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TAXATION IN INDIA
CURATED VIEWS

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FOREWORD

"The best things in life are free, but sooner or later the government will find a way to tax them". Industry is constantly on guard with regards to the government's evolving tax policies. The underlying fact is that taxes are ubiquitous and most of us are thinking of taxation 24/7.

Businesses today are facing immense challenges and doubts with regards to taxation in India. These range from macro to practical day - to day - issues in the direct, indirect, customs and litigation areas. Through this book we have tried to address the most recent and topical tax issues for businesses in India. This compendium of articles is a response to real time taxation queries of India Inc today.

The book addresses GST related issues including anti – profiteering, incongruities between GST and income tax laws and the need for alignment between GST and customs laws. Current trends such as amnesty laws and the need for a more comprehensive tax regulatory regime for the digital medium have also been covered. Additionally, the approach adopted by Indian tax authorities on management fee and international cross charges and India's increasingly dynamic approach to export controls also form part of the book. We have included a few sector and practice specific topics, ranging from GST implications on transactions in securities, debating the benefits of GST rate reduction in the real estate sector and key income tax concerns surrounding IBC. Finally, no book on tax can be complete without addressing the elephant in the room – tax litigation.

For each article, we have attempted to provide supporting case studies to help the reader derive a holistic understanding of the issue at hand. Our team has also endeavored to simplify and cut through the complex legal language to put forth these issues in a reader friendly format.

We do hope this makes for some interesting reading. We enjoy every reader's opinion and welcome your feedback on insights@elp-in.com.

Regards
ELP Tax Team

01

TAX LITIGATION: THE SAGA CONTINUES

Overview

One of the fears that haunts business entities doing business in/with India is the rampant litigation and the amount of time taken for litigation to conclude. GST, as it is being perceived by industry, is falling short of success on a core parameter for judging tax reforms i.e. reduced litigation. This article provides an overview of GST related disputes which are proving to be a massive pain point for industry. It also touches upon the issue of arrest for violation of GST laws.

'Litigation', said Ambrose Bierce, 'is a machine which you go into as a pig and come out of as a sausage'. A look at this year's Economic Survey will give us a sense of how many pigs are being turned into sausages in India. According to the recent Economic Survey 2019, close to INR 9.46 lakh crores is held up in tax litigation.

The Indirect Taxes in India included levy of Central Excise and Service Tax. The Hon'ble Finance Minister (FM) while presenting the Budget for the Fiscal year 2019-20 in her speech mentioned that currently INR 3.75 lakh crores is blocked in litigations in service tax and excise. The quantum of litigation that is pending in various appellate fora for excise and service tax could be imagined with the above statistic.

In order to allow the businesses to unload this baggage and be free from legacy litigations the FM introduced the 'Sabka Vikas (Legacy Dispute Resolution) Scheme, 2019' for excise and service tax matters. The scheme has been notified recently and at present not many taxpayers seem to have opted for the scheme considering there are certain grey areas which still leave the question open of whether a taxpayer is eligible to opt for the scheme or not. A clearer picture will emerge on the success of the scheme in December 2019 (the deadline for the opting for the scheme).

Given the increasing indirect tax woes being faced by industry, the Government of India introduced Goods and Services Tax (GST) in the year 2017. Key objectives for the introduction of GST were to remove the cascading effect of taxes, and to allow seamless credit of the taxed paid.

Another aim to be achieved with the introduction of GST was to reduce litigation. For businesses to flourish, it is imperative for the tax environment to be conducive. One of the fears that haunts business entities doing business in/with India is the rampant litigation and the amount of time taken for litigation to conclude. GST as it is being perceived by industry, is falling short of success on a core parameter for judging tax reforms i.e. reduced litigation.

Looking back, over 2 years have passed since the introduction of GST and the given objective seems far from being achieved considering the large amount of writ petitions and advance ruling applications that are being filed every day.

A number of disputes have already arisen in relation to credit transitioned by the taxpayers into GST let alone the credit availed under GST. An overview of some burning issues in the GST regime, which affects businesses across India will reveal the criticality of GST disputes that haunts business entities today.

Transitional credit

Most disputes that have arisen are in relation to technical glitches being faced at the time of filing of the Form TRAN-1 for transition of the existing credit by the assessees. Writ Petitions were filed in the jurisdictional High Courts to address the difficulties being faced and many High Courts have entertained the writ petitions and granted relief to the taxpayers.

The other class of disputes that have arisen are in relation to the time-limit for claiming of transitional credit. The Gujarat High Court and Bombay High Court have expressed contrary views on the said issue. The Gujarat High Court following the ratio of the Supreme Court decisions in the erstwhile

regime, held that the right to transitional credit is 'indefeasible' and the prescription of time-limit for claiming transitional credit is procedural in nature and not mandatory[1].

Apart from the above litigations which were more in nature of issues being faced during transitioning from old indirect tax regime into the new one, the other issues which challenge the jurisdiction of actions taken by the revenue are going ahead in full steam. Some of these are articulated below.

There was a huge hue and cry amongst the business community when GST was introduced in relation to transition of Education Cess, Secondary/Higher Education Cess and Krishi Kalyan Cess (KKC) into GST. Clarifications were issued by the CBIC vide FAQs that the said credit would not be allowed to be transitioned under GST. On challenge, Madras High Court allowed the writ petition and held that the transition of the said credit under GST is valid under law[2]. It is yet to be seen how the other High Courts of the country interpret the provisions with regard to the given issue.

Considering the contrary views taken by the High Court it appears that the said issues would be settled only by the Supreme Court which would entail costs for the taxpayers.

Advance Authorization - Exemption from IGST - 'Pre-import' condition

Investigations have been initiated by Directorate of Revenue Intelligence (DRI) against Advance Authorization (AA) holders for claiming exemption from Integrated Goods and Services Tax (IGST) post 01.07.2017 on imports against AA. Gujarat High Court struck down the pre-import condition inserted with effect from 13.10.2017 for claiming exemption from IGST and held it to be ultra vires[3] while Madras High Court dismissed the Writ Petition and upheld the constitutional validity[4].

Before the judgment was pronounced, the exemption notification was amended to remove the pre-import condition and to insert condition vi(a) and vi(b) whereby in case the export obligation has been fulfilled by the company and the duty free imports are made as replenishment, a bond is required to be submitted that the said imported goods would not be used in the manufacture of exempted or nil rated goods. While these conditions are trickily worded, in view of two conflicting decisions, the scope for litigation does not narrow and the DRI would continue investigating the matters for denial of exemption from IGST.

Levy of IGST on ocean freight

Various Writ Petitions have been filed across the High Courts in the country, challenging the levy of IGST on the component of ocean freight on the ground that the importer of goods not being the 'recipient of service' cannot be deemed to be the person liable to pay IGST under 'reverse charge mechanism' and supply of service by a person in a non-taxable territory (transporter) to a person in a non-taxable territory (exporter) is beyond the jurisdiction of IGST.

The Gujarat High Court has heard the petitions at length and the judgment is awaited. No final judgment has been received on this issue from any other High Court.

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[1] i) Siddharth Enterprises [TS-684-HC-2019(Guj)-NT] and Filco Trade Centre Pvt. Ltd. [TS-
ii) JCB India Ltd. [2018-TIOL-23-HC-MUM-GST]

[2] Sutherland Global Services Pvt. Ltd.

3 Maxim Tubes Company Pvt. Ltd. [TS-79-HC-2019(GUJ)-NT]

4 Vedanta Ltd [WP (MD) 18435 to 18438 of 2018]

Composition of GST Tribunal – Unconstitutional?

The Union Cabinet in January 2019 approved the proposal to set up a national bench of the GST Appellate Tribunal (GSTAT) in the capital city. The composition of GSTAT has come under criticism as there is a single judicial member with two technical members (each from Centre and State). Thus, the number of technical members would outnumber the judicial member which is certainly likely to result in an apparent imbalance in rendering justice and could undermine the impartiality of the Tribunal.

The Madras High Court allowed the writ petition challenging the constitution of the Tribunal and held that the number of expert members cannot exceed the number of judicial members on the bench. The other High Courts are yet to pass a judgment on the said issue.

While the number of appeals currently filed before the first appellate authority is insignificant the decision to constitute GST Tribunal will have a significant impact on the dispute redressal system.

The above disputes while they affect the businesses across India, another critical aspect of GST is the power to arrest for violation of GST laws.

Arrest under GST

Under GST, the officers have been granted the power to arrest a person in case he has a reason to believe that the said person has committed any of the four types of offences listed below and the amount of tax evaded or input tax credit wrongly availed exceeds INR 5 crore (Imprisonment for 5 years with fine) or INR 2 crore (Imprisonment for 3 years with fine) viz.

i. Supply of goods or services without issuance of invoice

ii. Issue of invoice or bill without the supply of goods or services leading to wrongful availment or utilization of credit

iii. Availment of input tax credit basis (ii)

iv. Collecting the tax but not paying to the Government

The heinous offences of collecting but not paying the tax and issuance of fake invoices coupled with availment of credit basis the same are covered under the scope of arrest. These offences are non-bailable and cognizable.

The Government officials have been robust and swift in their approach to nab such taxpayers dealing in fake invoices or involved in huge tax evasions. The Writ Petition filed by one such taxpayer challenging the action of arrest was dismissed by the Telangana High Court and the said decision was upheld by the Supreme Court. The Bombay High Court however in a similar matter had directed the revenue not to take any coercive steps and continued such relief. The Supreme Court in the appeal filed against the said order held that since contrary views are being expressed by High Courts a larger bench will be constituted by the Supreme Court to clarify the issue. Also, the Apex Court made it clear that in future the High Courts must keep in mind that Supreme Court did not interfere with the order of the High Court of Telangana dismissing the petition.

While the final verdict of the Supreme Court in the above matter is pending, the taxpayers on such arrest proposals approach the High Court seeking Bail under the provisions of Section 439 of Criminal Procedure Code and generally, on consideration of Bail applications, the taxpayers have been allowed Bail on a deposit of a huge sum with a condition for daily appearance before the police authorities.

Recently, these conditions were imposed on an MNC executive on grant of Bail in relation to case for default in payment of tax after collection of GST[5].

…. And the saga continues

Considering the of the size of Indian economy and the complex business models, disputes between the taxpayers and the tax authorities is inevitable. This saga of tax litigation seems to be continuing in the GST era too. While there is a shift in the model of levy of indirect taxation in India, whether that shift can be aligned in the way the Revenue thinks while administering the law, is the moot question. It would be interesting to see, given the controversial rulings from various High Courts, how the GST laws will shape up and if the government and the judiciary will be able to address the challenges in a time-bound manner.

[5] Choi Yongsuk and Chae Jae Won [TS-612-HC-2019(MAD)-NT]

02

GST ANTI-PROFITEERING CODE: CONTROL OR SAFEGUARD MOTIVE?

Overview

The advent of GST marked the implementation of formal anti – profiteering provisions for the very first time in India. However, two years on, the anti – profiteering tirade is so prevalent that industry is questioning whether the provisions are merely intended towards safeguarding interests against opportunistic gains or also aimed at controlling prices. In this chapter we seek to understand the real times issues being faced by industry on anti – profiteering issues.

The National Anti-Profiteering Authority (NAA), apex body to assess profiteering, has time and gain assured business that it is not a price regulator and neither does it have legislative intent. Though the body was established post GST roll out, the prospects of its establishment were enough to ensure businesses did not abuse the downward revision of GST rates and/or upward revision of Input Tax Credit (ITC) allowances.

