The expression 'shall not be necessary' contemplates overriding of general principle or carving out of an exception to a mandated action prescribed by general principle. In other words, the general principle stands overridden because of the phrase 'shall not be necessary'.

23. Notice under section 143(2) generally be issued, under regular assessment for passing order u/s 143(3), in cases where AO considers it necessary or expedient to ensure that (i) income has not understated or (ii) loss has not computed excessive or (iii) tax has not under-paid in any manner.

Non-obstante clause:

24. A non-obstante clause is a legislative device usually employed to give overriding effect to certain provisions either in the same enactment or in some other enactment; it is employed in order to avoid the operation and effect of all contrary provisions.[3]

Summary assessment vs Regular assessment:

25. Section 143(1)(a) intends a summary procedure for quick collection of tax and quick refunds, whereas regular assessment has been intended under section 143(2) and 143(3). Rectification under section 154 can be sought in case of objections on adjustments made by AO under section 143(1)(a). A regular assessment can be resorted to either *suo motu* or at the insistence of assessee, when ITR has been processed u/s 143(1)(a), whereas converse is not possible i.e. where regular assessment is commenced by issuing notice u/s 143(2), there is no need for making summary proceeding under section 143(1)(a).[4]

[3]Union of India v. G.M. Kokil [(1984) Supp. SCC 196]
[4]CIT v. Gujarat Electricity Board [2003] 129 Taxman 65 (SC)

AUTHOR's COMMENTS on Assessment:

Principles of natural justice:

26. Setting aside of entire order need not be resorted to in case of non-provision of opportunity for cross examination to assessee, instead specific direction must be provided to AO allowing for cross examination of witness, as it is one of the basic principles of natural justice.[5] Order of assessment must be made after giving a reasonable opportunity to the assessee for setting out his case.[6]

27. The cardinal principle of law is that if relevant materials and objections are produced before a quasi-judicial authority, it is duty bound on the authority, under law to advert to consider the same, discuss them and then reject it by recording reasons. Order passed without considering material on record, amounts to perverse based on his *ipse dixit* and in violation of principles of natural justice.[7]

Powers of AO:

28. The powers of AO, being quasi-judicial nature, must be exercised in a fair, proper and judicious manner and not in a partisan manner; exercise of such power should not result in more beneficial to revenue and consequently more adverse to the assesse but in a judicious manner.[8]

29. "A humane and considerate administration of the relevant provisions of the Income-tax Act would go a long way in allaying the apprehensions of the assessees and if that is done in the true spirit, no assessee will be in a position to charge the Revenue with administering the provisions of the Act with "an evil eye and unequal hand.""[9]

30. Powers of AO, being quasi-judicial nature though bound by the circulars issued by CBDT, shall not be at the instance of higher authority as it would impair his independence in making the assessment.[10]

31. When power to proceed is actually provided in the Act, mere mentioning of wrong section would not vitiate the proceedings and cannot be challenged through writs in court of law. Notice, being purported to be

[5]ITO v. M. Pirai Choodi [2012] 20 taxmann.com 733 (SC)
[6]Tin Box Co. v. CIT [2001] 116 TAXMAN 491 (SC)
[7]ACIT v. Balmiki Prasad Singh [2018] 99 taxmann.com 204 (SC)
[8]CIT v. Simon Carves Ltd. [1976] 105 ITR 212 (SC)
[9]Pannalal Binjraj v. Union of India [1957] 31 ITR 565 (SC)
[10]CIT v. Greenworld Corporation [2009] 181 Taxman 111 (SC)

preliminary, can be quashed only when it is lack of jurisdiction; 'writ of prohibition' arises only in such situations. 'Writ of mandamus' can arise only when the applicants show non-compliance with some mandatory provision and seek to get that provision enforced because some obligation towards them is not carried out by the authority alleged to be flouting the law.[11]

32. **Protective assessments:** where it appears that certain income has been received during the relevant assessment year either by A or B or by both together, but it is not clear who has received that income, then it would be open to the AO to initiate appropriate proceedings and determine the liability both against A and B.[12]

Validity of assessment:

33. Assessment in the name of non-exist company consequent upon merger with another company, after taking note of the development during assessment, was a nullity.[13]

34. Once the corporate entity is merged with another, the assessment has to be completed only on transferee i.e. in the hands of amalgamated or merged entity. Section 292B, which deals with validity of any assessment, notice, summon or other proceedings in case of any mistake, defect or omission is not applicable, as the substitution of successor in the place of dead person in the assessment order would not amount to mistake or defect of curable procedural nature.[14]

35. Loose sheets of papers should not be taken as a basis for considering undisclosed income.[15] However, when loose sheets were not disputed and when there was a clear and categoric admission of the undisclosed income, by the assessee, in sworn statement there is no necessity to scrutinise the documents and submissions made, without pointing out any mistake or incorrectness in the admission of income, at the time of assessment and assessment completed based on such admission was valid.[16]

[11]Isha Beevi v. Tax Recovery Officer [1975] 101 ITR 449 (SC)
[12]Lalji Haridas v. ITO [1961] 43 ITR 387 (SC)
[13]PCIT v. BMA Capfin Ltd. [2018] 100 taxmann.com 330 (SC)
[14]CIT v. Dimension Apparels (P.) Ltd. [2014] 52 taxmann.com 356 (Delhi)
[15]CIT v. Girish Chaudhary, [2008] 296 ITR 619/163 Taxman 608 [Del]
[16]B. Kishore Kumar v. DCIT [2014] 52 taxmann.com 449 (Madras); SLP dismissed [2015] 62 taxmann.com 215 (SC)

36. Assessment order could not be treated as barred by limitation when the assessee knew the facts, being ready to serve, of assessment order during his visit to department.[17]

37. When additions made on the value of obsolete items, taking at 50% its cost as realisable value without any basis for such adoption, held additions were arbitrary and not justifiable.[18]

38. Additions on the basis of unjustifiable evidence was deleted by CIT (A) and later confirmed by ITAT based on facts submitted; seeking direction for remand of assessment for fresh disposal, held since it is a question of appreciation of evidence and not of perversity of the finding, therefore, order of Tribunal is not erroneous.[19]

39. The intimation under section 143(1)(a) cannot be treated to be an order of assessment. The word 'reason' in the phrase 'reason to believe' will mean cause or justification. If the AO has prima facie justification, without conclusion by legal evidence, that income has escaped assessment, re-opening of assessment even if it is completed u/s 143(1)(a) would be possible. 'The function of the Assessing Officer is to administer the statute with solicitude for the public exchequer with an in-built idea of fairness to taxpayers.'[20]

40. Return of income filed cannot be amended for making a claim for deduction otherwise than by way of a revised return.[21] However, revised computation of income, claiming sale of agriculture land as exempt from tax held can be accepted and remanded back for fresh assessment considering merits of the case.[22]

Notice u/s 143(2):

41. Issue of notice under section 143(2) cannot be regarded as a procedural one as it becomes necessary only when it is desired to check the veracity of return filed. Therefore, the

[17]Binani Industries Ltd. v. CIT [2016] 73 taxmann.com 191 (SC)
[18]Alfa Laval India Ltd. v. DCIT [2003] 133 TAXMAN 740 (BOM.); affirmed by SC [2008] 170 Taxman 615 (SC)
[19]CIT v. Gujarat Heavy Chemicals Ltd. [2002] 256 ITR 795 (SC)
[20]ACIT v. Rajesh Jhaveri Stock Brokers (P.) Ltd. [2007] 161 Taxman 316 (SC)
[21]Goetze (India) Ltd. v. CIT [2006] 157 Taxman 1 (SC)
[22]S. Chockalingam v. DCIT [2014] 49 taxmann.com 210 (Chennai - Trib.)

omission to issue notice within the stipulated time on the part of assessing authority is not curable; therefore, the requirement of notice under Section 143(2) cannot be dispensed with.[23]

42. However, issue of notice to the address at PAN data base was justified in a case where change of address was neither intimated specifically to the AO nor amended the PAN data base; intimating the change of address in return of income would not be regarded as an adequate compliance.[24]

43. Notice u/s 143(2) must have emanated from the department; the section is not intended to cure the complete absence of notice but the infirmities in the manner of service of notice be cured. If the assessee had participated in the proceedings, by way of legal fiction, then the notice would be deemed to be valid even if there be any infractions for the purpose of Section 292BB (notice deemed to be valid in certain circumstances).[25]

44. Service of notice u/s 143(2) to authorised representative when the assessee was not traceable, held deemed to be a valid service of notice.[26]

45. Service of notice u/s 143(2) on the next working day, when due date falls on Sunday, deemed valid service of notice.[27]

CONCLUSION:

46. It is manifested that refunds cannot be withheld without any reasons in the normal course of assessment. Issue of notice u/s 143(2) and further intimating reasons for withholding refunds u/s 241A within the stipulated time would help the assessee to take appropriate decisions or actions at that point of time with regard to availability of funds (refund) for the business.

