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RECENT DEVELOPMENTS IN DIRECT & INDIRECT TAX

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DIRECT TAX - RECENT CASE LAWS

Himachal Pradesh High Court [1]quashes Income-tax Department's plea qua applicability of section 56(2)(viib) of the Income-tax Act, 1961 ('ITA') in connection with conversion of loan into equity as well as denying Tax Authority's contention of adopting alternate method of calculating Fair Market Value ('FMV') as against the method adopted by the tax payer.

FACTS OF THE CASE

- Assessee issued shares against cancellation of the outstanding loan amount. The shares were issued at a premium, which was backed by a Chartered Accountant certified valuation report adopting Discounted Cash Flow ('DCF') method for the purposes of valuation.
- The tax authority rejected the valuation report treating the DCF based valuation as bogus and computed the FMV basis adjusted Net Asset Value ('NAV') method – one of the two methods provided under the Income-tax Rules, 11UA ('the Rules') in this regard.

RULINGS OF THE HIGH COURT

High Court upheld the first and second appellate authorities' rulings ie Commissioner of Income-tax (Appeals) and Income-tax Appellate Tribunal (referred to as CIT(A) and ITAT) wherein the respective authorities stated that section 56(2)(viib) of the ITA ought not to apply when no money/consideration is received on issue of shares upon conversion of loan. The authorities also held that the right to select the method of valuation under section 56(2)(viib) of the ITA read with the Rules is vested with the assessee and the tax authorities can only verify such method and not apply the alternate method provided under the Rules.

ELP Comments

This is a welcome judgement which reinforces that the tax authorities cannot arbitrarily change the method of valuation as adopted by the taxpayer in case where more than one method of valuation is provided for in the law.

Visakhapatnam Income Tax Appellate Tribunal (ITAT)[2] held that classification into long term / short term capital gains should be done separately for Land and Building under a Joint Development Agreement ('JDA')

FACTS OF THE CASE

- Assessee had entered into JDA in the year 2008 with the developer in exchange for share in built-up area. The assessee received his share of built-up area in the year 2011 and subsequently sold the flat in 2012.
- Thereafter, in response to a notice received under section 148 of the ITA (dealing with provision where income has escaped assessment), assessee filed Income Tax Return disclosing the capital gains as NIL on sale of flat after claiming the indexed cost of acquisition as well as cost of improvement and a deduction under section 54EC of the ITA. Accordingly, assessee treated the flat as long term capital asset and the order was passed by the tax authorities, partly disallowing the cost of indexation but after considering the deduction claimed by assessee.
- Commissioner of Income Tax ('CIT') reopened the assessment by the virtue of their powers under section 263 of the ITA and considered the order passed by the lower tax authorities as erroneous. CIT considered the sale resulting into short term capital gains (as against long term capital gains) and consequently concluded that deduction claimed under section 54EC of the ITA is not allowable on the ground that the possession for the flat was received in February, 2011 and assessee sold the property in December, 2012. Assessee's argument that the

[1] Pr. Commissioner of Income Tax-1, Chandigarh Versus M/s I.A. Hydro Energy (P) Limited- High Court dated 31.05.2024
[2] Sivakama Sundar Manthravadi, Vidyavathi Manthravadi, United Kingdom. versus Commissioner of Income Tax (it & tp), ITAT Vishakhapatnam dated 28.05.2024

date of development agreement should be construed as date of acquisition of the capital asset was rejected by the CIT.

RULINGS OF THE ITAT

- Tribunal did not agree with the argument of the assessee that exchange should be considered as transfer in relation to capital asset and that the assessee had acquired right on the flat by transferring his land to the developer in the year 2008 itself. ITAT held that the residential flat came into existence only in February 2011, as completion and possession was granted in February 2011.
- ITAT also held that when an owner sells his share of property under a JDA, he sells two components - one is undivided share of land which he held for a longer period than the building and the building which he gets from the developer on completion of construction of the building. The period of holding of building is much shorter than the period of holding of the land. In this regard, the concept of bifurcation of undivided share of land and built-up area is a well-recognized concept.

ELP Comments

The period from the date of entering into JDA till the date of possession of the area share, if any, is not considered by ITAT. Accordingly, while the trigger of taxability is at the time of JDA (barring deferment provided in the context of individuals), the new asset would be regarded to be held from the date of possession.