It is interesting to note that the advent of GST also marked the implementation of formal anti-profiteering provisions for the very first time in India, to ensure that the implementation of the new law does not disrupt the economy & markets. Malaysia, Australia were amongst regions from where experiences were borrowed for the same. These jurisdictions, however, employed a strategy of determining unreasonably high rates in the transitionary phase and permitted those business decisions, which did not involve manipulation of prices. India, however, implemented profiteering provisions far more seriously and stringently. This article seeks to understand the real times issues being faced by industry on anti – profiteering.

What is Profiteering?

Profiteering has been defined in various ways in dictionaries – be it the act of making an unreasonable profit not justified by the corresponding assumption of risk, excessive or unfair profit or a word synonymous with exploitation. CBIC FAQ provides that , *' In terms of Section 171 of the CGST Act, 2017, the suppliers of goods and services should pass on the benefit of any reduction in the rate of tax or the benefit of input tax credit to the recipients by way of commensurate reduction in prices. The willful action of not passing on the above benefits to the recipients in the manner prescribed is known as profiteering'.* All references indicate that, there is one common theme which strongly comes forth - *profiteering is all about deriving opportunistic gains.*

However, two years on, the anti – profiteering tirade is so prevalent that industry is questioning whether the provisions are merely intended towards safeguarding interests against opportunistic gains or also aimed at controlling prices.

The dilemma

It is a given, that the provisions were introduced to contain profiteering impact of any favorable change in the rate of tax or allowance of input tax credits (i.e. GST paid on procurements or ITC) or conversely put, to push businesses into passing on GST benefits, if any. Given this, it would merit perceiving the impact of these provisions only on such commercial contracts (for buying and selling of goods/services), which existed and were not completed at the time of change in the rate of tax and/ or ITC allowance.

However, can the law define or contain pricing methodology in cases, where the contracts are entered into and serviced only post the above changes have taken effect? Alternately speaking, if the contracts did not exist on the change or transition date, how can there be any transition impact leave alone any benefit or loss?

As an illustration, A placed an order with B for the supply of 10,000 units of product 'X' say on 1 January 2019 (at INR 118, per unit, inclusive of tax), when the product was liable to 18% GST. Up to 31 January 2019 ~6,000 units were supplied; however, from 1 February 2019 the GST rate on the product was reduced to 12%. It was only logical that B demanded A to reduce the tax impact on the supply price (of pending quantity) to which A obliged. The tax outgo, for B, was accordingly reduced as A was now charging only INR 112 per unit (as the tax inclusive price). Notably, the contract transitioned a rate

change scenario and therefore, even if A and B contractually did not provide for a reduction in prices, the operation of law was clear, and the prices were required to be reduced irrespective for the serviced or balance portion of the contract.

The question, at this juncture, is assuming A reorders a supply of 10,000 units from B on 1 March 2019, is B legally obliged to offer the supply at INR 112 per unit or less? Following follow-on queries surface in this regard:

- If the price that B could offer had to be INR 112 or less in the above illustration, would it not tantamount to controlling prices in case of a newly negotiated commercial contract (that did not transition the relevant event of change in rate of tax). Would this approach not defy general logic as well as the rights bestowed upon a business by the Constitution of India i.e. free pricing?
- Assuming, for mere sake of argument, that the prices had to be kept down (i.e. a precise price control action) – For what length of time should this approach be maintained? When can the prices be next revised upwards and what quantum of upward revision would not trigger profiteering as seen under provisions of GST laws?

These are pertinent issues in view of the legal and commercial aspects that are involved or may be triggered. Even more so, when one views this from an overarching perspective of India's economic growth.

The debate of 'Fair' versus 'Forced'

Fair: In context of GST profiteering, we find that when two parties commercially negotiate the prices of supply, it involves an offer (including terms/assumptions about GST) and a consequent acceptance. Now that a *post facto* event changes the assumptions (about GST rate & ITC allowance) that the parties must have factored into their decision, it is only equitable to seek a restatement of prices by adjusting for such change. It is necessary to do so, as the change in relevant factor(s)/ assumption(s), that occurs *post facto* was not known and beyond control of either party.

Forced: In another case, if all facts are clear and then commercially negotiated to a certain price, without any further changes in law, it cannot be argued that one party made opportunistic gains as all factors were known/disclosed and parties still chose to transact, at a given price, at their own will. If the legislation argues profiteering in such a contract, in any manner, then it is nothing but forced as these contracts did not witness any change in law.

Given this context, when one considers the previous illustration – both logic and legal understanding are defied – why can the prices not be pegged higher than INR 112 (say INR 115/ 118/ 120) if the parties mutually agree? This is mere economics of demand/ supply & other market factors and strictly not covered by the intention of the anti – profiteering provisions, which are currently being implemented (in a manner) to control prices.

At this juncture, it is also pertinent to mention that article 19(1)(g) of the Constitution of India, allows imposition of such restrictions on business (read pricing control) that may be necessary to do so in public interest, but by effecting a law on the subject. However, the ground reality remains that the laws have been made only in cases of few/identified commodities under the Essential Commodities Act, 1955. If not covered by this enactment or similar, any other law cannot (in any manner) regulate the prices.

The NAA has on previous occasions opined that these provisions are sensitive to natural business outcomes and has appreciated that several factors contribute to pricing decisions such as supply and demand, supplier's cost and taxes, etc. How much of this is being implemented in word and spirit is an open book debate with data & information (for deliberation) available in the public domain.

Even assuming that the law intended that profiteering provisions should be applied to cases of subsequent contracts/transactions, unsold inventory, etc., it is important to codify/clarify the duration for which these provisions can apply. Economic factors being extremely volatile, this form of suppression could have a significant impact on business. Industry would benefit if the law clarified that prices or passing of benefits would be reviewed for a short window immediately following the changes, at best say for a month or so.

Last but not the least, the system at present lacks a prescribed methodology, which is sector or business specific. Current procedures, without a debate on their respective merits, are sector agnostic. It is commonly understood that a FMCG sector and say real estate sector cannot be compared, likewise a dine-in restaurant and food & beverage counter in a multiplex are incomparable – hence, a straight jacket approach to profiteering would automatically be unwarranted. Thus, unless a business and a case specific approach is deployed, a one size fits all approach leads to a distorted result insofar as determination of profiteering is concerned.

Business and regulation are inextricably linked. Industry will no doubt welcome norms, which correctly identify manipulators and differentiate between business/moral profit & tax profiteering. The administration needs to focus on two significant factors – governance and safeguarding the interests of business. Businesses have to make money as that's the only way to survive.

03

TAXATION OF THE DIGITAL ECONOMY: THE INDIAN APPROACH

Overview

With a rapid shift into the world of digitalization, governments across the globe have carved out various tax regulations to curb base-erosion of profits for all businesses. While lauding the Indian government's proactive and prompt approach towards devising separate taxation rules for such transactions, this article highlights some noteworthy trends in direct and indirect taxation of digital transactions in recent times.

Technology has changed the very paradigm of doing business. The digital commerce market in India is expected to reach USD 1 trillion of economic value in the year 2025 on the back of growing internet usage and increased online retail. In addition to leading e-commerce companies, even traditional businesses are increasingly expanding their digital footprint. Rapid advances in technologies will necessitate new regulations and judicial interventions time and again.

Tax regulations are one such critical sphere of governance which directly impact the fiscal health of the digital players. Globally there is a sharp increase in the discourse on devising means and mechanisms to curb base erosion of profits for all businesses. Simultaneously, a global dialogue as regards separate rules of taxation for the digital economy is occurring as well. It is repeatedly recognized that the existing traditional rules of taxation will need to adapt to the digital medium. Concerns have arisen as regards to a level playing field between locally situated brick and mortar stores and foreign online service providers in the global market. One can only hope that the global consensus on the Base Erosion and Profit Shifting (BEPS) Action Plans is achieved by 2020 as is planned. Considering the varied interests of 'host jurisdictions' and 'market jurisdictions', it would require tremendous concerted political will for a global consensus to be achieved to devise taxation rules at a global level. Till such time however, one can expect nations, including India, to continue to effectuate unilateral measures for taxing digital players to secure their revenue interests.

The Indian approach

In terms of the Indian approach to taxation of the digital economy, one can fairly say that the Indian government has been very proactive and prompt in its approach towards devising separate taxation rules for these transactions. Some noteworthy trends in direct and indirect taxation of digital transactions in recent times are summarized below:

Direct taxes

While there are no separate schemes of taxation prescribed for the digital economy as a sector (e.g. as provided for other sectors such as insurance, shipping, oil and gas etc.), the steps taken by the Indian government (explained below) allude to its growing ambition to treat and tax this sector differently:

- **Equalization Levy**

  One of the first steps towards separately taxing digital transactions and implementing one of the measures discussed (though not recommended) in the BEPS Action Plan 1, is the Equalization Levy. The Equalization Levy was introduced in the year 2016 and was based on the recommendations of a Committee (comprising of officers of the Income Tax department and members of the general public), constituted by the Government, to deliberate on the issue of taxation of the digital economy. Equalization Levy is levied at the rate of 6% and only on online/digital advertisement services as of now. India has chosen to bring in this levy by way of Finance Act, 2016 and not under the Income-tax Act, 1961. Given this context, a view may be taken that transactions liable to Equalization Levy will not enjoy benefits of DTAA. At present, it is charged in the form of a withholding which the Indian payee is obligated to carry out at the time of making payment to the foreign service provider (providing online advertisement services). In terms of Government estimates, Equalization Levy has helped the government garner substantial revenues - reportedly INR 590 crores in FY 17-18, which increased to INR 939 crores in FY 18-19.

- **'Significant Economic Presence'**

  With effect from April 1, 2019, India has introduced the concept of 'significant economic presence' for establishing a business connection in India. In the Indian context, 'significant economic presence' is to be computed in terms of broadly two criteria:

  - Revenue: If the aggregate payment arising from transactions in respect of any goods, services or property in India (including downloading of data or software) exceeds the prescribed threshold and
  - Users: Systematic and continuous soliciting of business activities or engaging in interactions with certain number of users as may be notified.

  However, as of now, these thresholds have not yet been prescribed and the concept is effectively in limbo. Until these thresholds are prescribed, and the DTAAs are re-negotiated and amended, assessees may continue to avail the benefit under the DTAA wherever these exists. On the global front, India has pressed for the widening of the scope of permanent establishment to tax digital enterprises (at the OECD and BEPS Inclusive Framework meeting) and push through its 'significant economic presence' proposal, in keeping with USA's suggestion of 'marketing intangibles' or UK's proposal of 'user base' principle.

- **Creation of Permanent Establishment (PE)**

  In the context of digital economy, the present jurisprudence suggests that mere presence of a 'website' would not constitute as a PE (refer judgements in Rights Florist and Pinstorm). However, noteworthy is the 2018 ruling of the Authority of Advance Ruling (AAR) in the case of MasterCard, where the AAR has taken the view that the presence of only a 'MasterCard Interface Processor' (MIP), which is the size of a computer, would constitute as a fixed PE. This ruling being only an advance ruling is binding only on the applicant (MasterCard) and not in rem and is presently challenged by way of a writ petition which is pending before the Hon'ble Delhi High Court. The approach of the AAR is however ominous and makes it difficult to predict if certain functionalities of digital players would amount to creation of a PE in India. To obtain certainty, certain assessees have adopted the Mutual Agreement Procedure (MAP) route and pre-decided with the Government as regards to the existence of a PE as also the method of computing its profits in India.