[23]ACIT v. Hotel Blue Moon [2010] 188 Taxman 113 (SC)
[24]PCIT v. I-Ven Interactive Ltd. [2019] 110 taxmann.com 332 (SC)
[25]CIT v. Laxman Das Khandelwal [2019] 108 taxmann.com 183 (SC)
[26]ITO, Etawah v. Dharam Narain [2018] 90 taxmann.com 325 (SC)
[27]Gujarat State Plastic Manuf. Association v. DCIT [2014] 51 taxmann.com 372 (SC)

LARGER BENCH OF CESTAT CLOSES THE FORECLOSURE DEAL

CA RAHUL JAIN & **CA. V. BARATWAJ**

The past two months have seen two key decisions being pronounced in respect of the Financial Sector from the indirect tax perspective. Both these decisions have provided a welcome relief to the industry. While the first decision in the case of South Indian Bank[1] was in the context of cenvat credit eligibility on services provided by Deposit Insurance and Credit Guarantee Corporation (DICGC) (refer to July 2020 CASC magazine for our in-depth analysis of this decision), the subject decision which forms the bedrock of this Article is in the context of exigibility to service tax on the foreclosure charges collected by Banks and NBFCs (referred to as 'financial institution' or 'financial institutions'). At this stage, we would highlight that though the decision was rendered in respect of financial institutions, the ratio of this decision would apply to a large number of transactions, the nature of which would be discussed later in this Article.

Background of the decision

The main purpose of any financial institution is to lend money and recover the same in instalments along with a consideration in the form of 'interest'. This interest compensates for the 'time value of money' and also includes a premium in the form of profit. Thus, a financial institution enters into a loan agreement with a customer to receive the principal and interest portion over a specified period of time.

The loan agreement usually contains a clause which allows the borrower to 'foreclose' or 'pre-close' the loan before the specified time period. The incentive for the borrower to close the loan before its tenure is when the rates of interest in the market becomes lower and the interest which he has to pay on the loan obtained is higher than the market rate. He can now obtain a new loan at a lower rate of interest and close the old loan, thus saving on the differential interest.

However, this practice is not desirable from the view point of a financial institution since the expectation is that the loan amount along with interest would be recovered over a fixed period of time. When the borrower pre-closes the loan, it may be difficult for a financial institution to figure out new investment opportunity for a huge amount of money immediately.

Further, the amount which is received on foreclosure may have to be lent at a lower interest rate as the market rate of interest would be lower. On the other hand, if the loan was not pre-closed, this investment would have earned a higher interest income for the financial institution. Therefore, immediate receipt of the funds results in loss to the financial institutions. To compensate for such loss, the financial institution charges an amount known as '**foreclosure'** or '**pre-closure**' charges specified in the loan agreement as a percentage of the outstanding principal amount.

Disputes arose in the pre-negative list service tax regime as to whether the 'foreclosure' or 'pre-closure' charges are a consideration for 'banking and other financial services' rendered by the financial institution and thus leviable to service tax. There were varying views expressed by Tribunals on this issue. Finally, the Larger Bench of the Tribunal in the case of Repco Home Finance Limited[2] has held that service tax is not leviable on such charges.

This Article analyses the decision of the Larger Bench and its implications in the Service Tax negative list (post 1-7-2012) and Goods and Services Tax (**'GST'**) regime. Before moving onto those aspects, it is important to obtain a brief understanding of the relevant statutory provisions in this regard.

Brief background of relevant provisions under the pre-negative list regime

Section 65(105) of the Finance Act, 1994 (**'Finance Act'**) defined the term 'taxable service'. In the aforesaid definition, clause (zm) deals with services provided by a banking company or a financial institution including a NBFC in relation to 'banking and other financial services'.

The term 'banking and other financial services' is defined in Section 65(12) of the Finance Act in a very wide manner. The part of the definition which is of relevance in the present case is the clause which states that 'banking and other financial services' means 'lending'. The term 'lending' was inserted in the definition w.e.f 10.09.2004.

The department was of the view that services in relation to pre-closure of loan was also a service in relation to 'lending' and therefore part of 'banking and other financial services'. Thus, service tax was leviable on this transaction. This view of the department was disputed by assessees in various decisions.

With this understanding, the decision of the Larger Bench is analysed below.

[1]2020-VIL-271-CESTAT-BLR-ST-LB
[2]2020-VIL-309-CESTAT-CHE-ST

Dissecting the decision of the Larger Bench

Before delving into the decision of the Larger Bench, it is important to have a brief understanding of the contrary decisions on this issue which is tabulated below:

Decisions which held service tax is not leviable		**Decision which held service tax is leviable**
SIDB[3]	**Magma Fincorp[4]**	**Hudco[5]**
Foreclosure is ending a loan given and is kind of a compensation for possible loss of interest revenue on the loan amount returned. Therefore, the activity of foreclosure of loan cannot be treated as Banking and other Financial services.	Following the decision in case of SIDBI, it was held that service tax is not payable on pre-payment charges.	i) Pre-payment charges can be considered as cost incurred by the borrower for value added services in the form of considering request for pre-payment, collection of the outstanding amount and closure of the loan. ii) These services are in relation to 'lending' which is part of 'banking & other financial services', after 10.09.2004. iii) The decision in case of SIDBI was rendered prior to 10.09.2004 when the words 'lending' was not part of 'banking & other financial services'. Therefore, service tax is leviable on the foreclosure charges.

When the issue in the case of Repco Home Finance Limited **('Repco')** came up for hearing before the Division Bench of the Hon'ble Tribunal (Ahmedabad Bench), noticing the conflicting decisions in the case of Hudco and Magma Fincorp, it was considered appropriate to refer the issue to Larger Bench of the Tribunal. Consequently, the Larger Bench was constituted which decided on this issue.

[3]2011 (23) STR 392 (Tri.-Delhi)

[4]2016 (4) TMI 21-CESTAT KOLKATA

[5]2012 (26) STR 531 (Tri.-Ahmd.)

The Arguments by the Department and Repco before the Larger Bench are tabulated below:

Arguments by Department	Arguments by Repco
i) The termination of the loan prior to the agreed term is a facility available to a borrower at a price in the same way as other facility is available to a borrower at a price. ii) The foreclosure charges are levied over and above the interest that is charged from the borrower and does not have the character of interest income iii) The charges cannot also be termed as penal interest since penal interest is chargeable only in case of default in making the regular payments.	i) The charges are not a consideration for a service provided but a compensation for breach of the contract as the borrower unilaterally seeks to make payment before the agreed tenure. ii) It is not the desire that a borrower should cut short the tenure and make the entire payment, for the business of a bank is to earn interest income on the loan. iii) Instead of claiming damages for the breach, the amount is incorporated in the loan agreement itself to provide certainty in dealings.