INDIRECT TAX - RECENT CASE LAWS

Bombay High Court quashed SCN demanding GST on Ocean Freight for transportation of goods from outside of India under FOB terms of contract[3]

- The Revenue had issued a SCN demanding IGST on freight by referring to Notification No.8/2017-Integrated Tax (Rate) dated 28-6-2017 wherein, transportation of goods from outside India was undertaken under FOB terms. The Petitioner challenged the said SCN on the ground that the Notification No. 8/2017-Integrated Tax (Rate) had been struck down by the Division Bench of Gujarat High Court in the case Mohit Minerals Pvt. Ltd. = 2020-TIOL-164-HC-AHM-GST, also upheld by the Supreme Court = 2022-TIOL-49-SC-GST-LB. Hence, the SCN was issued without jurisdiction.
- The Court observed that in Mohit Minerals (supra), the petitioner was importing coal from various countries on FOB and CIF basis, as clearly set out in paragraph 15 of the said decision. The Court on such facts, declared the revenue's decision *ultra vires* the IGST Act. The said decision has also been upheld by the Supreme Court. Hence, it was held that once the notification itself has been declared as *ultra vires* and the same has been upheld by the Supreme Court, following the mandate of the settled principle of law as laid down in the case of M/s. Kusum Ingots & Alloys Ltd vs Union Of India And Anr, 2004-TIOL-117-SC-CX-LB, the notification is no manner was available to the State Authorities to be applied as it would amount to applying an illegal notification. Therefore, the SCN was quashed having been issued without jurisdiction.

ELP Comments

While the Gujarat HC had struck down the notification, the SC had held that tax cannot be levied separately on one component i.e. freight in case of a composite supply involving importation of goods and freight charges for such import of goods. Be that as it may, the instant judgement will be beneficial for importers, who may claim the refund of IGST paid under RCM for past periods in case of FOB imports.

Madras High Court clarifies the treatment of Gift Vouchers under GST legislation.[4]

- The Assessee had challenged the AAAR order which had held that "Gift Voucher" issued by the petitioner was neither a supply of goods nor a supply of services. At the same time, the AAAR concluded that the voucher would be taxable at the time of its issuance in view of Section 12 (4)(a) of the CGST Act.
- As a part of the sales promotion, the petitioner formulated a Scheme by issuing different types of Pre-Paid Instruments (PPI's and/or/Gift Vouchers). These PPI's were known as "Gift Vouchers/Gift Cards" in the market. These "Gift Vouchers" were sold both in its retail outlets as well as through online portals by engaging the services of third party. It was the case of the petitioner that these Gift Vouchers/Gift Cards are "actionable claims" and therefore, not liable to tax as they fall within the purview of the exclusion under Section 7(2) of the CGST Act read with Schedule III. The Court held that Gift Vouchers issued by the Assessee are considered to be 'PPIs' as per the RBI's Master Direction. These Vouchers are deemed as documents and instruments under the relevant legislation as they function as debt instruments which can be redeemed for merchandise later. It was also observed that Gift Vouchers constitute as 'Actionable Claims' under CGST Act and are specified under Schedule III, thus not subject to GST. However, if the vouchers are issued for specific goods, tax is payable at the time of issuance. If they are issued for unspecified goods, tax is payable only upon redemption.

[3] Agarwal Coal Corporation Private Limited Vs. The Assistant Commissioner of State Tax 2024-TIOL-624-HC-MUM-GST
[4] Kalyan Jewellers India Ltd., Vs. Union of India, W.P.No. 5130 of 2022

ELP Comments

The judgment has corrected the notion that tax is applicable at the time of issuance regardless of the nature of the transaction. Thereby providing clarity on the tax treatment of Gift Vouchers under GST Regime, outlining when tax liability arises based on the nature of the transaction and the goods involved.

Madras High Court holds that Section 5 of the Indian Limitation Act, 1963 is not applicable as Section 107 of CGST Act is a complete code in itself[5]

- The Petitioner challenged the Order in Appeal under Article 226 of the Constitution which dismissed the Appeal on the ground of Limitation. It was argued by the Petitioner that even if there was a delay of 66 days in filing of the Appeal, Section 5 of the Indian Limitation Act, 1963 would be attracted as Section 107 of the CGST Act does not expressly or impliedly exclude the applicability of Section 5 of the Limitation Act.
- The Court held that Taxing statutes like the GST Act embody a comprehensive framework with specific limitation provisions tailored to expedite the resolution of tax-related matters. Section 107 of the GST Act - which operates as a complete code in itself, explicitly delineating limitation periods for filing appeals and implicitly excluding the application of general limitation provisions such as Section 5 of the Limitation Act.

ELP Comments

The judgment distinguished the decision passed by High Court of Calcutta in the f S.K. Chakraborty & sons vs. Union of India and others reported in 2024-T.L.D.-22-CAL which had held that Limitation Act would apply in the case of CGST Act as well.

Kerala High Court Upholds the constitutional validity of Section 16(4) of the CGST Act read with Rule 61(5) of the CGST Rules[6]

The issue before the Court was whether Section 16(4) of the CGST Act read with Rule 61(5) of the CGST Rules providing timelines for availment of input tax credit are *ultra vires* Articles 14, 19, 265 and 300A of the Constitution? The Court observed that the constitutional validity of the similar provisions under the Tamil Nadu Value Added Tax Act, 2006 was upheld by the Supreme Court in ***Jayam and Company Vs. Assistant Commissioner and Anr. [2016 (15) SCC 125]*** and in ***ALD Automotive Private Limited Vs. Commercial Tax Officer (CT) and others [2019 (13) SCC 225].*** Applying the principles laid down in the aforesaid rulings, the challenge to the constitutional validity of Section 16(4) of the CGST Act was dismissed.