- **Report on Profit attribution to Permanent Establishment**

  At present, under Article 7 in the Indian Double Taxation Avoidance Agreements, profits are to be attributed to a PE on the basis of the accounts of the PE. Where such accounts are not available to enable determination of profits attributable to the PE, the assessing officer, then, has the wide discretion to do so in terms of a mechanism he/she deems fit. To bring certainty and uniformity in the approach to be adopted by the assessing officer, the Central Board of Direct Taxes (CBDT) has in its report of April 2019 made significant suggestions as regards profit attribution. These are given below:

  - The adoption of fractional apportionment method – to attribute profits by taking into account the profits derived from India multiplied by the global operational profit margin, which profit is thereafter apportioned by three equally weighted factors – that of – sales, employees (manpower and wages) and assets.
  - Separately, for 'multidimensional enterprises', which would typically include digital players, it suggests the addition of a fourth factor i.e. of number of users. The weightage ascribed to

'users' is suggested to be 10% in case of low to medium user intensity business models and 20% for high user intensity business models (with a concomitant reduction in the weightage given to employees and assets).

– In the event that there are global losses or if the global profit rates are less than 2%, then to safeguard India's revenue interest, it is suggested that a deemed global profit rate of 2% be considered while computing the profit attribution.

These are significant suggestions and one will have to see that if such suggestions are implemented, whether it will bring certainty or proliferate litigation. Further, it is likely that India will take a firmer stance once the discussions at the global level are concluded.

Indirect taxes

The levy of indirect taxes on electronic transactions is not a novelty in the Indian context. However, as a comparison to the earlier sporadic attempts, now we see an overarching drive to cover any and every type of e-commerce activity, and in fact, an overlap of classification in certain spheres. Significant steps for taxation of e-commerce transactions in India are charted out as under:

- **Online Information Database Access or Retrieval (OIDAR) Services**

  Under the service tax regime, OIDAR service was first brought to tax as early as 2001. However, when introduced, it covered within in its ambit, limited amount of activities [typically of Computer Reservation Systems (CRS) companies]. Further, place of supply for such service was determined to be the location of supplier, which in case of a non-resident supplier would be outside India and thus a supply by a non-resident would be outside the purview of service tax. However, with effect from December 2016, there has been a tectonic shift in the taxation regime for OIDAR services. Firstly, the scope of OIDAR service has been drastically expanded and is somewhat comparable to the EU concept of Electronically Supplied Services (ESS). Post the amendment, OIDAR services was defined to include any service provided through the medium of internet where there is minimum human intervention and also specifically included certain supplies such as cloud services, online supply of e-books, music, software etc. An important point to note, is that the place of supply was changed to the location of the recipient. Further, a separate regime itself was introduced, in terms of which a foreign supplier of OIDAR services was required to take a service tax registration in India and discharge service tax, in case supplies are made on a B2C basis i.e. to a 'non-taxable online recipient' which is defined to include Government/individuals/unregistered entities who are using the services for non-commercial purposes. For facilitation, a pan India single and simplified registration was introduced for such foreign suppliers of OIDAR services.

  This separate regime for OIDAR services has been continued under the GST regime as well. The OIDAR scheme of taxation uniquely brings within the fold of the Indian GST, foreign service providers who may otherwise not have no physical presence in the country.

- **Electronic Commerce Operator (ECO)**

  Apart from the concept of OIDAR services, the concept of ECO has also been introduced, under the GST regime. ECO is defined to include any person who owns, operates or manages digital or electronic facility or platform for electronic commerce. An ECO is obligated to carry out tax collection at source (TCS) @ 1% as regards the supplies of goods and services made through it, provided the consideration in relation to such supplies is collected by the ECO (from the ultimate customers). Further for specified services, including radio-taxi services and certain

accommodation services, the ECO is itself liable to discharge 100% of the GST liability of the underlying supplier. Certain ambiguities/ issues however continue to pervade the indirect tax regime for the digital players. These include:

- For aggregators of services, there is a possibility that they will qualify both as an OIDAR service provider and also as an ECO and thus be required to obtain separate GST registrations.
- While a simplified and single registration regime exists for OIDAR service providers, an ECO is required to register in all States where the underlying supplier exists and thus, depending upon the exact operations, ECOs could have the onerous obligation to register in all States in India and comply with the associated procedural requirements. For foreign e-commerce operators who do not have any physical presence in a particular State, they may be required to appoint agents in such States, for the purpose of obtaining registrations.
- In cases where ECO is obligated to discharge 100% of the tax liability of the supplier for specified services, there is less clarity as regards the exact manner in which the other procedural formalities e.g. issuance of invoice etc. are required to be complied with.
- The timing of when the tax is to be collected by the ECO is somewhat unclear. The flier on e-commerce, as available on CBIC website suggests that the e-commerce operator should make the collection during the month in which the consideration amount is collected from the recipient. However, the FAQ clarifies that the ECO is liable to collect tax at source '*when the supply is made through it*'. However, it is unclear if this should be viewed as the date when the actual (underlying) supply is made by the supplier to the ultimate customer, or when the customer carries out the online transaction on the ECO's website and makes the online payment or at the time of supply of the underlying supply (which may be the date of invoice or date of supply). This aspect becomes crucial to determine, since the details of supplies furnished by an ECO in its statement for the month will be matched with the corresponding details of outward supplies furnished by the concerned supplier in his valid return for the same month or any preceding month. In case of a mismatch which remains un-rectified, the un-matched amount will be added to the suppliers output liability along with an interest consequence on the said amount.

Conclusion

While nations across the globe race to amend their laws to suit the taxation needs of this new world, India, with its proactive approach has introduced innovative concepts. However, it is more likely than not that with global consensus, some of these laws may undergo a change. One further aspect which would require deeper deliberation by the Government is with regards to the exact mechanism to enforce these laws. More specifically, what action will be taken by the taxation authorities to penalize foreign companies, without any PE in India, for any infraction in the above stated laws. More important, whether these would be susceptible to legal challenge on the grounds of extra-territoriality.

To conclude, while the law attempts to catch up with technology, it is imperative for businesses to also catch up with the layered nuances of the legal regime, deal with the complexities and live with the ambiguities.

04

GST RATE REDUCTION TO 5% IN THE REAL ESTATE SECTOR: A WINNING STROKE OR A RUN OUT?

Overview

Burdened with a high GST rate of 12 % (for under construction residential units), India's muted real estate sector received a relief in April 2019, when the Ministry of Finance reduced the GST rate to 5%. This has however been a contentious issue for many reasons - the lack of input credit, the issue of anti – profiteering and the increase in stamp duty to name a few. This article debates the benefits of this GST rate reduction by providing a comprehensive analysis of each issue.

Introduction

The real estate sector in India has faced several headwinds over the past few years. Demonetization in 2016, the introduction of GST in 2017 and the NBFC crisis in 2018. The question now is whether the revised scheme of GST will be a similar event in 2019.

At the outset, sale of a property pre and post construction, by a developer, has been treated differently for the purpose of levy of indirect taxes. This basic issue still bothers the sector as both the transactions eventually entail the sale of an immovable property.

Be that as it may, the scheme of taxation for this sector has been continuously changing. With this recent change, this sector is evidencing the 5th regime of taxation, within a decade. The facts are presented in the table below.

Period	Taxability	ITC	Taxation on development rights
Prior to 2005	Not liable	Not available	Not liable
2005 – 2010	Disputed but finally held to be liable for VAT and Service Tax	VAT – allowed Service Tax – not allowed	Not liable but disputed by VAT authorities
2010 – June 2017	Taxable to VAT & Service Tax	VAT – not allowed Service Tax – allowed	While not liable but disputed not only by VAT but also Service Tax authorities
July 2017 – March 2019	Liable to GST	Full ITC available	Taxable
April 2019 onwards	Liable to GST	No ITC	Exempt to the extent of sale prior to Completion Certificate

The basic ethos underlying the implementation of GST was revenue neutrality which means that the tax burden essentially pre and post GST regime remains the same.

However, one sector which stands out in revenue neutrality approach not being maintained is the real estate sector, which is evidenced from the fact that up to March 31, 2019, the GST rate of an under-construction property was 12% (effective tax rate). This proved to be a massive jolt to the real estate industry which was anyway struggling to stay afloat.

Post several representations being made by the industry and based on the recommendations of the GST Council, the Ministry of Finance finally notified a revised scheme whereby a GST rate of 5% without ITC, would be applicable to the sale of an under construction residential unit.

However, is this scheme of 5 % GST without ITC more beneficial than 12 % with ITC? Though the optics seem very good, on analyzing the finer details, one can infer that this move does not actually tilt the balance favorably to the sector or the consumer. The government has effectively retained the same tax burden but in fact in most cases, developers and consumers are worse off.

To understand the real impact of the GST rate reduction, it is important to understand the hidden effects of denial of input tax credits on the costs of construction and on the marketing costs. In the extended suburbs of the metros and in Tier II and Tier III cities, the ratio of cost of construction and marketing (Cost) to Sales Price (SP) is high as 45% to 50%. Consequently, the overall tax burden borne by the customer, will now, under the revised scheme be in the range of 14-15 % (in metro suburbs, Tier II and Tier II cities). Illustrating this with an example.

Sale price (SP)	COC	Total Tax Cost		Effective tax cost		Additional tax burden
A	B	C=A*5%	D= B*20%	E= C+D	Till March 31, 2019 [F=A*12%]	(E-F)
100	45	5	9	14	12	2

Note: Most of the construction related goods and services fall in 18% rate slab however cement continues to be under 28%. For the sake of calculation, ITC is computed on an average rate of 20%.

In a nutshell, the tax costs in the transaction is likely to be more and not less as would be expected.

It is also important to view the issue from the lens of anti – profiteering. Any reduction in rate of tax should ideally result in decrease in cost for the customer. This is the very core of the principle of anti-profiteering. However, what does a developer do in a scenario where due to the non-availability of ITC, the costs of the project have actually increased? Currently though, the anti – profiteering authority may expect, the benefit of a lower rate of GST to be passed onto the customer, after adjusting the loss of credit. Establishing the increasing costs before the anti – profiteering authority while still adhering to the anti – profiteering principles is now a challenge to the developers.

Adding to the industry's woes the States of India have increased stamp duty by 1% (for example, in Maharashtra the stamp duty has been increased to 6%).

At best, this move of reduction to 5% has achieved certainty for the industry. Also, the customer is correct in expecting a lower price of housing, however, the developers are facing their own set of woes – on one hand they need to meet the customers' expectations and pass on the lower rate of GST, however with the denial of ITC to them, they are squeezed from both ends of the spectrum.

When one considers the overall scheme of things, is this rate reduction of 5% a winning stroke or a run out?

05

THE INCONGRUITY BETWEEN INCOME TAX AND GST LAWS

Overview

Currently, there exists a substantial anomaly between the treatment of certain transactions under GST vis-à-vis Income tax. This article discusses the divergence between the treatment given to various business expenses under GST and the Income Tax Act. Transactions, where the synchronization of valuation principles under GST and transfer pricing need evaluation, are also analyzed in the article.

With the ever-evolving dynamic nature of business, there are multiple transactions which fall within the ambit of both Income Tax and GST laws, especially related party transactions. However, the treatment of such transactions may differ under both the taxing laws, which creates certain anomalies. This article attempts to highlight a few such incongruities.

Anomaly between the provisions of Income Tax Act for claiming deductions of business expenditure and availing ITC under CGST Act

The claim of deduction of business expenditure under Income Tax Act, 1961 (Income Tax Act) and ITC under the GST Laws are governed by a common underlying principle, that such expenditure should be for business purposes. However, irrespective of the commonality between the two Acts, there are differences between restrictions imposed on availing the claim of deduction and claiming credit.

The provisions under Section 30 to 36 of the Income Tax Act deal with deductions of business expenditure for computing profits and gains of business or profession and prescribe certain conditions to avail such deductions. The fundamental basis for claiming deductions under the Income Tax Act is that the expenditure incurred should be for carrying on the business. It is a settled position of law that the assessee should incur the expenditure in his capacity as a person carrying on the business/commercial expediency.[6]

Given the above context, it is also important to examine the provisions relating to availment of ITC of business expenditure under the GST regime. Section 16 of the CGST Act allows a registered person to avail ITC on the tax paid on the inward supply of goods and/or services, which is used by the person in course and furtherance of its business.