Findings of the Larger Bench

The Larger Bench of Tribunal relying upon various decisions in the context of consideration and also on provisions of contract law gave the following findings:

i) The foreclosure charges are not a 'consideration' for a service provided by the financial Institutions

To constitute 'consideration', an amount must flow from the service recipient to the benefit of the service provider for a taxable service provided. The charges in the present case are recovered for disruption of a service and not for provision of any service. Further, as per Section 2(d) of the Indian Contract Act, 1872, **consideration should flow at the desire of the promisor**. The financial institutions being the promisors in the present case do not desire pre-mature termination of the loan.

ii) The foreclosure charges are a compensation for unilateral breach of contract by the borrower

Premature termination of loan results in loss of future interest income. To compensate for the same, banks collect foreclosure charges. The unilateral act of the borrower of foreclosing the loan has resulted in breach of promise i.e. to service the loan for an agreed period of time. A breach of contract may give rise to claim for damages. Damages can be determined by courts or it can be incorporated in the loan agreements. These charges compensate the 'expectation' that the loan will be serviced over a specified period of time.

iii) The activity of foreclosure is not related to the service of lending

Foreclosure charges are not for providing a service, but for disruption of a service. The activity of foreclosure is anti-thesis to lending and therefore cannot be construed to be 'in relation to lending'. The phrase 'in relation to lending' cannot be stretched so as to bring within its ambit even activities which terminate the activity.

It was also held that the decision in case of Hudco is incorrect since there is no element of service rendered by the banks to borrowers and the charges are nothing but damages which the banks are entitled to receive when the contract is broken.

Based on the above, the Larger Bench concluded that foreclosure charges collected by banks cannot be regarded as 'consideration' for providing 'banking and other financial services' and thus not leviable to service tax.

Applicability of this decision to certain other issues

Apart from the finding on the aspect that the activity of foreclosure is not a service in relation to 'lending', the Larger Bench has also provided their finding on the aspect of 'consideration' which could be used in various other issues. Some of such issues are discussed below:

i) The issue on leviability of Service Tax on 'Liquidated Damages' has been under dispute for a very long time. This issue has been decided against the assessee at the lower levels in the absence of a clear-cut decision on the same until recently. While the

department is of the view that the amount of damages is a consideration for tolerating an act, the assessees would contend that the damages are merely a compensation for a loss suffered by the assessee and not a 'consideration' for any service. The finding in this case on the aspect that 'consideration' must be at the desire of the promisor could be applied in the disputes involving liquidated damages to point out that it is also not at the desire of the service provider, the customer does not abide by the contract and compensates them by way of damages. Hence, the argument that the amount of damages cannot be said to be 'consideration' and thus, not exigible to service tax is further strengthened by this decision.

ii) A question which may arise is whether this decision can be applied to levy of service tax or GST on any charges similar to foreclosure charges. For instance, a bank may collect charges for early termination of a forward contract, a lessor may collect charges for early termination of a lease or a mutual fund may collect exit load from its investors to discourage terminating forward contract or lease or exit from the mutual fund respectively. It is possible to argue that any charges of this nature are merely collected to compensate the loss suffered on account of early termination of a contract which not desirable from the view point of the provider of the services and thus cannot be regarded as 'consideration'. Therefore, any charges collected for early termination or breach of any contract may not be leviable to service tax or GST.

Applicability of the decision to negative list and GST regime

In the negative list regime, the term 'service' has been defined in the widest possible manner to include 'any activity' for a 'consideration'. Further, there are some services specified as declared services which includes 'agreeing to tolerate an act'. From the above, it is possible to take a view that the activity of foreclosure would satisfy the criteria of 'any activity' or could also be regarded as 'agreeing to tolerate an act'. However, it is important to note that such an activity must also be for a consideration.

The term 'consideration' is defined in an inclusive manner in the negative list regime too. Therefore, since financial institutions do not desire pre-closure of loan, the finding in this decision on the aspect that the charges are not at the desire of the promisor and hence not a 'consideration' would still hold good. Further, it is also possible to argue that the charges are merely a 'compensation' for the breach and not a 'consideration'. Therefore, in the negative list regime, since the criterion for 'consideration' does not seem to be satisfied, the activity of foreclosure is not leviable to service tax.

Similar to the negative list regime, in the GST regime, the term 'supply' is defined in a very broad manner to include any supply of 'goods' or 'services' for a 'consideration'. The term 'service' is also defined very widely under GST. Therefore, the activity of foreclosure could be regarded as a service. But as in case of the negative list regime, the finding on the aspect that charges not being at the desire of the financial institutions and thus not a 'consideration' could be applied in the GST regime too.

Conclusion

The Banking and NBFC industry has been in turmoil for the past few years in light of the various issues faced by them, the most important being rising Non-Performing Assets. The efficient functioning of this sector is very important for any economy because of the flow of credit to business houses from these sectors. The decisions by Larger Bench of CESTAT in the past couple of months has ensured that the sector is not pressed even more by the tax demands raised on them by the Department. These decisions are also important from audit view point in deciding on treatment of provisions and contingent liabilities created or disclosed earlier in respect of tax demands of similar nature. The applicability of this decision in other issues in the GST regime could also be explored which would result in lower burden of taxes.

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LEARNING SERIES ON MULTILATERAL INSTRUMENT UNDER TAX TREATIES
LS #12: TREATY ENTITLEMENT - PRINCIPLE PURPOSE TEST (PPT)

Objectives

A. Prelude - Tax Treaty Entitlement- Principle Purpose Test (PPT)

B. MLI Provisions- PPT: Article 7(1) -(5)

C. Key Components to trigger PPT scope clause - Article 7(1)

D. Key Terms under the PPT scope clause- Article 7(1)

E. Epilogue

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Annexure - Pictorial summary of PPT scope clause.

A. Prelude – Tax Treaty Entitlement

- In the earlier learning series, we looked at the Simplified Limitation on Benefits and the Preamble under the MLI which were measures introduced to curb tax treaty abuse. Another important concept in the tax treaty abuse, which acts as one of the central and pivotal forces to the OECD -BEPS project is the Principle Purpose Test (PPT). PPT is one of the minimum standards to be adopted by jurisdictions under the BEPS-MLI framework.

- Just to reiterate the treaty abuse measures, the Action 6 of BEPS plan[1] specifically addresses the concerns of treaty abuse and the ways for prevention of such abuse and makes suggestion of a three-pronged approach to address a treaty shopping situation. This includes

i) clear statement of objects of the tax treaty (Preamble Approach),

ii) Specific limitation on benefits for treaty shopping based on legal nature, ownership, etc., (LoB Approach) and

iii) test of principle purpose of transactions or arrangements addressing general forms of abuse (PPT Approach).

[1]OECD, Preventing the Granting of Treaty Benefits in Inappropriate Circumstances, Action 6 - 2015 Final Report (OECD / G20 Base Erosion and Profit Shifting Project 2015).

- From the BEPS Action 6, it infers that all the three rules will operate in tandem especially PPT and LOB being substantive rules. However, under the Multilateral Instrument (MLI) provisions, the PPT under Article 7(1) has attained a larger significance vis-à-vis the LoB, which is restricted to a simplified version plus a Simplified LOB is an optional tool, wherein States need not invoke Simplified LOB provisions subject to satisfaction of other compatibility conditions. It may be appropriate to say that, under the MLI context, PPT is regard as a General Anti-Abuse rule or a catch all rule, aimed to cover those arrangements that may fall-out to be covered under the LOB provisions or any other Specific Anti Avoidance Rule (SAAR).

Having seen the Simplified LOB and Preamble in the earlier series, we will now shift our focus in this learning series to lay the principles and concepts around PPT under the MLI context.