ELP Comments

Similar to this judgment, the High Court of Chhattisgarh as well as the High Court of Calcutta have upheld the validity of Section 16(4) of CGST Act. However, it is noteworthy that the decision qua the validity of Section 16(4) is pending before the Supreme Court in the case of Shanti Motors in Diary No. 4474/2024 for finality.

High Court of Bombay holds that recovery proceedings cannot be initiated against a former director[7]

The issue before the Court was whether recovery proceedings under Sections 79 or 89 of CGST Act can be initiated against a former director (Petitioner-Director) of a private limited company for the period during which he was not

[5] M/S Yadav Steels Vs. Addl. Commissioner and Anr. WRIT TAX No. - 975 of 2023
[6] M/s Hiremath Paints, Hardware and Electrical Vs. The Assistant Commissioner of Commercial Taxes, (Enforcement), Gangavathi & Ors. [2024:KHC-D:6596
[7] Prasanna Karunakar Shetty vs. State of Maharashtra [TS-212-HC(BOM)-2024-GST]

acting as a director. The Court observed that in terms of Section 79 of CGST Act, the principal liability is not on the Petitioner-Director as he is not a registered person under Section 79(1) of the CGST Act. Further, Section 89 provides that before taking any recovery action against the director(s) of a company, a prior subjective satisfaction is required to be achieved by the tax authorities in regard to whether a person against whom recovery is sought to be made was a director of the company during the concerned period. In the present case, for the period in question, the Petitioner-Director never acted as a director of the company. Also, Petitioner-Director was neither issued a SCN nor was he heard before the Order was passed. Hence, the basis on which the tax authorities sought to attach the property is not known as no reasons are provided by the tax authorities. It was thus held that the Attachment Order has been issued in breach of the rights guaranteed under Article 14 read with Article 300A of the Constitution of India.

ELP Comments

This is a welcome judgment from the High Court establishing that the recovery proceedings cannot be initiated against former directors of a company.

High Court of Gujarat quashed SCN issued alleging non-payment of Service Tax based on information received from Income Tax Department without disclosing the Nature of Services rendered[8]

The issue before the Court was whether a SCN issued only on the basis of information received from the Income Tax Department in Form 26AS would be a valid SCN? The Court observed that SCN alleging that the Taxpayer was liable to pay service tax was issued on the assumption that there was a sale of services without verifying the nature of services provided by the Taxpayer. The SCN, failed to disclose the facts pertaining to nature of services provided by the Taxpayer which were sought to be taxed, which is contrary to the provisions of the Finance Act, 1994. The tax authority had assumed jurisdiction without there being any basis for issuing the SCN as the same could not be issued only on the basis of information retrieved from the Income Tax department. In view of the above, the SCN and all the consequent proceedings were quashed and set aside.

ELP Comments

While there are multiple Orders rendered by CESTAT across jurisdictions on similar issues, the said decision of the High Court quashing the SCN demanding Service Tax basis difference between Form 26AS and Income Tax Return is uncommon. It is also worth noting that the High Court of Gauhati in the case of M/s NE Logistics and Anr. In WP (C) No. 1870 of 2022 in a similar issue had remanded the matter to the Authorities for de novo adjudication.

We trust you will find this an interesting read. For any queries or comments on this update, please feel free to contact us at insights@elp-in.com or write to our authors:

Vivek Baj, Partner, Email – *vivekbaj@elp-in.com*

Dipesh Jain, Partner, Email – *dipeshjain@elp-in.com*

Sumeet Agarwal, Associate Partner, Email *– sumeetagrawal@elp-in.com*

Aayush Tiwari, Associate Partner, Email *– aayushtiwari@elp-in.com*

Sai Dash, Senior Associate, Email *– saidash@elp-in.com*

Saiyam Jain, Associate, Email *– saiyamjain@elp-in.com*

[8] Z R Enterprise Vs. State of Gujarat [TS-182-HC-2024(GUJ)-ST]

ECONOMIC LAWS PRACTICE
ADVOCATES & SOLICITORS

MUMBAI

9th Floor, Mafatlal Centre
Vidhan Bhavan Marg
Nariman Point, Mumbai 400 021
T: +91 22 6636 7000

DELHI NCR

NEW DELHI

DR Gopal Das Bhawan, 16th Floor,
28, Barakhamba Road,
New Delhi – 110 001.
T: +91 11 41528400

NOIDA

9th Floor, Berger Tower, Sector 16 B,
Noida, Uttar Pradesh - 201301.
T: +91 120 6984 300

AHMEDABAD

C-507/508, 5th Floor, Titanium Square
Thaltej Cross Roads, SG Highway,
Ahmedabad - 380054
T: +91 79460 04854

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

GIFT CITY

GIFT CITY Unit No. 605,
Signature, 6th Floor Block 13B,
Zone – I GIFT SEZ, Gandhinagar 382355

elplaw.in

insights@elp-in.com

/elplaw.in

/ELPIndia

/company/economic-law-practice

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