While both the legislations are based on the same principle of the expenses being considered as business expenses, there is a degree of non-alignment between the provisions of deductions allowed under the Income Tax Act, and ITC available under the GST Act. To be clear, ITC of tax paid on inward supplies, being a business expenditure, may not be available to an entity – this, however, would be allowed as a deduction under the Income Tax Act.

Under the GST Regime (vide Section 17(5) of the CGST Act), the Government has provided for a *non-obstante* clause, by way of which it denies availment of ITC towards certain supplies. By virtue of this provision, even if the inward supply of goods/services mentioned therein is used in the course and furtherance of business, the ITC would not be available. A few instances, are mentioned below:

- **Rent free accommodation**

  Income Tax Act: In terms of the provisions of Income Tax Act, the expenditure incurred for rent-free accommodation would be considered as business expenditure.

  CGST Act: As per the provisions of the CGST Act, ITC is not available for the same. In a recent Advance Ruling[7] the issue raised was whether ITC was admissible in respect of GST paid for a hotel stay in case of rent-free residential accommodation provided to key personnel of the company. It was observed that even though expenditures for rent-free accommodation was part of the salary of key personnel, and allowed as business expenditure, ITC on the same was not available.

[6] S A Builders Ltd. v. CIT [2007] 288 ITR 1/158 Taxman 74 (SC)
[7] POSCO India Pune Processing Center Pvt. Ltd., 2019 (21) G.S.T.L. 351 (A.A.R. - GST)

- **Business expenditure for the welfare of the company's employees such as cost incurred on maintenance of township, security, residential colony, hospitals**

  Income Tax Act: These expenditures are allowed as business expenditure under the provisions of Income Tax Act.

  CGST Act: In terms of the provisions of the CGST Act, ITC of the same would not be available. The Appellate Authority of Advance Ruling in Orissa[8] in a recent ruling held that the said inward supplies were not integral to the business activity of the assessee and would therefore not be eligible to credit under the GST Law.

- **Expenditure incurred by rent-a-cab services for transportation of employees**

  Income Tax Act: This would be considered as business expenditure

  CGST Act: Credit on the inward supply of rent-a-cab services is not available, unless the same is mandated by the Government under any law or the assessee receiving such a service is also engaged in provision of the same outward supply of rent-a-cab services.

This non-alignment was also present in the pre-GST Regime, where a service or good, though eligible for deduction as a business expenditure, was not eligible for claiming Cenvat credit under the provisions of the Cenvat Credit Rules, 2004. In this context, the Hon'ble Bombay High Court[9] has held that the repair and maintenance services used in a residential colony of an assessee's employees, was a welfare activity and not an activity relating to business and hence the same was not covered under the definition of Input Service, even though such expenditure incurred was allowable as a deduction under Income Tax Act. The said anomaly continues in the GST regime as well.

It is, therefore, indeed evident that two different treatments appear to apply for the very same nature of expenditure – under the Income Tax Act and the GST Act. It would be prudent for the Government to consider the position adopted under the Income Tax Act, ensuring that the expenses on receipt of goods/services which are used by an assessee for its business purposes, would be available as credit even under the GST regime. This would be in line with the government's intent on creating an easier business environment for corporate India.

Provisions for valuation between related parties under the Income Tax Act and GST

The transactions between related parties have always been suspected as a tool to shift profits and therefore reduce the overall tax liability of a company or a group operating from multiple global locations with different tax laws. In terms of Section 92 of the Income Tax Act, any international transaction or specified domestic transaction between associated enterprises, shall be based on an arm's length price. Under the GST Regime, the transaction between related persons are deemed to be a supply, even when they are made without consideration. The valuation of such supplies ought to be determined as per Rule 28 of the Central Goods and Services Tax Rules, 2017 (CGST Rules).

While, the objective of both the Acts is to establish whether or not the price at which the transaction has been entered into has been influenced by the relationship between the parties and whether the tax payable has been understated or not, the provisions under the CGST Act and Rules do not accept the valuation as per the methodology prescribed under the Income Tax Law, for transactions between

[8] National Aluminum Company Ltd., 2019 (2) TMI 1527 – AAAR Odisha
[9] CCE, Nagpur v. Manikgarh Cement, [2010 (20) S.T.R. 456 (Bom.)]

related persons, and vice-versa. This may lead to a situation of any assesses arriving at different values qua the same transaction.

The key variation between the GST valuation and transfer pricing regulations have been outlined below:

Transfer pricing provisions under Income Tax	Valuation rules under CGST rules
Threshold limit	
It is only made applicable towards specified domestic transactions till the extent that the aggregate of such transactions entered between the parties are less than a sum of INR 20 crores in the previous year	There is no similar threshold limit prescribed for the applicability of valuation methods prescribed
Specific applicability of the valuation methods in specific circumstances	
It is applicable only to the specified domestic transactions between associated enterprises, wherein the recipient is enjoying certain tax benefits, for example, companies operating as industrial undertaking or enterprises engaged in infrastructure development	The valuation methods prescribed for supplies made between related persons, is applicable in all cases, and no specific exclusion is carved out, for the same
Order of applicability of valuation methods	
Arm's length price can be determined by following any of the prescribed methods of computation. The most appropriate method being that which gives regard to the nature of the transaction or the class of associated persons or the functions performed by such persons	It prescribes a sequential order of determination of the value, wherein, the primary method is based on the Open Market Value (OMV) of the supply of goods/services, followed by other methods, in case the OMV is not determinable
Deeming fiction for determination of value for related party transactions	
No deeming fiction provision. Hence, the assessee would be required to determine the arm's length price in all cases, subject to the conditions and restrictions prescribed	In a case, where the recipient is eligible for ITC for any supply made by a related person, the value declared in the invoice would be deemed to be the OMV for such supply
Comparable prices for transactions with respect to previous years	
It permits use of multi-year data of comparable uncontrolled transactions which could have an influence on the determination of transfer prices, or where the data for the current year is unavailable	It does not specify the determination of value of the supply of goods/services between related parties, based on prices of the goods/services of like kind and quality for the previous years

The divergence between the GST valuation method for related party transaction and the transfer pricing provisions under Income Tax Law, is yet to be settled and further clarification and guidance is awaited. Industry till then is managing in an ambiguous environment.

06

MANAGEMENT FEE AND INTERNATIONAL CROSS CHARGE

Overview

Over the years, MNEs have effectively integrated their overseas business operations with global practices by centrally rendering management and other services to their overseas subsidiaries. It is common practice to cross-charge management fee on account of such services by MNEs to the overseas entities. This article intends to discuss the approach adopted by Indian tax authorities on allowability of expenditure and evaluating the TP policies in respect of management fee. The article also suggests safeguards for taxpayers to avoid possible disputes.

Background

India's rank in the World Bank's Ease of Doing Business 2019 survey climbed 23 places to 77 among 190 countries surveyed. India's achievement can be attributed to the government's sustained efforts towards reforms. One of the key drivers of growth has been the gradual relaxations in the Indian foreign exchange control regulations. Foreign investments have been consistently increasing with FDI equity inflows in India from April 2000 to June 2019 amounting to USD 436,350 million. The service sector has been the most attractive sectors for FDI equity inflows amounting to 18% of the total cumulative FDI inflows. Uncertainty in regulations, long drawn dispute resolutions (including tax litigation) however, still continue to be a pain point for foreign investors.

Over the years, Multinational Enterprises (MNEs) have effectively integrated their Indian business operations with their global practices. Centralization of management functions and consequently rendering management services to all the group's entities globally is a common and tested method adopted by most large MNEs. Cost savings, protection of trade secrets, certainty of availability of services, consistent quality, administrative efficiency and synergies of operations are all important rationales for this centralization.

The provision of intra-group services by foreign parent/overseas group entities to Indian entities has been a much-debated topic between taxpayers and tax authorities. Indian tax authorities have been constantly taking an aggressive approach while examining the tax deductibility of the fees paid by the Indian entity towards receipt of such management services. Further, given that such services are rendered by Associated Enterprises, their appropriateness and quantification of the management services fee is also tested from an Indian transfer pricing perspective.

What is intra-group management service?

An intra-group service is a service performed by one member of an MNE group for the benefit of one or more group companies and it may be performed by a parent company or a sister company. In essence, intra-group services encompass a broad range of services that can potentially be provided by the parent/group company to another group company. In general, the categories of services that could be regarded as chargeable intra-group management services include:

- Coordination and control
- Product development
- Marketing
- Administration
- Research and development
- Public relations
- Human resource management
- Financial management
- Legal support, etc.

While there are certain categories of services which cannot be regarded as chargeable intra-group services. The main categories of such services include:

- On call services

- Shareholder/custodial services
- Duplicative services
- Stewardship services
- Services that provide incidental/ passive association benefits

International perspective

OECD and G20 have been collectively striving to simplify the transfer pricing rules with respect to low value-adding intra-group services for safeguarding payments such as management fees and head office expenses, which were subjected to base erosion in the service recipient country. As a result, OECD while addressing the 15 BEPS action points, made specific reference to transfer pricing implementation models for low value-adding services which form a part of Action 8-10 of the BEPS Action Plans.

Low value-adding services include support services which are non-core activities of the MNE group. To reduce the overall transfer pricing compliance of intra-group services, few categories subject to a threshold, were considered for a simplified approach for transfer pricing analysis. These categories were then defined in Chapter VII of the Transfer Pricing Guidelines under OECD BEPS Action 10 as low value-adding intra-group services. As per BEPS Action 10, the following activities could be considered as illustrations for low value-adding intragroup services:

- Accounting and auditing services
- Legal and corporate secretarial services
- Activities relating to tax obligations, litigations, representations, compliances
- Processing of accounts payable and receivable
- HR activities and payroll processing
- Information technology services
- Communications and public relations
- Data monitoring and compilation

Indian context

Based on the derived principles for acceptability of management fee from BEPS Action 10, India partly aligned itself to the report of the OECD and amended its Safe Harbour rules[10]. In order to optimize the wide net of transfer pricing issues involved in intra-group services, the amended Indian safe harbour rules inserted a new category of international transaction called 'low value-adding intragroup services'. According to the new category, a service provider is required to apply a mark-up to the costs separately identified as providing low value-added services to service recipients of an MNE group. This mark-up should command a limited profit mark-up, not exceeding 5%. However, as an effort towards reducing taxpayer's transfer pricing documentation, no benchmarking study is required to justify such mark up.

[10] Vide CBDT Notification 46 dated June 7, 2017

Key areas of litigation

Management support service/cross charge is the most common litigated topic in India. The main issues are:

- **Issues in respect of the India payer entity**
  - Determination of ALP - The tax authorities compute the price as Nil by following the judicial precedence in previous years
  - Tax deductibility of such expenditure – The tax authorities often challenge the need, actual receipt, commensurate benefits derived by the Indian entity
- **Taxability of management fee in the hands of the overseas payee entity**

Issues in respect of the India payer entity

Determination of ALP

Indian transfer pricing (TP) regulations include reference to intra-group services within the definition of international transaction. However, Indian TP regulations do not provide detailed guidelines for determination of arm's length price (ALP) for intra-group services. The law is still emerging in India and therefore reliance is placed on, and useful inferences are drawn from, the international tax practices followed in some other developed countries, along with the OECD Transfer Pricing Guidelines and the Guidance Note of the Institute of Chartered Accountants of India on transfer pricing.