B. MLI Provisions: Article 7(1) –(5)

- Article 7(1) of the MLI which covers the main scope of the PPT clause is as follows:

  *7(1) - **Notwithstanding any provisions of a Covered Tax Agreement**, **a benefit** under the Covered Tax Agreement shall not be granted in respect of an item of income or capital if it is **reasonable to conclude**, having regard to all relevant facts and circumstances, that obtaining that* benefit ***was one of the principal purposes*** *of any arrangement or transaction that resulted directly or indirectly in that benefit, unless it is established that granting that benefit in these circumstances would be **in accordance with the object and purpose** of the relevant provisions of the Covered Tax Agreement.*

- *Non-obstante clause:*

  From Article 7(1) of the MLI, where the PPT rule starts with a non-obstante clause indicates on a literal reading that PPT will override and encompass all SAAR. This raises significant issues as to whether the SAARs in a tax treaty will be redundant in lieu of PPT. Without dwelling into the details owing to brevity, in our view, PPT can be invoked only if the transaction or arrangement was not covered in the SAAR.

C. Key components of PPT to trigger scope clause

- Further it is a general principle that any general anti-abuse rule must satisfy the subjective and objective test before invoking the same. From the PPT clause in Article 7(1) one can decipher that
- Subjective clause: One of the principal purposes
- Objective clause: Benefit in accordance with the object and purpose of the relevant CTA.
- *Subjective: One of the principal purposes:*

  In this regard, the subjective element of proving that one of the principal purposes of the arrangement or transaction is to derive tax benefit appears to be with the tax payer. The onus on the burden to prove will be with the taxpayer, leaving the tax authorities to infer merely that it is *reasonable to conclude* that the arrangement's one of the purpose is obtaining a benefit. Subjectivity is always a threat to the taxpayer and a weapon in the hands of Tax Administration. It is no new phenomenon that this opens a pandora's box of emerging issues.

  In this context it is important to note the relevance of the "purpose" of a transaction in deciding the application of PPT rule to a transaction or an arrangement. For this purpose it is extremely relevant to note the literature from the commentary provided in paragraph 13 of the Final Action Report – 6 of 2015:

13. *A purpose will not be a principal purpose when it is reasonable to conclude, having regard to all relevant facts and circumstances, that obtaining the benefit was not a principal consideration and would not have justified entering into any arrangement or transaction that has, alone or together with other transactions, resulted in the benefit. In particular, where an arrangement* ***is inextricably linked to a core commercial activity,*** *and its form has not been driven by considerations of obtaining a benefit, it is unlikely that its principal purpose will be considered to be to obtain that benefit. Where, however, an arrangement is entered into for the purpose of obtaining similar benefits under a number of treaties, it should not be considered that obtaining benefits under other treaties will prevent obtaining one benefit under one treaty from being considered a principal purpose for that arrangement..."*

- In order to determine the purpose of the transaction or an arrangement relating to "persons concerned" the commentary provides that objective elements – the aims and the objects of all persons involved in a transaction or arrangement have to be considered to satisfy the test with conclusive proofs[2].

- *Objective Element: in accordance with the objects of the CTA:*

  With regards to the objective element, the benefit derived must be in accordance with the object and purpose of the CTA. Again, in this regard, the taxpayer must take the burden to prove that the benefit obtained is in accordance with the object and purpose of the relevant CTA. Also there arises difficulty in identifying the object and purpose of the relevant CTA. Further question arises as to whether the transaction has to be looked into specifically or whether the entire convention has to be looked into to determine the object and purpose. The OECD MC 2017, commentary provides some illustrations in this regard. However, the illustrations are vague and at times are ambiguous.

- Therefore, assessment of tax authority with reference to obtaining of a tax benefit under treaty must be based on the following aspects

i. Consideration of all facts and circumstances of the transaction or arrangement

ii. Each factor necessary for affirming the conclusions drawn are weighed appropriately

iii. Lastly, whether the even on satisfaction of PPT test, objective test is being fulfilled.

D Key terms under the PPT

- **'Benefits' for the purpose of PPT?**

  The commentary to BEPS Action 6: Final Report of 2015 on Preventing the Granting of Treaty Benefits in Inappropriate Circumstances, provides the explanation to these terms and phrases that have been used in this context. It is imperative to note that the anti-abuse provisions are understood to be with meanings of widest impute.

[2]Paragraph 10 - Commentary to Article - X on Preventing the Granting of Treaty Benefits In Inappropriate Circumstance - BEPS Action 6 of 2015- Final Report; page. 57

- The term "Benefit"[3] in the commentary defines as "*all limitations (e.g. a tax reduction, exemption, deferral or refund) on taxation imposed on the State of source under Articles 6 through 22 of the Convention, the relief from double taxation provided by Article 23, and the protection afforded to residents and nationals of a Contracting State under Article 24 or any other similar limitations*."

  A benefit under the treaty shall denote those benefits extended by a State of Source, having rights of taxation in respect of dividends, interest or royalties, gains derived from sale of movable property, paid to a resident (who being a beneficial owner) of other contracting state. The coverage shall also include other benefits derived such as a tax sparing provision in order to apply the PPT test.

  Hence one could even say, the State of Source shall have the right to deny the treaty benefit in cases where it satisfies that primary condition of "one of principle purpose of the transaction" was to derive such benefit, directly or indirectly, under that convention.

  Further, if the benefit is arising out of a domestic law implication of a residence state will not tantamount to benefit. For eg. Lower corporate tax rates.

- **The term "that resulted directly or indirectly in that benefit"[4] –**

  The commentary provides that phrase is *"deliberately broad and is intended to include situations where the person who claims the application of the benefits under a tax treaty may do so with respect to a transaction that is not the one that was undertaken for one of the principal purposes of obtaining that treaty benefit".*

  This implies that even if the transaction is well backed commercially, even then in case the if the facts show that the one of principle purposes of the transaction or an arrangement is devised to obtain the treaty benefit, the PPT rule shall be invoked.

[3]Paragraph 7 - Commentary to Article - X on Preventing the Granting of Treaty Benefits In Inappropriate Circumstance - BEPS Action 6 of 2015- Final Report; page. 55

[4]Paragraph 8 - Commentary to Article - X on Preventing the Granting of Treaty Benefits In Inappropriate Circumstance - BEPS Action 6 of 2015- Final Report; page. 56

- **"Arrangement or transaction" –**

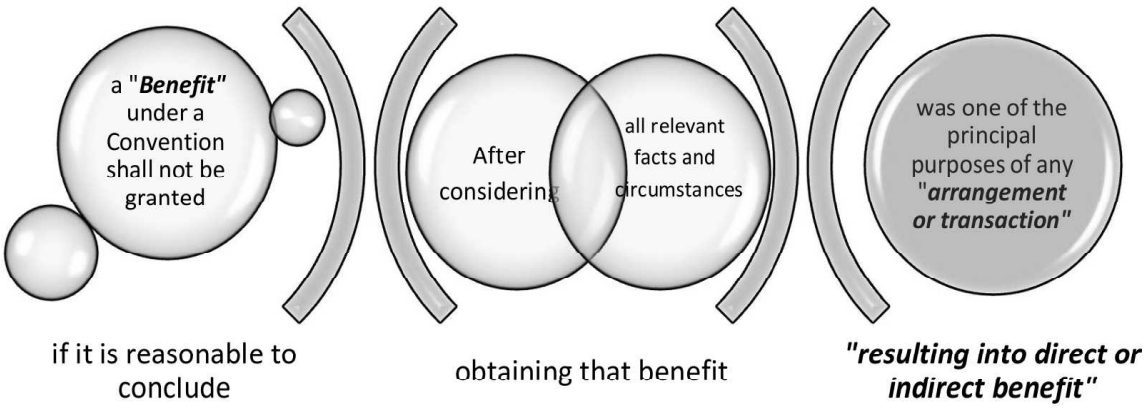
The commentary provides that*, the terms should be interpreted broadly and include any agreement, understanding, scheme, transaction or series of transactions, whether or not they are legally enforceable. In particular they include the creation, assignment, acquisition or transfer of the income itself, or of the property or right in respect of which the income accrues. These terms also encompass arrangements concerning the establishment, acquisition or maintenance of a person who derives the income, including the qualification of that person as a resident of one of the Contracting States, and include steps that persons may take themselves in order to establish residence.*