Most appropriate method for benchmarking - As per OECD Guidelines, the transfer pricing methods for selection of the most appropriate method for benchmarking management fee charge are:

- Comparable uncontrolled price (CUP) method
- Cost-plus method
  - Direct charge method
  - Indirect charge method

Determining whether intra-group services have been rendered – In the realm of transfer pricing, intra-group service transactions present as many challenges as opportunities to the multinational taxpayer. Needless to say, the management fee policy should be designed with an objective of neither overcharging nor undercharging management fees, while simultaneously also considering other tax and regulatory aspects. Any under or overcharging could result in adverse tax implications for the group as a whole.

Broad parameters for designing a policy for charging for intra-group services – The OECD Guidelines outlines two main issues that should be addressed when evaluating intra-group services in the context of transfer pricing, namely:

- Determining whether the activities undertaken by a parent company or group service genuinely constitute intra-group services (*i.e.,* whether the payer is receiving benefit)
- How to determine an arm's-length consideration for such services (in accordance with the benefit received)

Tax deductibility of management fee

Globally service-oriented transactions account for over 60% share in international trade. Service often classified as intangible in nature, is hard to evaluate and measure from a transaction perspective. This means, intangible benefits enjoyed by the service recipient often go unnoticed and the transfer pricing compliance and burden involved could be a challenge in many circumstances. This challenge could be from a perspective of the taxpayer as well as from the point of view of tax authorities. In most cases, the management fee is not for claiming tax benefit or repatriation of funds but is in fact a genuine transaction.

Globally, there was a need therefore, to resolve this issue in order to ease off pressure from the taxpayer and tax authorities for evaluation of service transactions. One widely accepted principle is that to evidence that management fee is a genuine expenditure, it needs to be proved that benefits derived are equal to or more than the cost of management service fee. This can be done based on the following tests**:**

- Need test
- Benefit test
- Rendition test
- Pay-out is not duplicate
- Service provided is not a shareholder service

Benefit test is the test involving a willingness to pay or existence of a benefit as the most important factor that determines whether a service recipient would pay for an intra-group service and, therefore, in turn, whether the service provider can justify a charge for the provision of the intra-group services. The objective of the benefit rule is not only to determine the quantum of benefit, but also the relative proximity of the benefit derived to the intra-group services rendered. Therefore, one should determine how direct or remote the benefits derived are in relation to the activity performed under the guise of intra-group services. A direct or perceived benefit from the service rendered must be identified. Consequently, allocations are not to be made if the probable benefit to other members is so indirect or remote that unrelated parties would not have charged for similar services.

Further, this management fee charge is to be consistent and commensurate with the relevant benefits intended for the services, based on the facts known when the services were rendered, and not based on benefits realized later. In other words, the use of hindsight is to be avoided.

Consequently, at a practical level, with a view to determining whether intra-group services have been rendered, each service must be evaluated on the basis of whether it provides a group member with economic or commercial value that enhances its commercial position in the market where it operates.

Taxability of management fee in the hands of the overseas payee entity

While there are quite a few Indian judicial precedents which lay down guiding principles on the circumstances in which the expenses can be allowed as a tax deduction to the payer and how the pricing for the same have to be benchmarked from a transfer pricing perspective, the issue of taxability of the amount in the hands of the recipient is relatively new. In cases where the relevant DTAA contain the beneficial 'make available' clause (like India-US, India-UK or India-Singapore), tax payers have been

taking a position that the services in question don't make available any technical knowledge, experience, skill, know-how, processes, etc., and hence the management fees are not taxable in India.

Recently, the Bangalore ITAT[11]decided on the issue relating to the taxability of the amounts received by a foreign company, which is a tax resident of the UK, from its Indian affiliate under the Management and Administration Services Agreement. The ITAT, in this decision drew distinction between experience/knowledge which is already available with a person and which has been shared with another person and the experience/knowledge which has been used by the first person to render services to another. It is only the first case which has been held to be in the nature of imparting the knowledge, experience or know-how and has been held to fall within the purview of 'royalty'. Since, in the above matter, the taxpayer was unable to provide break-up of the services into the aforesaid two baskets, the whole fee for rendition of services was held to be in the nature of 'royalty'. In summary, this decision of the ITAT emphasizes on the need to clearly demarcate the services under the broad heads and identify what services are actually being rendered and what are the charges which are being levied for the same.

Proof of actual receipt of service – Illustrative documentation

As transfer of services is less obvious than transfer of goods, documentation of service transfer has to be robust. One of the major aspects that enable tax authorities to challenge the management fee charge is the lack of a comprehensive and thorough identification, evaluation, and documentation process that can effectively present the best possible arguments to justify any charges for intra-group services. In the context of an aggressive audit and litigation environment like the one that currently prevails in India, the best defense for a multinational with intra-group service transactions is a thorough evaluation process, with the help of transfer pricing experts that results in adequate documentation to present the most persuasive case to tax authorities.

Description of service	Illustrative documentation
Business development & marketing which includes assistance in targeting new clients	Records of emails, presentations and benefits derived in terms of business
Financial and administration services which includes assistance in finance and tax issues (should not qualify as shareholder function)	Records of emails, logs of conference calls, memos, notes
Customer coordination services that provide client specific approach and strategic guidelines.	Emails, meetings, conferences, workshops, qualification and designation of the professional visiting India to assist a taxpayer, copies of stamped passports
IT Assistance - License to use group wide IT systems, maintenance support	Records of number of licenses, minutes of the calls, nature of trouble shooting done
Human Resource - Recruiting and training	Records of conference calls, online demonstration of the HR tool, access to websites

[11] TNT Express Worldwide (UK) Ltd (70 taxmann.com 129)

Key principles laid down by the Indian judiciary

In the context of management fee, following principles are laid down by the Indian judiciary:

- Documentary evidences are key to substantiate the genuineness of expenditure incurred on payment of management fee/intra group charges[12].
- It is difficult to place on record, by way of concrete evidence, the day-to-day advice given by various group centers to the group companies, but one can perceive the same by the way business is conducted[13]
- The legitimate business needs of the company must be judged from the perspective of the company. It is not for the tax authority to dictate what the business needs[14]
- When computing ALP, the tax authorities cannot question the commercial wisdom of the taxpayer. It is the taxpayer's prerogative to decide on how to conduct its business[15]
- The TPO cannot compute the ALP of the transaction on ad-hoc basis. The provisions of section 92C(1) mandates adoption of one of the prescribed methods mentioned therein for determining the Arm's Length Price of the international transactions[16]
- Benefit test is a necessary part of determining arm's length price of any intra group services. 'Benefit', is needed to be identified from an assessee's viewpoint, which could be potential, reasonable, foreseeable, may not be quantifiable in money alone, and may be strategic, but could not be incidental[17]

Conclusion

Management fees must be carefully analyzed and well documented in order to ensure compliance with the arm's length standard. Jurisprudence evolving on the subject suggest that robust document evidencing the availment of services would go a long way to avoid or minimize the exposure in respect of management services. In view of the complexities involved and the kind of detailed analysis required to be undertaken, it is advisable for taxpayers to be prepared well in advance.

[12]Verizon Communications India Private Limited
[13] TNS India Private Limited (152 ITD 123)
[14] McCann Erickson India Private Limited (24 taxmann.com 21) and AWB India P Ltd (152 ITD 770)
[15]Dresser Rand India Private Limited (53 SOT 173)
[16]Lintas India (P.) Ltd. (107 taxmann.com 426)
[17] Adcock Ingram Ltd (90 taxmann.com 298)

07

GST IMPLICATIONS ON 'TRANSACTIONS IN SECURITIES'

Overview

Securities' (shares, scrips, stocks, bonds, derivative instruments, etc.) have been explicitly excluded from the purview of GST, by virtue of their exclusion from the definition of 'goods' and 'services', as per Section 2(52) and Section 2(102) of the CGST Act respectively. However, even while not being a taxable transaction itself, a transaction in securities has several other implications in terms of GST law. This article analyzes the implications of the above issue.

'Securities' (shares, scrips, stocks, bonds, derivative instruments, etc.) have been explicitly excluded from the purview of GST, by virtue of their exclusion from the definition of 'goods' and 'services', as per Section 2(52) and Section 2(102) of the CGST Act respectively. However, even while not being a taxable transaction itself, a transaction in securities has several other implications in terms of GST law. This arises pursuant to treating such transactions as 'exempted' supplies for the purpose of determination of admissible input tax credit for the entity.

Do GST provisions explicitly require reversal of input tax credit?

Cognizant of the fact that several businesses engage in transactions in securities even while it is not part of their core business – usually such transactions are undertaken for efficient deployment of unused funds or for hedging commodity prices and currency exposures – the GST law has sought to ensure that ITC attributable to such activities undergoes reversal.

Section 17(2) and Section 17(3) of the CGST Act read with Explanation 2(a) to Chapter V of the CGST Rules, seek to achieve this. Relevant provisions are given below:

Provision	Relevant extract
Section 17(2)	Where the goods or services or both are used by the registered person partly for effecting taxable supplies including zero-rated supplies under this Act or under the Integrated Goods and Services Tax Act and partly for effecting exempt supplies under the said Acts, the amount of credit shall be restricted to so much of the input tax as is attributable to the said taxable supplies including zero-rated supplies
Section 17(3)	The value of exempt supply under sub-section (2) shall be such as may be prescribed, and shall include supplies on which the recipient is liable to pay tax on reverse charge basis, transactions in securities, sale of land and, subject to clause (b) of paragraph 5 of Schedule II, sale of building
Explanation 2(a) to Chapter V of the CGST Rules	For the purposes of this Chapter, ….(2) for determining the value of an exempt supply as referred to in sub-section (3) of section 17-… (b) the value of security shall be taken as one per cent. of the sale value of such security.

'Securities' whether exempt?

While the intention of the Government is clearly reflected in the given provisions, the application needs to be examined. It is noted that Section 17(2) of the CGST Act casts a restriction on availing ITC to the extent it is attributable to an 'exempt supply'. As per Section 2(47) of the CGST Act, the term 'exempt supply' means supply of goods or services which are exempted, or which attract nil rate of GST and includes non-taxable supply. Non-taxable supply is further defined under Section 2(78) to 'mean such supply on which no tax is leviable'. Therefore, to constitute an exempt supply/non-taxable supply of goods or services, the pre-requisite test of being a supply of either has to be met. Since 'securities' find an exclusion from the ambit of 'goods' and 'services' itself, the question of it qualifying as an exempt or a non-taxable supply would not arise, more so when the said terms are exhaustively defined.

The question which arises is whether Section 17(3) does enough to overcome the limitation placed under Section 17(2), so as to achieve the legislative intent. Unfortunately, a plain reading of the provision suggests that it fails to get the job done. As evident, the said provision is merely assigned the task of determining 'value of exempt supply' under sub-section (2). It, however, exceeds such

authority and attempts placing therein 'transactions in securities', even when the same does not constitute a supply in the first place. A 'notwithstanding clause' or a deeming fiction stretching/expanding the scope of the term 'exempt supply' to include within its ambit 'transactions in securities' could have unequivocally empowered the legislature to neutralize ITC attributable to the said activity.

Quite clearly, there is an ambiguity as to whether the law, as drafted, requires ITC reversal for transactions in securities. It may, therefore, be relevant to refer to the findings of the Constitution Bench of the Hon'ble Supreme Court in the case of *Commissioner of Cus. (Import), Mumbai vs. Dilip Kumar & Company*[18], wherein it was held that while interpreting a taxing statute, there is no room for intendment or presumption and that it has to be interpreted only on the basis of language employed, and any ambiguity in taxing provisions has to be interpreted in favor of the assessees.

However, an interpretation that there is no requirement for reversing ITC attributable to transactions in securities would render the applicable extract of Section 17(3) redundant and would be contrary to the settled law, inter alia, in terms of the decision of the Hon'ble Supreme Court in the case of *CCE, Calcutta vs. Hindustan Petroleum Corpn. Ltd.*[19], that an interpretation which ignores words, or which renders words superfluous, cannot be taken.

To conclude, there is a visible gap between the intent and the letter of law under the present GST law, which may inevitably lead to litigation. This could mean that possibly another retrospective amendment may be on the anvil.

Is the quantum of ITC reversal sought commensurate with the quantum of ITC usage?

Assuming that transactions in securities necessitate reversal of ITC, it needs to be seen whether the mechanism currently prescribed, achieves a reasonable and realistic reversal, commensurate to the extent of common services consumed in the course of the subject activity.

It is noteworthy that only a miniscule quantum of common infrastructure is directly consumed in such activity, primarily pertaining to employee costs, which are not within the ambit of GST, and certain other costs such as IT infrastructure, internet services etc. However, in terms of Rule 42 of the CGST Rules, the moment an activity qualifies as an exempt supply, all common input services, which may not be exclusively attributable to taxable/exempt operations, will have to undergo reversal. To this extent, various services – whose procurement is not determinant on conduct of the subject transactions e.g. office rent, legal and audit, security etc. – will suffer the brunt of ITC reversal. To this extent, the reversal mechanism appears to be arbitrary and unreasonable. On the contrary, it would be more logical if ITC reversal could have been restricted only to such inputs and input services, which are directly connected to transactions in securities.

Do hedging transactions merit ITC reversal?

Many entities which deal in commodities where prices are exchange determined (such as industrial metals, precious metals, etc.) often enter into commodity derivative transactions with the sole objective of hedging their future procurements or supplies from any adverse price movements. Similarly, entities which make procurements or supplies which require cross border settlement may enter into currency derivative transactions solely for securing foreign currency exposure.

[18] Commissioner of Cus. (Import), Mumbai vs. Dilip Kumar & Company, [2018 (361) E.L.T. 577 (S.C.)]

[19] Calcutta vs. Hindustan Petroleum Corpn. Ltd., [2005 (189) E.L.T. 258 (S.C.)]

It may be pertinent to note that any gain or loss arising out of such derivative transactions is proportionately linked to the corresponding variation in price at which the taxable supply is eventually made. In effect, no gain or loss independently arises on account of the derivative contract.

For better understanding, consider this illustration. Mr. X, a trader in certain commercial metals, intends to supply a certain quantity of the same after a month. Mr. X apprehends that one month hence, the price of such commodity may fluctuate. In order to hedge the pricing risk, he enters into a forward sell contract in such commercial metals with a month's maturity at a strike price of USD 20,000. Assuming that at maturity the market price is (a) USD 15,000, or (b) USD 25,000, the following alternative scenarios would emerge:

Particulars	Market price (USD 15,000)	Market price (USD 20,000)
1. Strike price of forward sell contract	USD 20,000	USD 20,000
2. Market price at the time of maturity*	USD 15,000	USD 25,000
3. Profit (loss) on forward sell contract [1-2]	USD 5,000	(USD 5,000)
4. Net effective consideration received, owing to the hedging transaction [2+3]#	USD 20,000	USD 20,000

**Note: -To offset his position, Mr. X will generally enter into a forward buy contract of equal denomination, price of which will be near equivalent to the market price*

#Price received on supply of goods (market price at maturity) + profit (loss) on the forward derivative contract

As evident, under either scenario, Mr. X is guarded from any price fluctuation, by virtue of the derivative contract and receives an identical overall consideration in respect of its taxable supplies. Thus, the only objective of entering into such derivative contracts is to secure the price of taxable supplies, which is equivalent to the strike price of the derivative contract. However, as already enumerated, derivative contracts qualify as 'securities' and any transaction therein, notwithstanding whether it is for trading or for hedging purposes, would necessitate ITC reversal. Therefore, seeking ITC reversal for transactions which are carried out as a part of the taxable business and for securing the price of taxable supplies being made under GST appear to be onerous, inappropriate and unreasonable.

In this regard, it is also relevant to note that jurisprudence under the Income Tax laws clearly recognizes such hedging transactions as forming part of normal business operations rather than speculative business operations. These hedging transactions cannot be construed as transactions independent of such business. This issue perhaps merits an active dialogue with the Government. It is no doubt beneficial for industry to seek exclusion for the activity of hedging from the ambit of 'transactions in securities.'

08

INTERPLAY OF GOODS AND SERVICES TAX LAWS VIS-À-VIS CUSTOMS LAWS

Overview

With the introduction of GST, the Customs Laws have also undergone a significant amendment. However, there still exists scope for further alignment of GST and Customs Laws. This article highlights, via illustrations, the strong interplay of GST and Customs laws in relation to international trade transactions and the need for an active dialogue with the Government to obtain clarity qua all the ambiguous provisions.

There is no doubt, the introduction of GST has allowed its effects to be felt in other Laws, *including* the Customs Law. This article highlights, via illustrations, the strong interplay of GST and Customs in relation to international trade transactions.

Valuation

As per the provisions of Section 14 of the Customs Act, 1962 (Customs Act) read with Customs Valuation (Determination of Value of Imported Goods) Rules, 2007 (Customs Valuation Rules), the value of the imported goods is the transaction value of such goods where the buyer and seller of the goods are not related and price is the sole consideration for the sale. Specific additions to the transaction value are prescribed under Rule 10 of the Customs Valuation Rules. Given that value of certain services is included in the transaction value of imported goods, there is double taxation *per se* in respect of those services wherein there is no exemption of IGST on the services which already form part of the transaction value of the imported goods.

Under the GST regime, certain instances of transactions where there is an element of double taxation are given below:

- **Levy of IGST on Ocean Freight**

  One of the most contentious issues under the GST regime, which is affecting almost all importers across industries, is whether the importers are liable to pay IGST under Reverse Charge Mechanism (RCM) on ocean freight paid for services of transportation of goods up to customs station of clearance in India, provided by a person located in a non-taxable territory. This is, even if such freight is a part of CIF value of imported goods on which the applicable Customs duty along with IGST (as a component of Customs duty) is already paid. Various Advance Rulings have been pronounced clarifying that the importer is liable to pay IGST on RCM basis on ocean freight even if such freight is part of CIF value of imported goods[20]. While multiple writ petitions have been admitted across various High Courts in India challenging the levy of IGST on ocean freight under RCM *inter alia* on the ground that the same amounts to double taxation[21], the final outcome of the petitions is still awaited.

- **Double taxation of service imports in certain other cases**

  Valuation provisions under Customs require adding value of certain services on to the transaction value of imported goods for the purpose of payment of Customs duty. In line with the same, exemption from payment of IGST under RCM has been granted to royalty and license fee to the extent that the same is included in the value of goods imported on which IGST (as a component of Customs duty) is paid[22]. However, no such exemption is currently available qua other services (such as commissions and brokerage, engineering, design work) which form a part of transaction value and wherein Customs duty and IGST (as a component of Customs duty) are already paid. This results in double taxation in respect of such services.

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[20] *IN RE: E-DP Marketing Pvt Ltd. [2019 (26) G.S.T.L. 436 (A.A.R. - GST)]; IN RE: Chambal Fertilizers & Chemicals Ltd [2018 (17) G.S.T.L. 526 (A.A.R. - GST)]; IN RE: Bahl Paper Mills Ltd. [2018 (14) G.S.T.L. 306 (A.A.R. - GST)]*

[21] *Mohit Minerals Pvt. Ltd. vs. Union of India [2018 (10) GSTL 424 (Guj.); Ghanshyamlal & Co. [TS-345-HC-2019(GUJ)-NT]; Indorama Industries [TS-361-HC-2019(HP)-NT]*

[22] *Notification No. 6/2018-Integrated Tax (Rate) dated January 25, 2018*

It is interesting to note that this double taxation goes against the fundamental principle of GST which is to curb cascading effect of taxes.

Scope and ambit of 'export' in the context of Duty-Free Shops (DFS)

Under the erstwhile Value Added Tax and Central Sales Tax laws, the Hon'ble Supreme Court of India[23] had held that sale of goods by duty free shops at International Airports, which are undisputedly beyond the Customs frontier of India, cannot be subjected to the levy of Sales Tax.

Under the GST regime, the controversy started with an Advance Ruling pronounced by the Delhi AAR[24] wherein a view contrary to that of the Apex Court was taken thereby holding that supplies made by a DFS to outbound passengers is amenable to GST as export under GST takes place only when goods cross territorial waters/airspace of India and not merely on crossing customs barriers. A similar view was also adopted by the Bombay High Court[25] and Madhya Pradesh High Court[26]. However, a similar issue also came up for consideration before the Allahabad High Court[27] wherein it was held that sales made by DFS constitute as exports as the goods are taken outside India and will not attract GST.

Given the conflicting judgments, recently, the Government of India granted exemption[28] to any supply of goods by a retail outlet established in the departure area of an international airport, beyond the immigration counters, to an outgoing international tourist, from IGST. Interestingly, the exemption from payment of IGST indicates that the Government considers the supply to be otherwise, amenable to GST. This fact has also been categorically mentioned in a Circular[29]. Further, the exemption has only been granted to supplies that take place from the departure area and that too to 'outgoing international tourists'.

The term 'outgoing international tourist' has been defined to mean a person not normally resident in India who enters India for a stay of not more than 6 months for legitimate non-immigrant purposes. A natural conclusion to this would be that no exemption will be available to an Indian resident purchasing goods from such retail outlets. This is for the simple reason that they cannot be called as persons who are not normally residents.

The limited exemption is expected to bring additional responsibility on the DFS since they will now be required to maintain a separate record of sales to 'outgoing international tourists' and also cast a responsibility upon DFS to scrutinize if the passenger qualifies for an exemption or not.

Classification

In any indirect tax, classification of goods is very vital. The same has wide implications particularly in the case of a multi rate tax structure like GST. Customs adopt the global classification of goods, based on the Harmonised System of Nomenclature (HSN) read along with General Rules of Interpretation. The rate Notification of goods under GST regime also adopts the classification, rules of interpretation, section notes and chapter notes as specified under the Customs Tariff Act, 1975. However, certain anomalies in classification are observed with respect to 'goods' and 'services'. For example – any Intellectual Property Right (temporary transfer) imported into India over a physical medium is