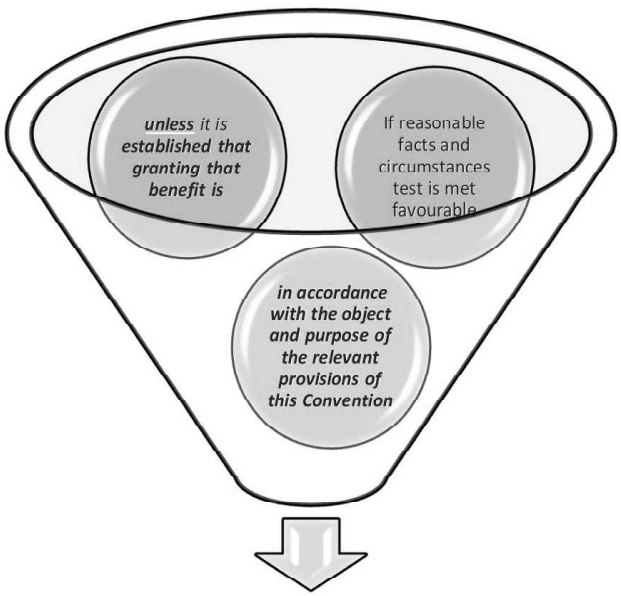
The effect of such a broad interpretation would mean that any conduit activity or positioning the residency of a taxpayer or any such arrangement lacking commercial logic or reasons could trigger the PPT application.

E Epilogue

As can be seen, PPT is a very key component and tool of the BEPS project. As a GAAR provision and being a common minimum standard, countries will be use it as a potential tool by its tax authorities for combatting tax abuses and avoidance. If SAAR cannot catch a particular treaty abuse, the PPT is expected to fill in that void. In a way one can look at PPT as a residuary anti-avoidance provision. Having said that it's possible that tax authorities might trouble genuine taxpayers whose main objective would be non-tax. We have given a summary through a pictorial representation of applicability of PPT in Annexure 1. In the next series we will look into the other provisions of PPT under the MLI such as the discretionary PPT clause and compatibility provisions.

Annexure - Application of PPT





A Discussion Paper on Chapter-III-Direct Taxes of Finance Act, 2020 - February And March - 2020

CA. VIVEK RAJAN V

Introduction- Thanking everyone for our Discussion Papers of 2016, 2017, 2018 & 2019(Interim and Final)

The Finance Bill, 2020 (Bill No. 26 of 2020) was presented in Lok Sabha on 01st February 2020 by Ms. Nirmala Sitharaman, Union Finance Minister. In Chapter III of Finance Bill, 2020, there has been 104 amendments to the Income-tax Act, 1961. The Finance Bill, 2020 got the assent of the President of India on 27th March 2020 and thereby becoming **THE FINANCE ACT, 2020** [ACT NO 12. OF 2020]

Scope of the Discussion Paper

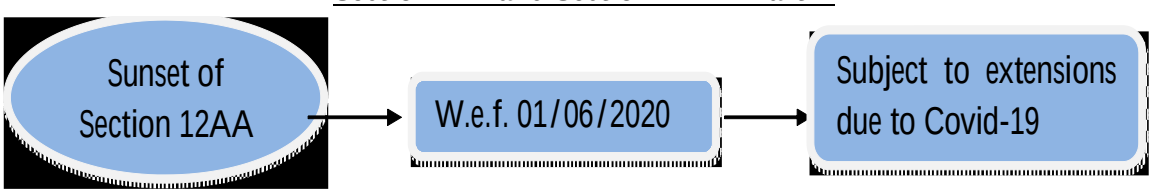
This discussion paper attempts to cover **all sections of the Finance Act, 2020** relating only to Direct Taxation. This discussion paper attempts to cover all the aspects about the amendments broadly and **not in detail.** Further unless otherwise specifically mentioned, sections discussed in this paper, relates to Income-tax Act, 1961 and the Finance Act, 2020. Please refer to Finance Act, 2020 and the relevant pronouncements before taking any decision. The readers are requested to contact the author, in case of errors (which are unintentional) and also in case of divergent views with the author's note.te.

We thank the readers for giving their support for the 100% coverage attempted for the first time for the Budget 2019. Similarly, we are attempting to extend the coverage of the discussion paper **to all the sections of the Finance Act, 2020 and also to coin FAQ's to the best extent possible.** Giving due consideration to the volume of the discussion paper and the challenges involved in publishing, we intend to present this in a phased manner (August 2020 and September 2020). ***The sections which are not covered in this month's bulletin, would be covered in the subsequent months.*** We sincerely hope that this effort is of value addition to the readers.

Acronym and Description

FA	Finance Act
CG	Capital Gains
IFHP	Income from House Property
LTCG	Long Term Capital Gain
The Act	Income Tax Act, 1961
PY	Previous Year
AY	Assessment Year
PCIT	Principal Commissioner of Income-tax
CIT	Commissioner of Income-tax
NRI	Non- resident Indian
RBI	Reserve Bank of India
NCLT	National Company Law Tribunal
FMV	Fair Market Value
TDS	Tax Deducted at Source
TCS	Tax Collected at Source

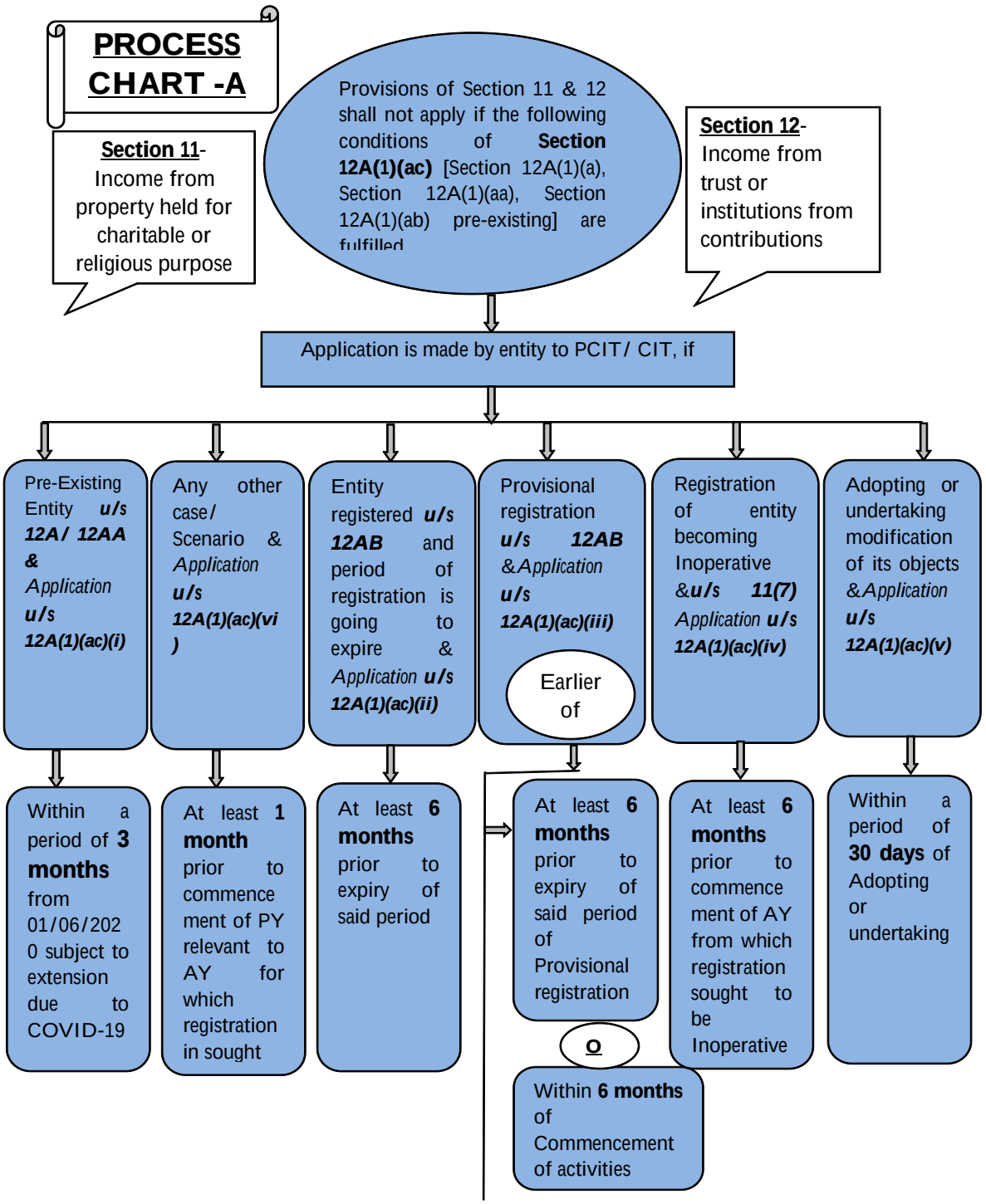
Implications for organisations seeking fresh registration u/s 12AB with time limit from the organisation's perspective & amendment of Section 12A and Section 12AA- Part II