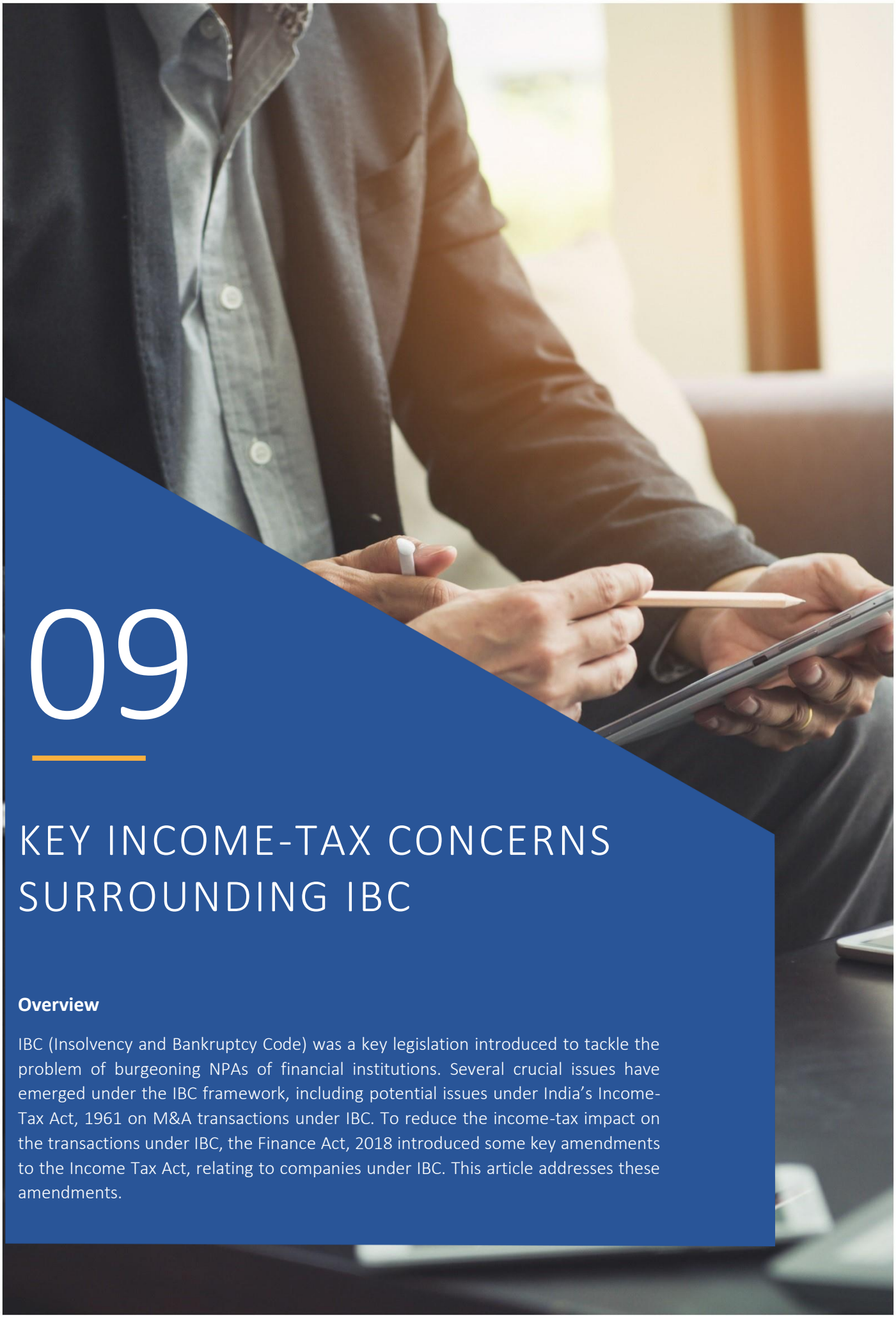
[23] *Hotel Ashoka v. Assistant Commissioner of Commercial Taxes — 2012 (276) E.L.T. 433 (S.C.)*
[24] *IN RE: Rod Retail Pvt. Ltd. [2018 (12) GSTL 206 (AAR – GST)]*
[25] *A-1 Cuisines Pvt. Ltd. vs. Union of India [2019 (22) GSTL 326 (Bom.)]*
[26] *Vasu Consulting Pvt. Ltd. vs. Union of India [2019 (22) GSTL 163 (MP)].*
[27] *Atin Krishna vs. Union of India [2019 (25) GSTL 390 (All.)]*
[28] *Notification No. 11/2019 – Integrated Tax (Rate) dated June 29, 2019*
[29] *No.106/25/2019-GST dated June 29, 2019*

considered as goods for the purposes of Customs whereas under the GST, by virtue of Entry 5(c) of Schedule II of the Central GST Act, 2017 the same is classified as service. This may lead to issues in future if there is a difference in the IGST rate, double taxation[30], availment of any exemption benefit restricted to goods etc.

There is no doubt, given so much ambiguity, that GST and customs laws need to align. Amongst other things it will reduce expensive and long drawn litigation. This is where regulators will need to step in.

Uncertainty in taxation laws, especially interplay between different tax laws and consequently long drawn out litigation, is a pain point with corporate India. Clarity on issues, consistency of implementing regulations and continuous dialogue between government and businesses is the need of the hour.

[30] There is no double taxation with effect from January 25, 2018 in light of the specific exemption granted vide Notification No. 06/2018-I.T. (Rate) from payment of IGST under RCM for royalty and license fee - to the extent the same is included in the value of imported goods on which IGST (as a component of Customs duty) is paid. For the period prior to January 25, 2018, the issue of double taxation persists.



09

KEY INCOME-TAX CONCERNS SURROUNDING IBC

Overview

IBC (Insolvency and Bankruptcy Code) was a key legislation introduced to tackle the problem of burgeoning NPAs of financial institutions. Several crucial issues have emerged under the IBC framework, including potential issues under India's Income-Tax Act, 1961 on M&A transactions under IBC. To reduce the income-tax impact on the transactions under IBC, the Finance Act, 2018 introduced some key amendments to the Income Tax Act, relating to companies under IBC. This article addresses these amendments.

Introduction

The Insolvency and Bankruptcy Code, 2016 (IBC) was a key legislation introduced to tackle the problem of burgeoning NPAs of financial institutions. Though this proved instrumental in addressing the corporate insolvency situation in the country, several crucial issues have emerged under the IBC framework, including potential issues under India's Income Tax Act on M&A/transactions under IBC. To reduce the income-tax impact on the transactions under IBC, the following key amendments were introduced to the Income Tax Act pertaining to companies under IBC. A snapshot is provided below:

Key amendments to the Income Tax Act

- **Carry-forward of losses**
  As a general rule, under the Income Tax Act, a company is not eligible to carry forward its accumulated losses of earlier years where there is a (more than 50%) change in the ownership of the company. However, companies under the IBC have huge accumulated losses and further, the resolution plan usually involves substantial change (which generally exceeds 50%) in the ownership of these companies under the IBC. In order to provide relief to companies under IBC, an exception has been introduced in the provisions of Income Tax Act to exempt the change in shareholding effectuated through an approved resolution plan under IBC.

- **Relief from Minimum Alternate Tax (MAT)**
  As per the Income Tax Act, companies can avail a deduction of either brought forward losses or unabsorbed depreciation against their book profits while computing MAT. In order to grant relief to companies under IBC, the provisions governing MAT have been amended to provide for aggregate deduction of brought forward losses and unabsorbed depreciation against the book profits for companies for whom an application for resolution process has been admitted by the Adjudicating Authority under IBC.

Significant ground to cover

These amendments, while being timely and welcome, are not enough to resolve all the income tax issues impacting IBC transactions since there is no blanket exemption provided to such transactions. Some of the key income tax issues still impacting IBC transactions are:

- **Remission of trading liability**
  Under IBC, operational creditors as well as creditors providing working capital loans may take a haircut. As per section 41 of the Income Tax Act, any such haircut (i.e. remission of any trading liability) is chargeable to income-tax under normal provisions. In addition, there may be MAT implications as well on such haircut.

- **Write-back of loans**
  - Waiver of interest and even the principal (in some cases) runs the risk of taxation. However, based on judicial precedents, it may be possible to argue that waiver of loans availed on capital account may not be liable to tax under the normal provisions of Income Tax Act.
  - Currently, any haircut taken by creditors risks a MAT levy at the rate of approximately 20%, subject to set-off of accumulated losses. Thus, a potential bidder, in the absence of any exemption from MAT provisions, is required to factor in this tax cost and, accordingly, lower his or her bid. This translates to a substantial reduction in bid amounts.

- **Reduction of capital**
  - Capital reduction is one of the common modes adopted by a company under the purview of IBC, in order to reorganize its capital structure. As per section 2(22)(d) of the Income Tax Act, any distribution by a company to its shareholders, on the reduction of its capital, to the extent of accumulated profits, whether capitalized or not, would be treated as deemed dividend. Accordingly, the company is liable to deposit the Dividend Distribution Tax (DDT)

(approximately @20%) within 14 days of distribution of such proceeds. Any failure in depositing DDT within 14 days, will lead to levy of interest and penalty.

- Further, it is equally important to evaluate the taxability of such distribution for shareholders. The matter has been settled by the Apex Court's ruling in the case of G. Narasimhan (236 ITR 327), wherein it has been held that the amount distributed by a company on capital reduction has two components: distribution attributable to accumulated profits and distribution attributable to capital. Any distribution over and above the accumulated profits is chargeable to capital gains tax for shareholders.
- Additionally, the provisions of section 50CA of the Income Tax Act may also be triggered. As per section 50CA, where the sales consideration on transfer of shares is less than its Fair Market Value (FMV), the FMV is deemed to be the sales consideration. Accordingly, when the payout to the shareholders exceeds accumulated profits and the payout price of the shares is less than the FMV of the shares, provisions of section 50CA may be triggered and such FMV is deemed to be the sales consideration for computing capital gains for the shareholders.

- **Conversion of debt into equity**
  - Any structuring measure such as conversion of debt into equity would have to be taken after taking into consideration the share valuation rules, Transfer Pricing provisions and ECB regulations as the same could have income-tax implications for both, the buyer as well as the seller. Under the Income Tax Act, there are deeming provisions such as section 50C, 50CA, section 56(2)(x) etc. which would come into play. Accordingly, conversion of debt into equity below FMV may result into income-tax implications for the lender or company or both depending upon the exact fact pattern.
  - Companies under the insolvency resolution process may convert their existing outstanding debt into equity which may necessitate fair valuation of such debt instrument and the difference between its carrying value and the fair value may need to be recognized as gain/loss in profit or loss account. Accordingly, such differential when credited to the P&L account is subject to MAT for the company.

- **Issue / transfer of shares less than FMV**
  - In case shares are received for a consideration lower than the prescribed fair market value, the difference is taxed as income of the recipient of the shares as income from other sources under Section 56(2)(x) of the Income Tax Act. Thus, issue of equity shares at prices lower than their fair market value to lenders/new investors under a resolution plan may result in tax implications for the recipients of shares.

Relief proved	Issues still impounding
Companies under IBC can carry-forward and set-off brought forward losses	Haircut on operational credit and loan may attract liability under normal provisions as well as MAT
Brought forward losses and unabsorbed depreciation, both, can be adjusted against book profits under MAT	Issue or conversion of any securities not in-line with FMV under Income Tax Act may have income tax impact
As per a recent Apex Court ruling, IBC overrides Income Tax Act	Reduction of capital /buy-back /any distribution to shareholders has income tax hurdles

To conclude, no doubt IBC is widely considered as one of the most effective reforms for resolving India's predicament on overwhelming NPAs in the corporate sector. However, path breaking ideas and reforms always come with their own set of challenges. As the IBC process gains more momentum, it would be imperative for the Government to recognize and address emerging issues to ensure its continuing effectiveness.

10

TAX AMNESTY: AN OPPORTUNITY WORTH EXPLORING

Overview

A step in the right direction, amnesty schemes have drawn significant interest from industry. This article discusses the Sabka Vishwas Legacy Dispute Resolution Scheme and more importantly, in what situations would the scheme be effective/ineffective.

Amidst the increasing fiscal deficit and the drop in GST collections, the Central and State Governments have managed an unlikely alternate to fill up their coffers – that of tax amnesty. There has been a flurry of Tax Amnesty schemes for, both, Central and State levies in recent times. These schemes have been unique and unprecedented on many counts and have drawn significant interest from the industry at large. The schemes aim at benefitting the taxpayers to bury the legacy pre-GST litigation and at the same time help Governments in liquidating tax demands locked up in litigation at various forums over the years.

Central and State amnesty schemes

The Maharashtra Government in its State Budget introduced the Maharashtra Settlement of Arrears of Tax, Interest, Penalty or Late Fee Act, 2019, which was effective up to 31.08.2019. This scheme offered VAT and other State tax waivers in the range of 20% to 50% and interest and penalty waiver of 70% to 95%. The Gujarat Government subsequently introduced Gujarat Tax Amnesty Scheme, 2019 which provides for up to 100% remission of interest and penalty in cases of legacy VAT and other State tax matters. The applications under the Gujarat Tax Amnesty scheme can be made up to 15.11.2019.

Even for the Central levies such as Excise duty and Service tax which are subsumed under GST, the Central Government has introduced the Sabka Vishwas Legacy Dispute Resolution Scheme, 2019 (LDRS scheme) through the Budget 2019-20. The extent of tax waivers provided under the LDRS scheme have been unprecedented and reflects the strong intent of the Central Government to clear the baggage of pre-GST litigations.

LDRS Scheme

The key features of the LDRS scheme have been summarized below:

- The scheme prescribes tax waivers in the following cases:
  - Show cause notice or one or more appeals arising out of such notice are pending as on 30.06.2019.
  - Arrears of tax reported in the return or arising out of an order which has attained finality would also be eligible for waiver under the scheme.
  - Tax quantified in an enquiry, audit or investigation.
- The tax waiver in the above cases ranges between 40% to 70% of the tax amount, depending upon the size of tax dues.
- The scheme entails 100% waiver of interest and penalty. This comes as a huge relief for historical matters involving high tax demands.
- The taxpayers can also make voluntary disclosure of any tax liability, not disclosed in the return. In such cases, the relief would only be to the extent of interest and penalty.
- In cases where only penalty or interest is under dispute, full waiver of penalty and interest would be available.

One may note that on an average a case starting at the adjudication level and finally settling at the Supreme Court, takes a minimum of 15 – 20 years. If the final outcome of the case is negative, in a normal scenario, the taxpayers would end up shelling out the principal amount, equivalent penalty and interest, which would be three times the principal amount. In simple terms, for a case involving a demand of INR 100, the taxpayer may be required to pay INR 500 (if the final outcome of the case is negative). On the other hand, if the same matter is settled under the LDRS scheme, the case would be

closed on payment of 50% of the tax demand (i.e. INR 50 in the given case). Therefore, it would be financially prudent to opt for the LDRS scheme in cases where the chance of success is not high. Even in legacy interpretational matters relating to classification and valuation, one must carefully evaluate the risk involved in continuing with litigation and consequently take a decision on opting for the LDRS scheme.

The LDRS scheme is unique in terms of coverage and size of waivers and is no doubt a game changer in the present scenario. The scheme gives the Government and the taxpayers the opportunity to get rid of the ghosts of past as well as impending litigation (where demand has been quantified), particularly where the outcome could be uncertain.

It is pertinent to note that the validity of Amnesty Schemes has been challenged in the past on the ground that the same are detrimental to and against the interest of the honest taxpayer vis-à-vis the assessees who have evaded payment of tax. Considering the size of waiver accorded under the LDRS scheme, the likelihood of the constitutional validity of the scheme getting challenged cannot be ruled out. However, amnesty schemes being a matter of economic policy of the Government, the constitutional validity of such schemes has been upheld by the Courts in the past.

Conclusion

In conclusion, the amnesty schemes introduced by the Central and State Governments offer a good opportunity to the industry to reduce their contingent liabilities and thereby, unqualify their financials. One must assess the probability of success vis-à-vis the liability to pay in case of negative outcome and thereafter, decide the cases where the amnesty schemes should be opted for. While arriving at a decision, it is also important to bear in mind the factors like uncertainty in litigation and cost of litigation.

It is also a great opportunity for the Government to make windfall gains in a short span of time. However, in order to make the schemes successful, the Government will have to ensure smooth implementation to ensure maximum participation by the industry.

11

INDIA'S EXPORT CONTROL REGIMES: ALIGNMENT WITH GLOBAL STANDARDS

Overview

The admission of India as the 42nd member of the Wassenaar Group in December 2017, marks a significant milestone for India. The Government of India has been proactively undertaking a review of its existing laws as well as raising awareness through public dialogue on export control laws and the necessity of its compliance. This article provides a brief overview on India's current export control regime.

Background

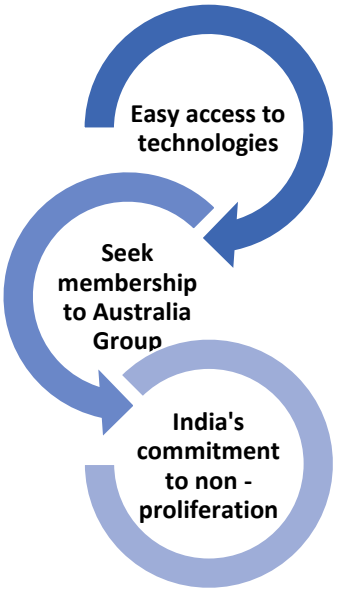
The admission of India as the 42nd member of the Wassenaar Group in December 2017, marks a significant milestone for India. Since the Indo-US civil nuclear deal in 2005, India has been trying to make its way into the major export control regimes namely Nuclear Suppliers Group, Wassenaar Group, Missile Technology Control Regime and Australian Group. With persistent efforts and constant upgradation of export control laws, India had managed a breakthrough with the membership of the Missile Technology Control Regime (MTCR) in June 2016. The membership in Wassenaar shortly after the membership in the MTCR is also an ode to India's emergence as a responsible economic superpower.

Effect of India's admission into The Wassenaar Arrangement

The Wassenaar Group had been established to contribute to regional and international security and stability by prescribing the participant countries to adhere to export control restrictions on the transfer of conventional arms and dual-use goods and technologies, thereby preventing any misuse through unwarranted acquisitions, amongst other things, by non-state actors and terrorist groups.

The participant countries, inter alia, are required to share, on a bi-yearly basis, their arms transfer and permissions or denial of dual use of goods and technologies to countries that are not a party to the Wassenaar Group. This is to ensure greater transparency and a common understanding of the risk of transfer amongst the participant states. Consequently, there are greater restrictions imposed on the transfer of technology or goods from a participant states to states which are non-members.

The admission in the Wassenaar Group is expected to provide multiple benefits to India



Firstly, as a member party India would have easy access to technologies which have potential uses for both civil and military purposes in critical sectors such as aerospace, telecommunication, electronics etc. At a time when India has opened up its defence sector, entry into Wassenaar Group will help Indian companies and joint ventures in the easy identification, transfer and confabulation about sensitive technology. It shall further help India in obtaining cutting edge technology in various other sectors of mass goods such as information technology, telecommunication and consumer and medico electronics.

Second, the membership within the Wassenaar Group would make it easier for India to seek membership in the Australia Group as most of the member countries therein are common.

Third, admission within the Wassenaar Group is indicative of the international communities' growing recognition of India's commitment to non-proliferation. In this regard, India was accepted into the Missile Technology Control Regime (MTCR) only last year. It would now be easier for India to counter the opposition posed by China and Pakistan against its membership of the NSG. In fact, apart from Japan and South Korea, India is the only member from Asia to be part of the Wassenaar Group which pre-dominantly comprises of European countries.

Indian domestic laws as applicable to export control

With the membership to the majority of multilateral export regimes, there have been regular changes being made to the domestic export control regulation from time to time in keeping with the dynamic export control regimes as well as best practices from India's trading partners. By way of background, for all matters concerning foreign trade including exports and imports thereof, applicable policies derive their legality from the Foreign Trade (Development & Regulations) Act,1992 (FTDR Act). Under the powers granted under FTDR Act, the Foreign Trade Policy (FTP) and Indian Tariff Classification (Harmonized System) of Export and Import items [ITC (HS)] had been issued. More specifically, an item-wise export policy is contained in Schedule 2 to the ITC (HS), which sets out an Export Licensing Schedule.

The Export Licensing Schedule sets out the export policy regime applicable on the items, based on which the items are Prohibited/restricted /free for exports. The Schedule is divided into two parts viz. Table A and Table B.

Table A inter-alia includes the SCOMET list- a single unified control list of all dual-use items (set out under Appendix 3 to Schedule 2). It may also be noted that the Special Chemicals, Organism, Material, Equipment and Technologies ('SCOMET') list is notified by the Central Government under the empowerment of the FTDR Act. Further, the FTDR Act itself contains specific provisions/chapter which seeks to provide for "controls on the export of specified goods, services and technology". *Hence, determination of whether a particular item is regulated by export control provisions has to be primarily seen within the provisions of the FTDR Act and the SCOMET list.*

In addition to the regulations under the FTDR, 1992 and ITC (HS), the export of certain goods are also prohibited/restricted under the other enactments such as Atomic Energy Act, 1962, Chemical Weapons Convention Act, 2000, Environment Protection Act, 1986, Indian Arms Act, 1959 and Weapons of Mass Destruction and their Delivery Systems (Prohibition of Unlawful Activities) Act, 2005 ('WMD Act').

In fact, over the past year, the Government of India has been proactively undertaking a review of its existing laws as well as raising awareness through public dialogue on export control laws and the necessity of its compliance. In furtherance thereof, in May 2017, the Government completely overhauled the decade old SCOMET list and notified a new list which confirmed to / aligned with the international export control lists.

It is relevant to note that a new Category 8 dealing with "Special Materials and Related Equipment, Material Processing, Electronics, Computers, Telecommunications, Information Security, Sensors and Lasers, Navigation and Avionics, Marine, Aerospace and Propulsion" was introduced and a Munition List was populated under Category 6 of the SCOMET list to align India's export control laws with that of Wassenaar Group.

USA recognizes India as a trusted STA-1 trade partner for sensitive products

The entry into Wassenaar Group is evidently a big boost for India along with India receiving the STA-1 status from USA by way of relaxing a key condition set by the Obama Administration that India would be eligible only after it had secured the membership of all four technology control regimes — the NSG, the Missile Technology Control Regime, the Wassenaar Arrangement and the Australia Group. This will enable shortly, subject to the official changes in the US export regulation, for India to acquire single comprehensive project licenses for any dual-use or sensitive product imports instead of stage-

wise authorisation for the project stages, from various relevant licensing authorities. Any license sought through a country in this category will move through the process as politically deemed approved. Any authority would now have to actively intervene to stop the approval process of any such licenses. Earlier, the process would not progress without authorised approvals at every point. *The STA-1 status reaffirms that there is mutual trust between India and the USA regarding trade in sensitive products. While the category benefits both private and public entities, it also sets a presumption of in-principle approval for any projects underwritten by governments of both sides.*

The MTCR and Wassenaar memberships, as well as the implied seal of approval from the USA in the form of the STA-1 status, would mean that India's desire to join the NSG could soon be realised. This development will not only boost ties between both the countries but will also provide an opportunity for India to take advantage of producing technologies for dual use including sensitive products.

MUMBAI

109 A, 1st Floor, Dalamal Towers
Free Press Journal Road, Nariman Point
Mumbai 400 021
T: +91 22 6636 7000

NEW DELHI

801 A, 8th Floor, Konnectus Tower, Bhavbhuti Marg
Opp. Ajmeri Gate Railway Station, Nr. Minto Bridge
New Delhi 110 001
T: +91 11 4152 8400

AHMEDABAD

801, 8th Floor, Abhijeet III
Mithakali Six Road, Ellisbridge
Ahmedabad 380 006
T: +91 79 6605 4480/8

PUNE

202, 2nd Floor, Vascon Eco Tower
Baner Pashan Road
Pune 411 045
T: +91 20 4912 7400

BENGALURU

6th Floor, Rockline Centre
54, Richmond Road
Bengaluru 560 025
T: +91 80 4168 5530/1

CHENNAI

No 18, BBC Homes, Flat-7 Block A
South Boag Road
Chennai 600 017
T: +91 44 4210 4863

elplaw.in

insights@elp-in.com

/elplaw.in

/ELPIndia

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