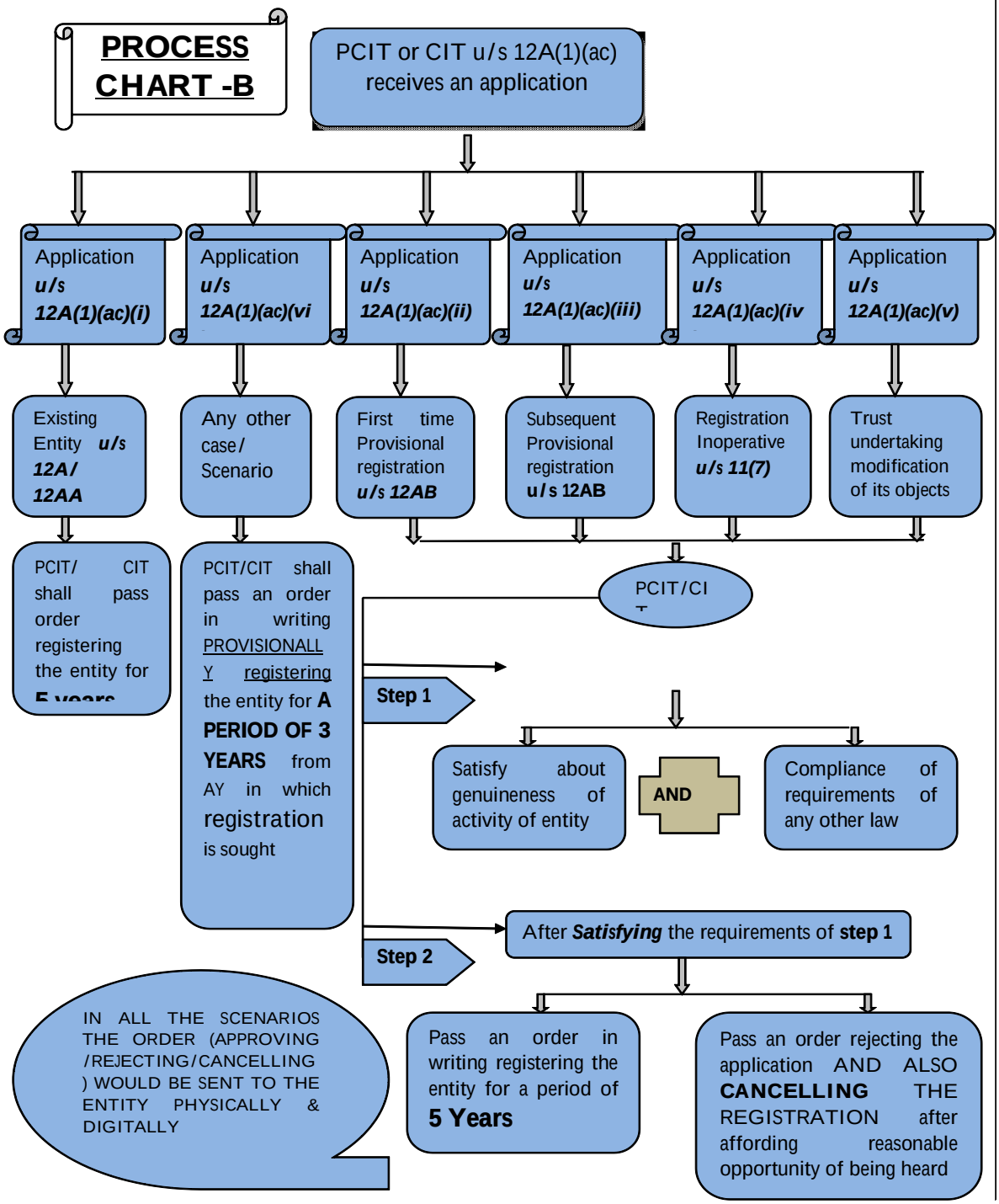
Structuring of Part- II

1. The **Process Chart – A** deals with the time limit for filing of application **u/s 12A(1)(ac).**
2. The **Process Chart – B** deals with the receipt of application by the PCIT/ CIT and the related processing and **also the validity of registration in various scenarios.**
3. The **Process Chart - C** summarises **the validity of registration separately to give additional emphasis.**
4. The **Process Chart – D** deals with the **time limit for the PCIT/CIT**

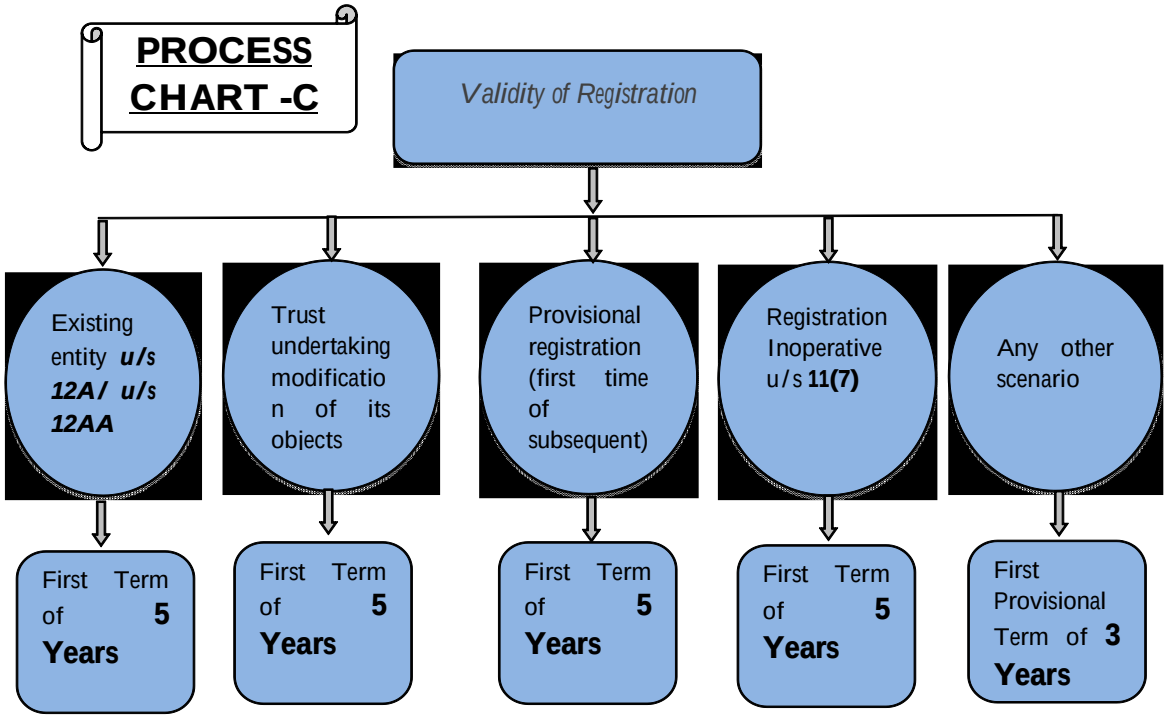
Amendment of Section 12A- Condition for applicability of Section 11 & 12-



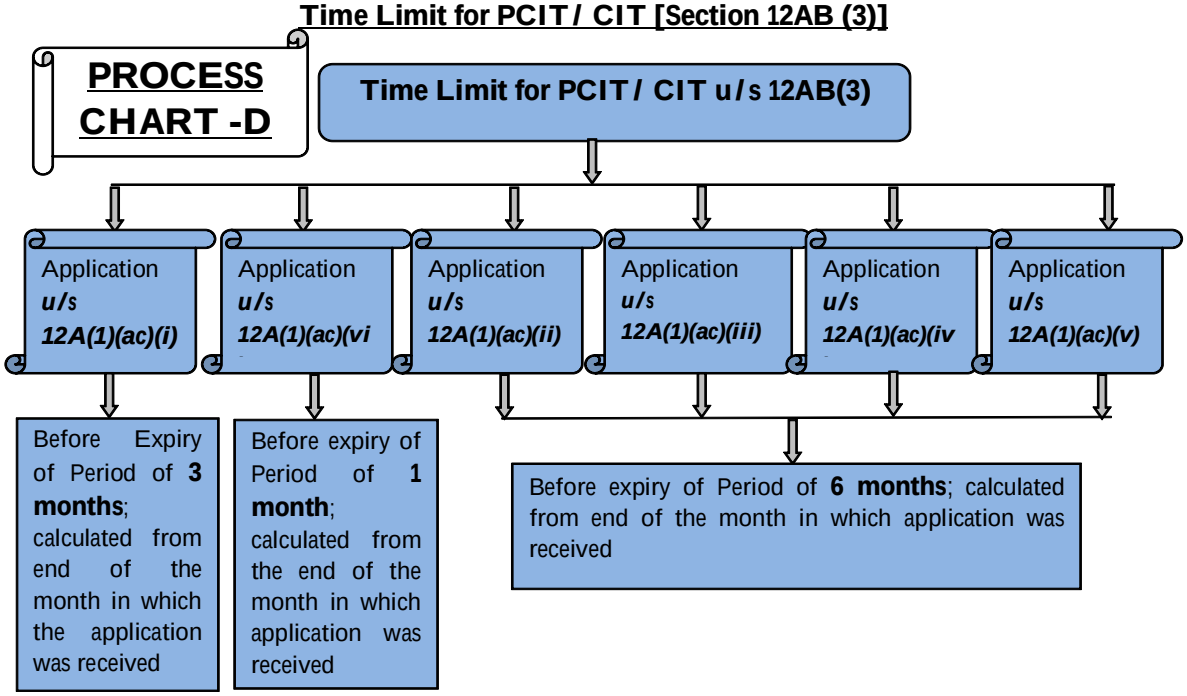
Section 12AB-Procedure for fresh registration:



Validity of registration



Time Limit for PCIT/ CIT [Section 12AB (3)]



Few FAQ's

1. **Can an example be given "*registration under any other case"* as it is common in the Process Charts A, B, C.**

   According to section 12AB (2), all application pending before the PCIT / CIT on which no order has been passed u/s 12AA, before the date on which section 12AB came into force, shall be deemed to be an application ***u/s 12A(1)(ac)(vi).***

   For instance, if an existing trust / charitable organisation applies for the renewal of registration **and the order for the same has not been passed by the PCIT/ CIT** before the date of coming into force of section 12AB, then the application , shall be deemed to be **any other application u/s 12A(1)(ac)(vi).**

   In such scenario, the PCIT / CIT shall pass an order ***provisionally registering the entity for 3 years.***

   As a converse, if the order had been passed by the PCIT / CIT, then the validity of registration of the existing trust / charitable organisation ***shall be for a period of 5 years and the registration would not be a provisional one.***

2. **When can the registration of the trust / charitable organisation be cancelled by the PCIT/ CIT, in case the trust / charitable organisation is not required to comply with the requirement of any other law apart from Income-tax Act, 1961?**

   According to section 12AB (4), where the trust / charitable organisation has been granted registration u/s 12A(1)(ac)(i) to (v) , except registration **u/s 12A(1)(ac)(vi) (registration under any other case)** . and where the PCIT / CIT is satisfied that the activities of such trust or institution are not genuine or are not being carried out in accordance with its objects, then the registration can be cancelled after affording an opportunity of being heard.

3. **When can the registration of the trust / charitable organisation be cancelled by the PCIT/ CIT, in case the trust / charitable organisation is required to comply with the requirement of any other law apart from Income-tax Act, 1961?**

According to section 12AB(5), where the trust / charitable organisation has been granted registration u/s 12A(1)(ac)(i) to (v) , except registration **u/s 12A(1)(ac)(vi) (registration under any other case) ,** and subsequently it is noticed that

a. the trust / charitable organisation has not complied with the requirement of any other law and

b. the order / direction / decree holding that such non-compliance has occurred, has either not been disputed or has attained finality,

then, the PCIT/CIT may by an order in writing, after affording an opportunity of being heard, cancel the registration.

For example, if the Trust is registered under FCRA Act, 2010 and the FCRA registration of the trust is cancelled due to non-compliance with the FCRA law and such order has reached finality and has not been disputed, then following the strict rules of interpretation, the registration under Income-tax Act, 1961, can be considered for cancellation.

In addition to the above, registration can be cancelled u/s 12(5), if the activities of the trust or institution, are carried out in a manner that the benefits conferred by sections 11 and 12 fail to apply owing to implications of section 13.

4. Section 12AB (4) and Section 12AB (5) excludes from its scope entities registered u/s 12A(1)(ac) (vi) (registered under any other case as covered in FAQ 1). Whether can it be inferred that, for entities registered u/s 12A(1)(ac)(vi), the provisions of cancellation of registration u/s 12AB (4) and 12AB (5) do not apply?

Non inclusion of Section 12A(1)(ac)(vi) in Section 12AB(4) and Section 12AB(5) does not seem to be the legislative intent and since the registration u/s 12A(1)(ac)(vi) is ***provisional*** and not final , cancellation can be effected through other generic provisions. This matter ideally would require a clarification from the CBDT.

(The author is a Chennai based Chartered Accountant in Practice. He can be reached at vvr@vvrcas.com)

TAXABILITY OF LIQUIDATED DAMAGES

CA. DEBASIS NAYAK & CA AMAN GOYAL

Taxability of Liquidated damages (LD) under the erstwhile Service Tax law has always been a matter of intense debate considering its very nature and pro-revenue approach of the department. This is also continued under the GST regime which is clearly visible from the interpretation adopted by the various Advance Ruling Authorities and subsequent affirmation by the Appellate Authorities. While, one school of thought argues that the activity does not constitute 'service' at all but on the other hand some argues it is a declared service under Finance Act by the virtue of deeming fiction created under the law or an entry under the Schedule II if the CGST Act and hence liable to tax.

Before going into the intricacies of the taxability, let us first understand the meaning of LD

Black's Law dictionary defines as

- *"An amount contractually stipulated as a **reasonable estimation** of actual damages to be recovered by one party if the other party breaches; also*
- *If the parties to a contract have agreed on Liquidated Damages, the **sum fixed** is the measure of damages for a breach, whether it exceeds or falls short of the actual damages."*

Hence, LD arises as a result of loss caused to other party due to the breach of contract which may be quantified or not quantified at the time of entering into the contract.

Considering the definition, we have highlighted some of the instances below which may be qualified as liquidated damages:

- Penalty for Breach of Contract
- Cancellation Charges
- Fees for delay caused in performing the obligation

Service Tax Law

In the erstwhile era of Service Tax, there were a plethora of cases where the department had levied Service Tax on LD at the adjudication level by treating it as a declared service of **"agreeing to the obligation to refrain from an act, or to**

tolerate an act or a situation, or to do an act" under Section 66E(e) of the Finance Act, 1994. Generally, amount involved in LD cases are quite significant and hence, the authorities are reluctant in taking a no tax position.

At all times, taxpayers have argued that considering the definition of service under Section 65B(44) of the Finance Act, 1994, there is no element of service in LD. For a transaction to qualify as a 'service' under Service Tax law, it is necessary that there is an underlying **'activity'** performed by **one person to another** for a **consideration**. For this, there should always be a contractual reciprocity hence, an act done without corresponding desire or reciprocal contractual obligation cannot be considered as an activity for a consideration. Payments made on account of LD shall not be treated as 'consideration' as they are neither 'in respect of' nor 'in response to' any identified service.

Further, with regard to the declared service, it has been argued that the expression 'to tolerate an act' covers cases only where the consideration is being charged by one person in order to allow another person to undertake any particular activity. LD are in the nature of claim of compensation for pre-estimated damages and not in the nature of consideration for agreeing to tolerate an act. Thus, the LDs are merely in nature of compensation for losses suffered.

For justifying the non-taxability, there have been good number of judgments pronounced by various Tribunals across the country and a consistent view has been taken that LD is not a service and hence, not chargeable to service tax. Reliance is placed on the following judgments:

- **K.N. Food Industries Pvt. Ltd. v. The Commissioner of CGST & Central Excise, Kanpur [2020 (1) TMI 6 - CESTAT Allahabad]**

  In the given case, demand of service tax was raised on the claim of ex-gratia charges which arises only in situation when the appellant's capacity, as a manufacturer, is not being fully utilized, so as to compensate them from the financial damage/injury. It was held that, the same are not covered by any of the acts as described under Section 66E (e) of the Finance Act, 1994. Such charges received for making good the losses, damages, etc. from "unintended" events do not emanate from any obligation on the part of any of the parties to tolerate an act or a situation and cannot be considered to be the payments for any services.

- **Accounts Officer, Madhya Pradesh Kshetra Vidyut Vitran Company Ltd. v. Commissioner of Central Goods and Service Tax, Customs & Central Excise [2019 (7) TMI 500 – CESTAT New Delhi]**

  In the given case, the appellant had an income under the head "Miscellaneous Income not pertaining to Revenue" which pertained to deduction and refund of penalty, which is deducted from the suppliers and contractor's bills. Hon'ble Tribunal held that when the amount is already taxed and it is part of the taxed amount, being deducted from the bill, by way of penalty, the said amount cannot be again subjected to service tax on this score alone. Further, this amount is not for any service to be rendered under Section 66E(e) of the FA, 1994.

- **Amit Metaliks Limited v Commissioner CGST, Bolpur 2019-TIOL-3177-CESTAT-KOL**

  In the given case, the appellant had received amount as per 'Settlement Agreement' for the termination of Development Agreement and the compensation for non-supply of manganese ore on account of rate difference. The revenue argued that the said amounts are liable to service tax under 'Declared service' u/s 66E(e) of the Finance Act, 1994 or otherwise. In this regard, the Hon'ble Tribunal held that appellant has not provided any service as the Development Agreement itself has been cancelled and so there is no question of any liability towards the service tax on payment. Further, with regard to the compensation received, the tribunal held that it is more in the nature of an actionable claim in view of the Apex court decision in case of Kesoram Industries [AIR 1966 SC 1370]. Thus, the compensation received by the appellant towards termination of Development Agreement is to be treated as actionable claim which is not liable to service tax in terms of s.65B(44) of the Finance Act, 1994.

Reliance is also placed in other tribunal judgments such as Reliance Life Insurance Company Ltd. v. Commissioner of Service Tax [2018(4) TMI 1407- CESTAT Mumbai], Jaipur Jewellery Show v. CCE & ST [2017 (49) S.T.R. 313 (Tri. - Del.)], CCE v Vikhroli Corporate Park [2016 (12) TMI 484 - CESTAT Mumbai], Cricket club of India v. Commissioner of Service tax [2015 (40) STR 973] and Mormugao Port Trust v. Commissioner of Customs, Central excise and service tax, Goa [2016 TIOL 2843 CESTAT Mum]

Recently the Larger Bench of the Chennai Tribunal in case of ***COMMISSIONER OF SERVICE TAX vs. M/s REPCO HOME FINANCE LTD 2020-TIOL-1039-CESTAT-MAD-LB*** held that foreclosure charges collected by banks and NBFCs on premature termination of loans is not leviable to service tax. The Tribunal also analysed what constitutes "consideration" for service and damages for breach of contract. Reference was made to the provisions of the Finance Act, the Indian Contract Act, 1872, relevant Indian and foreign decisions and a few dictionaries and commentaries, to analyse the meaning of "consideration," "breach of contract" and "liquidated damages."

GST Law

The legacy of the dispute regarding taxability of LDs is continued in GST regime also in pursuant to entry no. 5(e) of Schedule II to the Central Goods and Services Tax Act, 2017 (CGST Act) which provides "agreeing to the obligation to refrain from an act, or to tolerate an act or a situation, or to do an act;" as deemed supply of service. Initially, the expression supply under Section 7(1)(d) includes, certain activities as enumerated in Schedule II as deemed supply of goods or services. However, by virtue of the CGST Amendment Act 2018, the said sub clause (d) was removed and new section 7(1A) was inserted due to the contradictions in the provisions of the law. The said new section 7(1A) is worded wisely to cover the loop holes left after GST enactment to provide that activities under Schedule-II of CGST Act has to first satisfy the meaning of supply under Section 7(1) and then it would be categorized as either supply of goods or services.

Entry 5(e) to the Schedule II is a mere replica of Section 66E(e) of the Finance Act, 1994. Hence, the positions taken by the various courts under the erstwhile law will act as a precedence under the GST law as well.

Under the GST regime, the dispute is continued as seen in the rulings pronounced by various Advance Ruling Authorities across the country. For instance, The Maharashtra Authority for Advance Ruling (AAR), in the case of **Maharashtra State Power Generation Company Ltd**. held that liquidated

damages in case of default of the contractor to complete the work in time are to be viewed as consideration for an act of tolerance of non-performance, and thus, are subject to GST at 18%. The said ruling has been further affirmed by the Maharashtra Appellate Authority for Advance Ruling [TS-464-AAAR-2018-NT].

Similar ruling is also pronounced by the Andhra Pradesh AAR in case of **Rashtriya Ispat Nigam Ltd (AAR No. 01/AP/GST/ 2019)** wherein it is held that liquidated damages and other penalties like "milestone penalties" levied on supplier / contractor is a supply of service in terms of entry 5(e) of Schedule II of the CGST Act and hence leviable to GST.

Further, there are also few similar advance rulings in this matter:

- North American Coal Corporation India Pvt. Ltd (Order No. GST / ARA / -07 / 2018-19 / B-63 dated 11th July 2018)

- Bajaj Finance Limited (Order No. MAH / AAAR / SS-RJ / 24 / 2018-19 dated 14th March 2019)

Conclusion

Given the above-mentioned jurisprudence in the erstwhile law, a consistent view has been taken by the tribunals that consideration element and reciprocity is missing in the case of LD. Further, it has also been viewed that there can't be an obligation for tolerance of any act. Under the GST law as well, the term consideration and supply need to be applied before levying GST. We all have experienced that judgments pronounced by AAR or AAAR are mostly pro-revenue. Further, it may be observed that AAR may not conclude legacy matters in favour of taxpayers. LD is yet to be tested in the appellate forums under the GST laws.

The facts of each agreement and the attending circumstances would have to be seen to conclude whether LD is a supply under GST. Liquidated damages are determined and imposed on vendor / contractor based on the contractual terms and conditions. In order to avoid challenges in future, proper care shall have to be taken in drafting the clauses of LD in the contract.

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